STAFF PAPER

18–22 November 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 paper details the areas and questions on which the staff believe the Request for Information (RfI) should focus and provides information about the next steps. It additionally asks the IASB about the appropriateness of those areas and questions and it also asks whether the IASB has any additional feedback that the staff should consider for inclusion in the RfI.

Scope and content of the RfI

2. On the basis of the input received during Phase I of the Post-Implementation Review (PiR) we think that the RfI should include questions to identify issues that deal with the usefulness of the information provided and practical implementation matters relating to the following areas of the Standard:

   (a) definition of a business, including whether different accounting treatments between businesses and asset acquisitions are warranted;

   (b) fair value measurement and associated disclosures;

   (c) accounting for intangible assets and goodwill; specifically:

      (i) separate recognition of intangible assets from goodwill, and

      (ii) non-amortisation of indefinite life intangible assets and goodwill;

   (d) accounting for non-controlling interests (NCIs);

   (e) step acquisitions; and

(f) disclosures (other than those relating to fair value measurement).

3. We think that the RfI should also include three additional questions:

(a) To understand the background and experience of the respondents in accounting for business combinations, we would like to ask for the respondents' experience with the accounting for business combinations since 2004.

(b) To ensure completeness, we think that the RfI should include a question asking constituents whether there is any other relevant area or matter that they think this review should contemplate. This would ensure that matters that have been assigned a medium or low degree of relevance in Agenda Paper 13A (ie issues relating to contingent consideration, contingent liabilities, consideration vs compensation etc) would be covered.

(c) The input received during Phase I on costs and benefits derived from the implementation of the Standard has been limited. We think it is important to have a better understanding of what have been the causes of benefits and unexpected costs when implementing the Standard.

4. The following table sets out tentative questions for the RfI based on the main areas of the Standard and additional matters identified in paragraphs 2 and 3.

Areas	Tentative questions in the RfI
Background and experience	**1. Please describe your background and experience in accounting for business combinations.**
Definition of a business	**2. IFRS 3 (2008) amended the definitions of a business and of a business combination and additional guidance was added for identifying when a group of assets constitutes a business.[1] The assessment to**

[1] 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

Areas	Tentative questions in the RfI
	determine whether a transaction involves a business is critical to determining whether a transaction is within the scope of the Standard or whether it corresponds to 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:** **(a) 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);** **(b) 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** **(c) 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.** **Questions** **(i) What are the relative benefits in terms of the information provided of one basis of accounting compared with the other (ie business combinations accounting vs asset acquisition accounting)?** **(ii) What are the main practical implementation challenges you face when assessing a transaction to determine whether a business is present? What are the main considerations that you take into account in your assessment?**

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".

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Fair value measurement and associated disclosures	**3. 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 to understand 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 on business combinations:** **(a) The amendments to the criteria for recognition of intangible assets in IAS 38 *Intangible Assets* carried out by IFRS 3 (2004) and IFRS 3 (2008) (see question 4) may have resulted in an increase in the intangible assets recognised as a result of business combinations.** **(b) The exchange notion included in the previous definition of fair value was revised in IFRS 13 *Fair Value Measurement*, issued in 2011, and was modified to be an exit price notion.** **(c) The financial crisis that started in 2007 may have increased the challenges to measure specific assets and liabilities at fair value.** **Fair value is also used in the impairment calculations of goodwill and other assets or group of assets.** **Disclosure requirements relating to the fair value measurements as of the date of the acquisition (for example, the valuation techniques(s) and significant inputs used in the measurements) in IFRS 3 (2008) are limited to NCIs.** **Questions** **(i) To what extent is the information disclosed about fair value measurements sufficient? If there are deficiencies, what are they?** **(ii) What have been the most significant valuation challenges in measuring fair value within the**

