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Request for Comment on IFRS 3: Business Combinations

Dear Sirs

In relation to the above invitation I would like to comment as follows.

Question 2: There are benefits of having separate regulations addressing business combinations and asset acquisitions provided:

- They provide detail guidance not separately relevant;
- Are consistent (not contradictory) on their requirements; and,
- Do not provide the opportunity and incentive for regulatory arbitrage.

This is not seen as particularly problematic in relation to IFRS 3, except in so much as it may allow separate asset acquisitions to be aggregated as a business combination. In these circumstances where the fair value of assets acquired exceeds cost, the excess is able to be recognized as a gain in the income statement. This is in my opinion the equivalent of allowing asset revaluation increments through the income statement, and revaluation of assets in circumstances where this may not otherwise be permitted (i.e., identifiable intangible assets). It may also create the incentive for regulatory arbitrage and the overstatement of asset fair values. This is probably best addressed by recognizing gains on business combinations through OCI, which would be analogous to the treatment of asset revaluations.

Questions 3 and 4: I find this question highly problematic. Intuitively I believe that acquired assets should be properly identified for users of financial users and this information should be highly relevant to financial statement users. Unfortunately, there is little incentive to recognize identifiable intangible assets as long as there is no disincentive to recognize goodwill such as that which was created by mandatory amortization of goodwill. If the aim of the regulation was to achieve more recognition of identifiable intangible assets this should be reconsidered. Furthermore, the treatment of identifiable intangibles would need to be better developed, otherwise analysts and other users of financial statements will continue to 'back out' intangibles (balance sheet and income statement) from financial statements.

Problematically, while there is a substantial academic literature identifying identifiable intangible assets as value relevant for equity investors, this is most likely a consequence of historically recognized assets. In contrast there is evidence that the recognition of identifiable intangible assets is associated with higher acquisition premiums, in much the same way as pooling of interest was associated with higher acquisition premiums in the US, and this has been attributed to overpayment. Consistent with this conclusion there is no evidence of an association between acquired identifiable intangible assets and post acquisition performance (upto 3 years) either before or after Australia transitioned to IFRS. This result may be a consequence of decisions to recognize goodwill as opposed to identifiable intangible assets, but it does question the recognition of such assets. A consequent issue is that while the cost of acquired identifiable intangible assets might be determined by a transaction, whether the value is more reliable than any other valuation as suggested by IAS 38 is highly suspect.

Accordingly, it is difficult to see how the current distinction between goodwill and identifiable intangible assets is achieving the outcome of greater financial statement relevance. This might be addressed by increasing the incentive to recognize identifiable intangible assets appropriately (i.e., mandatory amortization of goodwill). A further issue also arising from the treatment afforded to gains on business combinations is that overvaluation of identifiable intangible assets would be recognized as gains in the income statement.

Question 8: An area of uncertainty that exists in the disclosures associated with business combinations is the extent to which the disclosed fair value of assets acquired in a business combination differs from the historic book value of the assets in the acquired business. This would be relevant in highlighting the extent to which the value of assets had been increased as a result of the transaction. While clearly different, this might be considered sufficiently similar to a revaluation as to require separate disclosure. This comment is motivated by corporate restructurings where assets where recognized at a cost significantly in excess of historic values and these where then labeled cost, whereas revalued amount may have been more appropriate.

Yours faithfully

Peter Wells