Post-Implementation Review: Business Combinations

Issues Paper

This Issues Paper has been prepared by AASB staff to identify issues that the Board may wish to address in a submission to the IASB on its Request for Information *Post-implementation Review: IFRS 3* Business Combinations.

Agenda paper 15.1 provides an overview and background to this project. Papers 15.3 (submissions from constituents on AASB ITC 30) and 15.4 (summary of significant matters raised at the AASB Discussion Forum) provide comments from constituents that should be considered in addressing the issues upon which the IASB is seeking input. This issues paper should be read in conjunction with those materials, since this paper does not repeat the detail in those.

The issues are characterised in the IASB's Request for Information (RFI) as questions, each with various parts. These are addressed below in turn.

Q1 Your background and experience

Please tell us:

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

(a) Type of user includes: buy-side analyst, sell-side analyst, credit rating analyst, creditor/lender, other (please specify).

(b) your principal jurisdiction. …

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

(d) if you are a preparer of financial statements …

(e) if you are a user of financial statements …

A submission from the AASB would note that the AASB establishes accounting standards in Australia that incorporate IFRSs. Entities required to, or electing to, comply with Tier 1 requirements under Australian Accounting Standards would simultaneously comply with IFRSs.

IFRS 3 *Business Combinations* (2004) was incorporated into AASB 3 *Business Combinations* (2004) and IFRS 3 (2008) was incorporated into AASB 3 (2008).

Q2 Definition of a business

(a) Are there benefits of having separate accounting treatments for business combinations and asset acquisitions? If so, what are these benefits?

(b) What are the main practical implementation, auditing or enforcement 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?

The principal differing treatments between business combination and asset acquisition accounting relate to the recognition of goodwill and deferred tax (only for combinations) and the capitalisation or expensing of acquisition costs (asset acquisitions and combinations respectively). Most participants at the AASB Discussion Forum and the respondents to ITC 30 support separately identifying combinations and asset acquisitions, although not necessarily agreeing with all aspects of the accounting. Respondent #2 raised the possibility of separate asset acquisitions being aggregated as a business combination, potentially having the effect of recognising asset revaluations in profit or loss.

<u>Staff View</u>

There is a difference of substance between combinations and asset acquisitions, in that combinations result in the acquisition of identifiable and unidentifiable assets and liabilities, resulting in the appropriate recognition of goodwill. Different accounting treatments are warranted.

The AASB has previously commented to the IFRS Interpretations Committee on issues concerning the definition of a business and the acquisition of investment property. This and the need for improvements to the Application Guidance in IFRS 3 should be raised in a submission to the IASB.

Q3 Fair value

(a) To what extent is the information derived from the fair value measurements relevant and the information disclosed about fair value measurements sufficient?[a] If there are deficiencies, what are they?

(a) According to the *Conceptual Framework* information is relevant if it has predictive value, confirmatory value or both.

(b) What have been the most significant valuation challenges in measuring fair value within the context of business combination accounting? What have been the most significant challenges when auditing or enforcing those fair value measurements?

(c) Has fair value measurement been more challenging for particular elements: for example, specific assets, liabilities, consideration etc?

Most participants at the AASB Discussion Forum and the respondents to ITC 30 support the use of fair value but note that there are various difficulties with its application, such as various methodologies, wide range of fair values, difficulty in measuring unusual or untraded assets (e.g. intangible assets), differing measurement bases in other Standards applying to subsequent measurement of assets and liabilities.

<u>Staff View</u>

The use of fair value should be supported. The issuance of IFRS 13 *Fair Value Measurement* in 2011 should assist in developing greater consistency in applying fair value measurement models. However, the interaction with other Standards deserves consideration, particularly where fair value as per IFRS 3 differs from fair value under other Standards.

Q4	**Separate recognition of intangible assets from goodwill and the accounting for negative goodwill**
(a)	Do you find the separate recognition of intangible assets useful? If so, why? How does it contribute to your understanding and analysis of the acquired business? Do you think changes are needed and, if so, what are they and why?
(b)	What are the main implementation, auditing or enforcement challenges in the separate recognition 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 the underlying reasons why the transaction resulted in a gain?

Most participants at the AASB Discussion Forum and the respondents to ITC 30 support the separate recognition of intangible assets and goodwill, on the basis that it would reflect the various assets acquired through the business combination. However, Respondent #2 considered that the current distinction was not value relevant to users of financial statements as there is little incentive to recognise identifiable intangible assets given that (a) goodwill is subject to impairment testing rather than amortisation and (b) the recognition of identifiable intangible assets may be associated with higher premiums and overpayment.

