STAFF PAPER

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IASB Meeting

Project	**Post-implementation Review**		
Paper topic	IFRS 3 *Business Combinations*		
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Purpose of this paper

1. This paper sets out our plans for the Post-implementation Review (PIR) of IFRS 3 *Business Combinations* including our proposed timetable for the review. In particular, the objective of this paper is to:
   (a) provide you with information about the initial planning consultation that we aim to undertake during the next few months with the purpose of assessing the scope of the PIR for IFRS 3 (Phase I of the PIR); and
   (b) to ask you for your input and feedback on matters that you want us to consider when undertaking this consultation.

Structure of the paper

2. This paper is structured as follows:
   (a) background to PIRs;
   (b) background to IFRS 3;
   (c) proposed scope of the PIR of IFRS 3 including its timeline; and
   (d) consultation activities during Phase I of the PIR including their timeline.

The IASB is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRSs. For more information visit www.ifrs.org

Background to PIRs

3. The Trustees added PIRs as a mandatory step to the IASB's due process requirements in 2007. These requirements were updated in the revised *Due Process Handbook* ('the Handbook'), published in February 2013. The Handbook states that the PIRs "must consider the issues that were important or contentious during the development of the publication (which should be identifiable from the Basis for Conclusions, Project Summary, Feedback Statement and Effect Analysis of the relevant Standard), as well as issues that have come to the attention of the IASB after the document was published."

4. The Handbook also states that a PIR "normally begins after the new requirements have been applied internationally for two years, which is generally about 30 to 36 months after the effective date" and that each review has two phases:

> 6.54 […] The first involves an initial identification and assessment of the matters to be examined, which are then the subject of a public consultation by the IASB in the form of a Request for Information. In the second phase, the IASB considers the comments it has received from the Request for Information along with the information it has gathered through other consultative activities. On the basis of that information, the IASB presents its findings and sets out the steps it plans to take, if any, as a result of the review.

5. IFRS 8 *Operating Segments* was the first of the IASB's Standards to be subject to a PIR. IFRS 3 *Business Combinations* will be the second review.

Background to IFRS 3

6. In 2001 the IASB began a project to review IAS 22 *Business Combinations* (revised in 1998) as part of its initial agenda, with the objective of improving the quality of, and seeking international convergence on, the accounting for business combinations. The IASB decided to address the accounting for business combinations in two phases.

7. As part of the first phase, the IASB published in December 2002 Exposure Draft (ED) 3 *Business Combinations*, together with an Exposure Draft of proposed related amendments to IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*.

8. The IASB concluded the first phase in March 2004 by issuing simultaneously IFRS 3 *Business Combinations* and revised versions of IAS 36 and IAS 38. The IASB's primary conclusion in the first phase was that virtually all business combinations are acquisitions. Accordingly, the IASB decided to require the use of one method of accounting for business combinations—the acquisition method.

9. The main changes introduced by IFRS 3 (2004) from IAS 22 were:

    (a) All business combinations within its scope to be accounted for using the purchase method. The pooling of interests method is no longer permitted.

    (b) All assets and liabilities and contingent liabilities of the acquiree (with some specific exceptions) are measured at their fair values at acquisition date. IAS 22 had permitted identifiable assets and liabilities to be measured as the aggregate of the acquirer's share of their fair value plus the minority's proportion of their pre-acquisition book value. The value of minority interest under IAS 22 was therefore affected by the measurement of the acquiree's assets and liabilities.

    (c) Liabilities for terminating or reducing the activities of an acquire can only be recognised in purchase accounting if the acquiree had, at the acquisition date, an existing liability in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

    (d) Contingent liabilities of an acquiree must be separately recognised and not subsumed within goodwill.

    (e) An intangible asset acquired in a business combination is assumed to satisfy the recognition criterion that it is probable that future economic benefits will flow to the entity and will therefore be recognised provided it meets the definition of an intangible asset and its fair value can be measured reliably.

    (f) Goodwill acquired in a business combination was no longer amortised but instead is subject to annual impairment testing.

    (g) Negative goodwill arising on a business combination is recognised immediately in profit or loss. IAS 22 had required negative goodwill to be deferred and amortised to profit or loss according to the pattern of

expected future losses or over the average useful life of the identifiable depreciable/amortisable assets acquired, in most cases, although sometimes immediate recognition in profit or loss was required.

10. The US-based standard-setter, the Financial Accounting Standards Board (FASB), also conducted a project on business combinations in multiple phases. The FASB concluded its first phase in June 2001 by issuing FASB Statements No. 141 *Business Combinations* (SFAS 141) and No. 142 *Goodwill and Other Intangible Assets*. The scope of that first phase was similar to IFRS 3 and the FASB reached similar conclusions on the major issues.

