Post-Implementation Review: Business Combinations

Staff Summary of Significant Matters raised at AASB Discussion Forum

April 2014

A forum to discuss the request for information published in AASB Invitation to Comment ITC 30 "Request for Comment on IASB Request for Information on Post-implementation Review: IFRS 3 *Business Combinations*" was held in Melbourne on 29 April 2014. Participants were from large, medium and specialist accounting firms and from large corporations. The participants are listed in the Appendix to this paper.

Staff notes to Board

- The following notes are a high level summary of the main comments made by participants at the Forum. They are not a transcript of the discussions. Staff have endeavoured to reflect faithfully the points made, but have exercised significant judgement in identifying the main points and interpreting the comments. Some meaning may have been lost inadvertently in the process of summarisation.
- Participants expressed their comments as individuals and their views may not necessarily reflect the views of their organisations.

The notes of the discussion are set out according to the issues raised in the IASB's Request for Information (RFI). The issues are characterised in the RFI as questions, each with various parts. Question 1 seeks information about the respondent's background and experience. Participants at the Forum outlined their considerable involvement with business combinations. This information is not summarised further, and thus these notes commence with Question 2.

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?

Most participants noted that the separate accounting treatments for business combinations and asset acquisitions encouraged entities to choose which treatment was preferred when significant judgements were required to distinguish them. However, many participants took the view that it was appropriate to identify goodwill under a business combination as internal processes acquired had value, and not to identify goodwill for an asset acquisition. Some concerns were expressed in relation to the differing deferred tax accounting (recognised in business combinations but not for asset acquisitions) and acquisition cost treatments (expensed in business combinations but capitalised for asset acquisitions). Some participants thought that there should be more guidance in relation to asset acquisitions.

Many participants queried the Application Guidance in IFRS 3/AASB 3 regarding the definition of a business (paragraphs B7-B12) rather than the definition itself, on the grounds that the guidance is too general and, in some cases, provides the latitude for entities to choose whether a transaction is or is not treated as a business combination. Others considered that the guidance needed to be reworked as it was difficult to apply in practice. Examples noted in Australia were acquisitions of mines and investment properties. One participant suggested that it could be particularly difficult to distinguish businesses under development from asset acquisitions under the current guidance.

Some participants were particularly concerned that there are potentially conflicting messages in the guidance about situations where processes are acquired compared with situations where the acquirer's processes can be applied to acquired assets.

Some participants also noted the concern that potentially conflicting messages in the guidance contribute substantially to the time taken (and cost incurred) in analysing transactions in order to distinguish between asset acquisitions and business combinations.

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?

Participants considered that fair value was an appropriate starting point but that difficulties in application included the potential range for fair value measured under various models and the difficulty of measuring contingent consideration, contingent liabilities and untraded intangible assets. The range of measurement models and values potentially allowed entities to choose the fair values that suited their preferred accounting outcomes, subject to audit views where applicable.

Some participants noted that the fair value measurement requirements in business combination accounting were somewhat at odds with the requirements of other Standards. For example, IAS 38/AASB 138 *Intangible Assets* permits the revaluation of intangible assets at fair value only where there is an active market for the asset. However, under business combination accounting, all identifiable intangible assets acquired are required to be measured at fair value as a result of one transaction. In addition, impairment testing under IAS 36/AASB 136 *Impairment of Assets* reflects value in use for the recoverable amount when value in use exceeds fair value less costs of disposal.

Some participants considered that greater consistency in fair value measurement was developing, as entities and external experts gained more experience.

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?

Some participants took the view that the separate recognition of intangible assets and goodwill was appropriate as it generally would reflect the due diligence analysis carried out by the acquirer prior to undertaking the acquisition. Other participants thought that cost-benefit issues were significant in this matter, since there was evidence that analysts ignored the recognition, amortisation and impairment of intangible assets recognised under business combinations.

Some participants noted that identifying the useful life of intangible assets was important since the shorter the useful life, the greater the likelihood of amortisation expenses and the longer the useful life, the more limited the impact of amortisation expenses or the more likely that subjective impairment testing would be required rather than amortisation.

There was limited discussion of negative goodwill (a bargain purchase gain). Most participants noted that the treatment of negative goodwill was not a major issue in Australia since bargain purchases were not common.

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?