<u>Staff View</u>

Separate recognition of intangible assets should be supported, as goodwill is substantively different. However, the issues raised by constituents should be noted. Further application guidance would be useful.

The recognition of negative goodwill is appropriate, given the requirements for remeasurements before identifying any bargain purchase.

Q5	**Non-amortisation of goodwill and indefinite-life intangible assets**
(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)	Do you think that improvements are needed regarding the information provided by the impairment test? If so, what are they?
(c)	What are the main implementation, auditing or enforcement challenges in testing goodwill or intangible assets with indefinite useful lives for impairment, and why?

There are some concerns over the effectiveness of impairment testing of indefinite-life intangible assets and goodwill. Some participants at the Forum considered that a return to simple amortisation methods might be superior in terms of cost-benefit analysis. Respondents to ITC 30 also noted a dilemma here.

<u>Staff View</u>

Arbitrary amortisation methods are not supported. However, further work appears necessary to seek to improve the application of impairment testing. Are there any lessons for the IASB in the work done over many years in respect of the impairment testing of financial instruments?

Q6	**Non-controlling interests**
(a)	How useful is the information resulting from 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 NCIs, or auditing or enforcing such accounting? Please specify the measurement option under which those challenges arise. To help us assess your answer better, we would be grateful if you could please specify the measurement option under which you account for NCIs that are present ownership interests and whether this measurement choice is made on an acquisition-by-acquisition basis.

Participants and respondents note that the accounting policy usually adopted in Australia is to measure non-controlling interests based on the proportionate share in the recognised amounts of the acquiree's identifiable net assets, rather than using fair value.

Staff View

Although the use of fair value would be more consistent with the fair value basis for the assets and liabilities acquired, the proportionate share basis is well entrenched. The assessment of measurement models under the Conceptual Framework may serve to better distinguish the existing measurement bases for non-controlling interests.

Q7	**Step acquisitions and loss of control**
(a)	How useful do you find the information resulting from the step acquisition guidance in IFRS 3? If any of the information is unhelpful, please explain why.
(b)	How useful do you find the information resulting from 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.

Some participants and respondents expressed disquiet over the present fair value basis for step acquisitions, but supported the fair value basis for interests retained subsequent to a loss of control.

Staff View

The obtaining and loss of control are significant economic events, and a consistent measurement basis in both circumstances is preferred.

Q8	**Disclosures**
(a)	Is other information needed to properly understand the effect of the acquisition on a group? If so, what information is needed and why would it be useful?
(b)	Is there information required to be disclosed that is not useful and that should not be required? Please explain why.

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

Participants and respondents raised a number of specific disclosures that might be added (fair value adjustments) or removed (proforma revenue and profit or loss disclosures). Respondent #4 supported the disclosure requirements and noted their lack in certain cases. Respondent #2 thought the uplift in fair values compared with carrying amounts would be useful information.

Staff View

The issues raised by constituents should be addressed in a submission to the IASB.

Q9 Other matters

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 and the related amendments is, and whether improvements are needed, and why;

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

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

A number of particular issues were raised by participants and respondents, including determining whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the business combination or separate remuneration transactions. Respondent #4 noted a need for summarised financial information about material subsidiaries to better present information relating to non-controlling interests, and questioned whether regaining control of an entity after previously losing control represented a new business combination.

No constituents thought that a major project to consider revisions of IFRS 3 was warranted without proper consideration of competing projects

Staff View

The particular issues raised should be addressed by the IASB, but a project to reconsider IFRS 3 should be subject to an appropriate agenda consultation.

Q10 Effects

From your point of view, which areas of IFRS 3 and related amendments:

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

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

(c) have had an effect on how acquisitions are carried out (for example, an effect on contractual terms)?

Participants and respondents identified external valuation costs as a significant matter, however this is not explicitly a requirement of the Standard itself. Arrangements for contingent payments to employees or selling shareholders were also noted here.

<u>Staff View</u>

These points can be made in a submission.

Other Issues arising from the Request for Information?

The principal issues considered by staff to arise from the RFI are covered by the comments above in relation to the Questions raised.

Are there any other issues arising from the RFI that Board members consider should be discussed for possible inclusion in a submission from the Board?

Questions for the Board

Q1 Do members agree with the recommendations by staff on matters that should be addressed in a submission?

Q2 Are there any other issues arising from the RFI that members consider should be addressed in a submission?