11. The two boards began deliberating the second phases of their projects at about the same time. They decided that a significant improvement could be made to financial reporting if they had similar standards for accounting for business combinations. They therefore agreed to conduct the second phase of the project jointly with the objective of reaching the same conclusions.

12. The second phase of the project addressed the guidance for applying the acquisition method. In June 2005 the boards published jointly an Exposure Draft of revisions to IFRS 3 and SFAS 141, together with Exposure Drafts of related amendments to IAS 27 *Consolidated and Separate Financial Statements* and Accounting Research Bulletin No. 51 *Consolidated Financial Statements*.

13. The boards concluded the second phase of the project by issuing their revised standards, IFRS 3 *Business Combinations* (as revised in 2008) and FASB Statement No. 141 (revised 2007) *Business Combinations* and the related amendments to IAS 27 and FASB Statement No. 160 *Noncontrolling Interests in Consolidated Financial Statements*.

14. The main revisions made in 2008 were:

    (a) The scope was broadened to cover business combinations involving only mutual entities and business combinations achieved by contract alone.

    (b) The definitions of a business and of a business combination were amended and additional guidance was added for identifying when a group of assets constitutes a business.

(c) For each business combination, the acquirer must measure any non-controlling interest in the acquiree either at fair value or as the non-controlling interest's proportionate share of the acquiree's net identifiable assets. Previously, only the latter was permitted.

(d) An acquirer is no longer permitted to recognise contingencies acquired in a business combination that do not meet the definition of a liability.

(e) Costs that the acquirer incurs in connection with the business combination must be accounted for separately from the business combination, which usually means that they are recognised as expenses (rather than included in goodwill).

(f) Consideration transferred by the acquirer, including contingent consideration, must be measured and recognised at fair value at the acquisition date. Subsequent changes in the fair value of contingent consideration classified as liabilities are recognised in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*, IAS 37 or other IFRSs, as appropriate (rather than by adjusting goodwill). The disclosures required to be made in relation to contingent consideration were enhanced.

(g) For business combinations achieved in stages, having the acquisition date as the single measurement date was extended to include the measurement of goodwill. An acquirer must remeasure any equity interest it holds in the acquiree immediately before achieving control at its acquisition-date fair value and recognise the resulting gain or loss in profit or loss.

Proposed scope of the PIR of IFRS 3 and its timeline

15. We expect that the preliminary scope of the PIR of IFRS 3 will entail:

(a) the whole Business Combinations project (ie the first and the second phases of the project) which resulted in the issuance of IFRS 3 (2004) and IFRS 3 (2008); and

(b) any consequential amendments resulting from the Business Combinations project (ie amendments to IAS 12, IAS 27, IAS 36, IAS 38 etc).

16. Appendix 1 to this paper includes an initial assessment of the issues that were important or contentious during the development of the Standard, identified from the Basis for Conclusions, Project Summary, Feedback Statement and Effect Analysis of IFRS 3 and matters submitted to the IFRS Interpretations Committee. The consultations carried out during Phase I of the PIR will help us to either confirm or discount the relevance of the matters included in Appendix 1 as well as to identify any other matters that the Request for Information (RFI) should include. In other words, during Phase I of the PIR we will seek to gather information to assist the IASB in confirming this preliminary scope at the end of Phase I.

17. In addition, the consultations carried out during Phase I of the PIR should also enable us to gather information about whether there has been sufficient acquisition activity throughout the period during which the revised IFRS 3 has been applied to make it worthwhile to proceed to the RFI and Phase II in 2014 or whether the IASB should defer Phase II of the PIR until there has been more acquisition activity.

18. In terms of timing, we expect the following timeline for the PIR of IFRS 3, assuming that the IASB concludes that there has been sufficient acquisition activity to proceed with the PIR in 2014:

Activity	Timing
Phase I of the PIR	July 2013–November 2013
Publication of RFI	December 2013–January 2014
Phase II of the PIR	
Public consultation (120 days)	Comment deadline April 2014–May 2014
Analysis of public comments and extensive outreach	Undertaken during 1st half of 2014
Publication of Feedback Statement	3rd quarter of 2014

Question for the IASB

Question 1—Proposed scope
Question 1A—Does the IASB agree with the preliminary scope of the PIR for IFRS 3 as described in paragraph 15? Question 1B—Do you think that Appendix 1 is a good initial assessment of the areas in which the implementation of IFRS 3 might have been challenging? Do you think that there any other issues that should be added?

