

## International Financial Reporting Standards

# Post-implementation Review of IFRS 3 *Business Combinations*

*Michael Stewart – Director of Implementation  
Activities*

*Leonardo Piombino – Visiting Fellow*

The views expressed in this presentation are those of the presenter,  
not necessarily those of the IASB or IFRS Foundation.

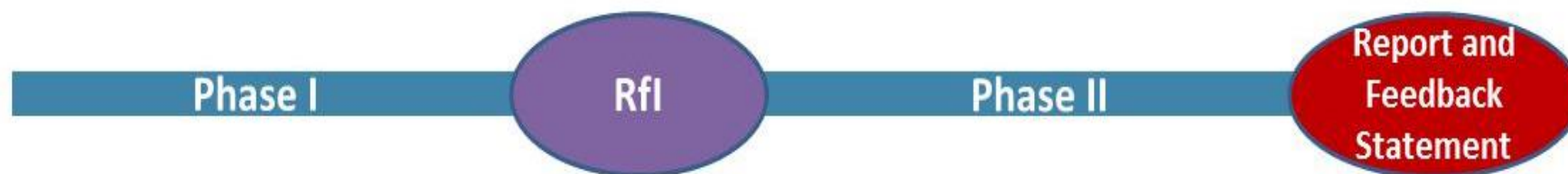
- Current status of the Post-implementation Review (PIR) for IFRS 3 *Business Combinations*.
- The key issues arising from comment letters and outreach activities
- Next steps
- Questions to ASAF members

# Current status of the Post-implementation Review for IFRS 3

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# Current status of the PIR for IFRS 3

- Request for Information published on 30 January 2014.
- Comment period ended on 30 May 2014.
- Summary of the comment letters received will be presented at the September IASB meeting\*



- Planning and agree scope
- Identification of the issues

- Submissions analysis
- Investigation of the issues through outreach activities

- Publication of the findings and the IASB's responses to them

\* This presentation was prepared in August 2014.

# The key issues arising from comment letters and outreach activities

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## Definition of a business:

- The definition of a business is broad, especially the term “*capable*”.
- There is limited guidance on what is not a business.
- Most of the uncertainty regarding the definition of a business arises from consideration of the processes that need to be in place in a business.
- The assessment is particularly challenging for specific industries (eg real estate, shipping, mining, oil and gas, pharmaceutical).
- Some of the existing accounting differences between asset acquisitions and business combinations should be eliminated, for example the accounting for:
  - deferred tax assets and liabilities,
  - the acquisition-related costs,
  - contingent consideration,
  - contingent liabilities.

## Fair value measurements

The most significant valuation challenges are:

- identification and measurement of intangible assets, in particular:
  - non-contractual intangible assets;
  - intangible assets for which there is no active market;
  - intangible assets in the “early stage” of development.
- Contingent liabilities - due to the uncertainties regarding outcomes. A number of different valuation approaches are used in practice
- Contingent consideration - due to the complexities and uncertainties in the arrangements. This is particularly relevant in the pharmaceutical industry.

# PIR IFRS 3 – Key Issues

## Separate recognition of intangible assets from goodwill:

- Usefulness - Users have mixed views.
- It is useful because:
  - it provides an insight on why a company purchased another company;
  - it provides information on the future cash flows arising from the acquiree;
  - it helps in understanding the components of the acquired business, including its primary assets (i.e. the value-drivers).
- It is not useful because:
  - The valuation of intangible assets such as brands and customer relations, is highly subjective. These intangible assets should be recognised only if there is a market for them.
  - Amortisation of these intangible assets appears to be double counting; post-combination results include amortisation and ongoing maintenance expense.
  - Management value the business as a whole, rather than individually value the assets acquired and the liabilities assumed.



# PIR IFRS 3 – Key Issues

## Non-amortisation of goodwill and indefinite-lived intangible assets:

- Usefulness - Users have mixed views.
  - Non-amortisation of goodwill:
    - is useful to calculate performance measures (such as Return of Invested Capital), which can be used to assess stewardship;
    - permits understanding of whether management has overpaid or whether the acquisition was successful.
  - Impairment test is not effective. Impairment losses are not recognised early enough. The market ignores the impairment test results.
- Challenges:
  - Impairment test is costly and complex.
  - The assumptions used in the impairment test are subjective/too optimistic.
  - Purchased goodwill may be supported by internally-generated goodwill (ie it is difficult to separate the cash flows between these two).

## Academic literature review

- We reviewed 28 published academic studies on business combination accounting.
- This review provides evidence generally in support of the current requirements relating to goodwill and other intangible assets.
- In particular, several studies show that:
  - the amount of goodwill and other intangible assets recognised in accordance with IFRS 3 is positively associated with share prices (ie the information is useful for investors)
  - there is a significant negative association between goodwill impairment expense and share price (ie impairment expense provides relevant information)
  - managers are exercising their discretion in the recognition of goodwill and impairment expense. Some studies point to earnings management and income smoothing and a lack of timeliness in recognising impairment.
  - impairment-related disclosures are important to users but there are some areas for improvement.

## Step acquisitions and loss of control

### Usefulness

- the previously held equity interest should not be remeasured at the acquisition-date fair value, because
  - remeasurement gains or losses of previously held/retained interest are non-recurring items that are not part of the performance of the entity.
  - the cost paid for each stake is useful to assess management stewardship;
  - the more the acquirer pays, the bigger is the gain on the remeasurement.
  - the unit price for a large block of shares is different from the unit price for the last few shares needed to acquire control. A previously held large minority interest should not be remeasured at the price paid to acquiring the last few shares that were publicly traded.
- remeasurement gains or losses should be recognised in OCI.

# Next Steps

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# Next steps

- Present to the IASB:
  - an analysis of the comments received.
  - a review of the academic literature on IFRS 3
  - a comparison between our findings and FAF findings.
- Publication of the findings and the IASB's responses to them
- Discuss and compare our findings with FASB/FAF Staff.

# Questions to ASAF members

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# Questions to ASAF members

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## Key Issues:

1. In your view, which are the most critical/urgent issues from the PIR that the IASB should consider as part of its agenda-setting process?
2. Should the IASB consider some of these issues (eg intangible assets) only in the context of IFRS 3 (eg intangible assets acquired in a business combination) or in a broader project (eg all intangible assets)?
3. Many academic studies provide evidence generally in support of the current requirements on goodwill. However, many respondents to the RFI think that the impairment test is not effective. What advice do you have on how the IASB should handle these conflicting results?

## Next Steps:

4. In previous meetings, we understood that in your view maintaining convergence with US GAAP is important. Are you still of that view?
5. Do you have any comments or suggestions about the next steps that we plan to take?



# Where to go for more information

- Project page on the IFRS website:
  - <http://www.ifrs.org/Current-Projects/IASB-Projects/PIR/PIR-IFRS-3/Pages/PIR-IFRS-3.aspx>
- Contacts:
  - Michael Stewart: Director of Implementation Activities  
([mstewart@ifrs.org](mailto:mstewart@ifrs.org))
  - Leonardo Piombino: Visiting Fellow  
([lpiombino@ifrs.org](mailto:lpiombino@ifrs.org))



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