Impairment testing of goodwill was criticised by various participants. Some took the view that the impairment requirements did not reflect the underlying circumstances, in that the accounting treatment could result in the non-impairment of goodwill over the long term due to the existence of internally generated goodwill, which otherwise could not be recognised. Others considered that impairments often resulted when there were changes of management, “cleaning up the books”. Some participants suggested that preparers might resist recognising impairments, potentially resulting in a market shock where an unexpected, delayed and larger impairment ultimately had to be recognised.

Some participants suggested that the problems in applying the impairment requirements indicated that returning to a policy of amortisation of goodwill might be appropriate, with some favouring a quite short amortisation period, such as three years. Such a policy might result in entities identifying a broader range of intangible assets.

Some participants expressed the view that it is difficult to consider potential changes to IFRS 3/ AASB 3 in isolation of the treatments required under IAS 36/AASB 136 *Impairment of Assets* and IAS 38/AASB 138 *Intangible Assets*.

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 considered that most entities in Australia measured non-controlling interests based on the proportionate share in the recognised amounts of the acquiree's identifiable net assets, rather than using fair value. Some suggested that this indicated that preparers did not want to recognise increased goodwill under the fair value basis, as increased impairment expenses could result in the future.

Some participants suggested the option is not needed, except for consistency with US GAAP.

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 argued that recognising a gain or loss on the fair value remeasurement of a previously held equity interest in the acquiree would be consistent with measuring non-controlling interests at fair value, but inconsistent with the typical measurement basis for non-controlling interests (i.e. the proportionate share of acquiree net assets). Others suggested that the recognition of a fair value remeasurement in profit or loss was difficult to understand.

Nevertheless, the general view was that fair value remeasurement through profit or loss was appropriate for retained investments upon the loss of control of a former subsidiary, and easier to understand.

Some participants noted that similar issues arise with step acquisitions of interests in associates.

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?

The nature and amount of fair value adjustments during the measurement period was raised by some participants as a potentially useful disclosure, along with disclosure of assets that were not previously recognised. Some suggested that the extent of adjustments to provisional amounts might simply reflect how close the acquisition date was to the subsequent reporting date, with the need to provide provisional amounts in a short time frame. Others proposed that the extent of adjustments might reflect the extent and quality of the due diligence work prior to the acquisition date.

Many participants questioned the proforma disclosure requirements in paragraph B64(q)(ii) of IFRS 3/AASB 3: the revenue and profit or loss of the combined entity as if all business combinations during the period had occurred at the start of the period. This was considered to be an onerous disclosure requirement, due to the costs of preparing the information and the anticipated limited benefit of the information given the estimation difficulties.

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.

Many participants suggested that there are significant implementation issues in relation to determining whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the business combination or separate remuneration transactions, i.e. payments for services rendered in the post-acquisition period. Paragraphs B54 and B55 of IFRS 3/AASB 3 address this distinction, providing a range of indicators when the classification is unclear.

Various issues arising from IFRS 3/AASB 3 were noted by individual participants, such as improved examples for reverse acquisitions and the differing treatment of similar items under other Standards (e.g. deferred tax is not recognised upon the initial recognition of an asset unless the asset is a business; intangible assets not revalued without an active market).

Participants generally did not regard revision of IFRS 3/AASB 3 to be a priority, noting various other IASB projects or issues that were considered more important.

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 identified external valuations as adding significantly to the costs of applying business combination accounting. Although not a requirement of IFRS 3/AASB 3, there is increasing market pressure for external valuations to support the accounting.

Some participants noted that the difficulties in distinguishing contingent consideration and separate remuneration transactions noted under Q9 above have resulted in the structuring of payment arrangements to achieve desired outcomes.

Some participants expressed the view that it would be difficult to undertake rigorous research on the information about business combinations that users are finding useful (or otherwise) because it would depend greatly on the information provided in the past, which can vary widely from case to case. Roundtable discussions may be the best source of feedback in this respect.

APPENDIX

Participants at the Discussion Forum

Constituents

Wayne Basford	Partner, BDO Audit (WA)
Tony Donnelly	Manager – Accounting Policy, BHP Billiton
Stephen La Greca	Institute of Public Accountants
Pat McLay	Partner, Deloitte
Nicole Perry	Group Accounting Development and Advice Manager, AGL
Gordon Thomson	Partner, PwC
Lynda Tomkins	Partner, Ernst & Young
Peter Wells	Head of Accounting Discipline Group, UTS Business School
Chris Westworth	Principal, Westworth Kemp

IASB Staff

Leo Piombino	Visiting Fellow

AASB Members

Kevin Stevenson
Peter Carlson
Taryn Rulton
Ann Tarca

AASB Staff

Angus Thomson
Clark Anstis
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