Phase I of the PIR for IFRS 3—Consultation activities

19. The objective of Phase I of the PIR is to establish the scope of the review, and in particular to identify the areas of focus for the RFI that will be published at the start of Phase II. We will do this by undertaking targeted outreach to help us identify areas where the main implementation problems or unexpected costs were encountered.

20. Paragraph 6.56 of the Handbook states:

> 6.56 This initial review should draw on the broad network of IFRS-related bodies and interested parties, such as the Interpretations Committee, the IASB's consultative groups, including the Advisory Council, securities regulators, national accounting standard-setting bodies, regional bodies involved with accounting standard-setting, preparers, auditors and investors. The purpose of these consultations is to inform the IASB so that it can establish an appropriate scope for the review. How extensive the consultations need to be in this phase will depend on the Standard being reviewed and on what the IASB already knows about the implementation of that Standard. The IASB needs to be satisfied that it has sufficient information to establish the scope of the review.

21. As mentioned in paragraph 16, the consultations and activities that we plan to undertake during Phase I of the PIR, which are shown at the table below, will help us to either confirm or discount the relevance of the matters included in Appendix 1 as well as to identify any other matters that the RFI should include. We will also commence a review of academic and other literature relevant to this PIR.

PLANNING OF CONSULTATIONS AND ACTIVITIES IN PHASE I

CONSTITUENTS / ACTIVITIES	TIMING
Accounting firms Input from the large international audit networks	July 2013
Investors Input from main investors groups: * Corporate Reporting Users' Forum (CRUF) * European Society of Financial Analysts Societies (EFFAS) * CFA Institute * Joint investors outreach with FASB	July 2013 and ongoing
National Standard-Setters Input from the following organisations: * Financial Accounting Foundation (FAF), as the organisation responsible for the review of Statement 141R (see paragraph 23 of this paper) * National Standard-Setters and endorsement advisory bodies (through meetings with the International Forum of Accounting Standard Setters (IFASS), the World Standard-Setters (WSS) and by teleconference) (1)	May 2013 and ongoing July 2013 and ongoing
Valuation specialists Input from the International Valuation Standards Council (IVSC)	September 2013
Regulators Input from the following organisations: * European Securities and Markets Authority (ESMA) * International Organization of Securities Commissions (IOSCO)	September 2013 October 2013
Academic research	July and ongoing
Internal input * IFRS Interpretations Committee * IFRS Advisory Council * Capital Markets Advisory Committee (CMAC) * Global Preparers Forum (GPF) meeting	September 2013 October 2013 October 2013 November 2013

(1): Accounting Standards Advisory Forum (ASAF) members will be consulted through IFASS.

Liaison with FAF and FASB

22. As mentioned in paragraph 11, the FASB and the IASB concurrently deliberated the issues in the second phase of the Business Combinations project and reached the same conclusions on most of them.

23. Even though the Standards are the result of a joint effort, our corresponding Post-implementation Reviews are conducted separately. In the case of the US Standard, its review has already been undertaken by the independent private-sector organisation responsible for the oversight of the FASB, the Financial Accounting Foundation (FAF), which led to the publication of the *Post-Implementation Review Report on FASB Statement No.141 (revised 2007),* Business Combinations (Statement 141R) in May 2013.[1]

[1] The FAF's report on Statement 141R can be found at: http://www.accountingfoundation.org/cs/ContentServer?c=Document_C&pagename=Foundation%2FDocument_C%2FFAFDocumentPage&cid=1176162641881

24. The IASB will conduct its own PIR of IFRS 3, however, we plan to interact with the FAF staff and FASB staff during our review. We have already had calls with FAF staff responsible for the review of Statement 141R to learn about their findings. We have also spoken with FASB staff about how we can work with them when getting input from US-based stakeholders. FASB staff will work with us in seeking input from US investors.

25. The FASB, in responding to the FAF's review of Statement 141R, has stated that it will wait for the completion of our PIR on IFRS 3 and will co-ordinate with us before deciding whether to undertake any standard-setting action.[2]

Next steps

26. If the IASB agrees with the plans set out in this paper, we plan to bring the results of the consultations and activities undertaken during Phase I to the November 2013 IASB meeting. At that meeting we will present proposals for the scope and content of the RFI and our assessment of whether the level of acquisition activity is sufficient to proceed with Phase II in 2014, or whether we think the IASB should defer Phase II until a later date.

Question for the IASB

Question 2
Does the IASB (a) agree with the overall plan set out in this paper for the PIR of IFRS 3? (b) have any questions on how we are thinking of carrying out Phase I of the PIR? (c) have any suggestion on the initial plan of consultations and activities, which aims to lead to the publication of the Request for Information?