Areas	Tentative questions in the RfI
	context of business combination accounting? (iii) Are there particular elements, for example, specific assets, liabilities, consideration etc, that have presented particular challenges in the measurement of fair value?
Separate recognition of intangible assets from goodwill	**4. IFRS 3 (2004) stressed the existing 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.** **In addition, IFRS 3 (2004) and IFRS 3 (2008) amended the criteria for recognition of intangible assets arising from business combinations in IAS 38. The expected effect of the changes in the requirements is an increase in the intangible assets recognised as a result of business combinations.** **Questions** **(i) What do you find useful about this separate identification of intangible assets? Does it provide you with the information you need to understand and analyse the acquired business? If not, what changes do you think are needed?** **(ii) 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?**
Non-amortisation of indefinite life intangible assets and goodwill	**5. One of the main changes to business combinations accounting introduced by IFRS 3 was to require goodwill to be tested annually for impairment, instead of being subject to an annual amortisation charge. The main reason for this change is that we understood that assessing the impairment of goodwill annually provides better information than**

Areas	Tentative questions in the RfI
	an arbitrary allocation through amortisation. **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 and indefinite useful life are not amortised but tested for impairment annually.** **The requirements for performing the annual impairment test of goodwill and of an intangible asset with indefinite useful life are set out in IAS 36 *Impairment of Assets*.** **Questions** **(i) How useful have you found the information provided by the annual impairment test, and, why?** **a. Do you think improvements are needed? If so, what are they?** **(ii) What are the main implementation challenges in testing goodwill or indefinite life intangible assets for impairment (or auditing or enforcing the impairment tests), and why?**
Non-controlling interest	**6. 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.**[2]

[2] 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,

Areas	Tentative questions in the RfI
	In addition, IFRS 3 (2008) introduced: **(a) 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; and** **(b) 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.** **Questions** **(i) How useful is the information about NCIs? Does it adequately reflect the claims on consolidated equity that are not attributable to the parent? If not, what improvements do you think are needed?** **(ii) What are the main challenges in the accounting for NCI, or auditing or enforcing such accounting?**
Step acquisitions	**7. 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 another stake that, cumulatively, gives it control of the target entity. The two main changes to the accounting for step acquisitions that were introduced by IFRS 3 (2008) are:**

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".

Areas	Tentative questions in the RfI
	(a) 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 interest 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 recognised at each step in a step acquisition; and (b) 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 be more useful information. The recognition of gain 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, ie the IASB thought that obtaining control was a significant change in the nature of and economic circumstances surrounding that investment. Question (i) How useful do you find the information provided by the step acquisition guidance under IFRS 3 in comparison to the previous requirements? If any of the information is unhelpful, please explain why.

Areas	Tentative questions in the RfI
Disclosures	8. IFRS 3 requires information to be disclosed about the assets and liabilities of the acquiree, the consideration transferred, and the contribution by the acquiree to the performance of the group. Questions (i) What other information is needed to properly understand the effect of the acquisition on the group? (ii) Of the information provided, what parts are not useful and therefore should be reassessed? (iii) What are the main challenges to preparing (or auditing or enforcing) the disclosures required by IFRS 3, and why?
Other matters	9. What other matters do you think the IASB should be aware of as it considers the implementation review of IFRS 3? The IASB is interested in practical implementation matters, whether from the perspective of applying the Standard, auditing the information or enforcing the Standard. The IASB is also interested in understanding how useful the information that is provided by the Standard is, and what improvements are needed, and why.
Effects	10. From your point of view, which matters or areas of the Standard: (i) have contributed to benefits to users and/or preparers of financial information; (ii) have represented considerable unexpected costs to users and/or preparers of financial information; or (iii) 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?

Next steps

5. We aim to bring a final draft of the questions to be included in the RfI to the December meeting of the IASB, and also at that time to request permission from the IASB to publish the RfI.

6. We estimate that the publication of the RfI will take place in January-February next year.

Question for the IASB

Question 1
Does the IASB: (a) agree with the main areas that the staff believe the questions in the RfI should focus on? (b) have any feedback for the staff on the tentative questions for inclusion in the RfI?