[2] The FASB's response to the FAF's report on Statement 141R can be found at: http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176162713156

Appendix 1—Issues that might have been challenging when implementing IFRS 3

1. Based on the Basis for Conclusions, Project Summary, Feedback Statement and Effect Analysis of IFRS 3 and matters addressed to the IFRS Interpretations Committee, the following list includes some of the areas in which the implementation of IFRS 3 might have been challenging. The list is not intended to be comprehensive and exhaustive and will be revised during Phase I of the PIR.

    (a) All business combinations are acquisitions (the abolition of pooling of interests)

    This was one of the core changes brought in by IFRS 3 (2004) to the former Standard for the accounting of business combinations, IAS 22.

    (b) Definition of a business

    Identifying when a transaction involves a business compared with when it involves just a collection of assets is critical to determining whether a transaction is a business combination or just the purchase of assets. The difference in the accounting requirements for a business combination compared with the accounting for the purchase of a group of assets that is not a business elevates the importance of the definition of a business.

    (c) Scope exception: common control transactions

    Common control transactions were not within the scope of IAS 22 and neither were they within the scope of IFRS 3 (2004) or IFRS 3(2008). Any feedback we receive in relation to this topic during the PIR of IFRS 3 it will be passed on to the Business Combinations Under Common Control research project.

    (d) Measurement of assets and liabilities at fair value

    According to the FAF's report, this matter was identified as one of the main challenging areas for preparers when applying Statement 141R. We might receive similar feedback on this area, because IFRS 3 was being applied before the issuance of IFRS 13 *Fair Value Measurement* and, as result, entity-specific instead of market-based assumptions might have been used more extensively in a number of cases.

    (e) Recognition of intangible assets (especially the recognition of customer relationship intangible assets)

    We expect that identifying and measuring the intangible assets acquired in a business combination would have been a challenging area for entities implementing IFRS 3. The FAF's report on Statement 141R states that preparers and practitioners had difficulties in this area.

    In addition, it has been argued there is a lower hurdle in IFRS 3 for the recognition of intangible assets when compared to IAS 38 *Intangible Assets*.

(f) Non-amortisation of goodwill

IFRS 3 (2004) prohibited the amortisation of goodwill acquired in a business combination and instead required goodwill to be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired, in accordance with IAS 36 *Impairment of Assets*.

Some constituents have expressed concerns about whether the impairment test is able to present negative economic cycles in entities' financial statements in a timely manner. We have also learnt of concerns relating to the high number of assumptions used for the calculation of the impairment and the risk of this information being too subjective.

(g) Contingent consideration

We expect that measuring contingent consideration at fair value would have been a challenging area for entities implementing IFRS 3. The FAF's report on Statement 141R states that preparers and practitioners had difficulties in this area.

(h) Acquisition-related costs

IFRS 3 (2008) modified the requirements for the accounting for fees paid in relation to a business combination from IFRS 3 (2004), in which those costs were included in the cost of the acquisition. The requirements of IFRS 3 (2008) required that acquisition-related costs should be recognised as an expense at the time of the acquisition. This was generally not well received when IFRS 3 (2008) was issued. Some constituents argued that acquisition costs should be included in goodwill to ensure that the total outlay was reflected in the statement of financial position.

The PIR will offer us an opportunity to understand whether this and other concerns at the time when IFRS 3 (2008) was issued have remained and whether any other related issues have arisen (eg acquisition-related costs associated with non-controlling interests).

(i) Measurement of non-controlling interests

The general concern in this area is a general lack of accounting framework for transactions with non-controlling interests.

We also expect to receive feedback relating to, among other things, the following matters:

(i) the measurement option allowed in IFRS 3 (2008) for non-controlling interests; and
(ii) the accounting for impairment testing of goodwill when non-controlling interest are recognised.

(h) Accounting for step acquisitions

IFRS 3(2008) requires the remeasurement of any previously held interests in the acquiree at fair value. When IFRS 3 (2008) was issued, some constituents expressed their disagreement with this accounting model

because they viewed each step in a step acquisition as a transaction in which the acquirer only obtains more shares in the acquiree. Because the shares that the acquirer previously held have not been exchanged or sold, they believed that the recognition of profit or loss was not appropriate.

The PIR will offer us an opportunity to understand whether this and other concerns at the time when IFRS 3 (2008) was issued have remained and whether any other related issues have arisen.

(i) Disclosures

The PIR should enable us to receive feedback relating to the usefulness of the information provided by the disclosure requirements in IFRS 3 in order to assess opportunities for improvements in the Standard and also to identify any general enhancements that could be considered by the IASB.