8 May 2014

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
VICTORIA 8007

Email: standard@aasb.gov.au

Dear Kevin

Invitation to Comment – Post-implementation Review: AASB 3 Business Combinations

Thank you for the opportunity to comment on the above Invitation to Comment. CPA Australia and the Institute of Chartered Accountants Australia (the Institute) have considered it and our comments are set out below.

CPA Australia and the Institute represent over 210,000 professional accountants. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

Overall, we believe the fundamental principles and concepts that form the basis for AASB 3 remain sound. However, the impact of other accounting standards (AASB 112 *Income Taxes*, AASB 116 *Property, Plant and Equipment*, AASB 136 *Impairment of Assets* and AASB 138 *Intangible Assets*) on AASB 3 and its application remains problematic. We suggest an examination of the relationships between these standards and AASB 3 to identify and address existing inconsistencies.

We also believe there are interpretative issues arising from the definition of a business, including what constitutes the boundaries of a business. In addition to providing supplementary implementation guidance and examples to address this issue, we also suggest examination of the existing implementation guidance and examples to ensure such interpretative issues are properly addressed.

Our detailed response to the questions posed in the invitation to comment are contained in the attached IASB submission. If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au or Kerry Hicks (the Institute) at kerry.hicks@charteredaccountants.com.au.

Yours sincerely

Alex Malley
Chief Executive
CPA Australia Ltd

Lee White
Chief Executive Officer
Institute of Chartered Accountants in Australia

8 May 2014

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Via online submission: www.ifrs.org

Dear Hans

Request for Information – Post-implementation Review: IFRS 3 Business Combinations

Thank you for the opportunity to comment on the above Request for Information. CPA Australia and the Institute of Chartered Accountants Australia (the Institute) have considered it and our comments are set out below.

CPA Australia and the Institute represent over 210,000 professional accountants. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

Overall, we believe the fundamental principles and concepts that form the basis for IFRS 3 remain sound. However, the impact of other accounting standards (IAS 12 *Income Taxes*, IAS 16 *Property, Plant and Equipment*, IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*) on IFRS 3 and its application remain problematic. We suggest an examination of the relationships between these standards and IFRS 3 to identify and address existing inconsistencies.

We also believe there are interpretative issues arising from the definition of a business, including what constitutes the boundaries of a business. In addition to providing supplementary implementation guidance and examples to address this issue, we also suggest examination of the existing implementation guidance and examples to ensure such interpretative issues are properly addressed.

Our detailed response to the questions posed in the discussion paper is contained in the attached appendix. If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au or Kerry Hicks (the Institute) at kerry.hicks@charteredaccountants.com.au.

Yours sincerely

Alex Malley
Chief Executive
CPA Australia Ltd

Lee White
Chief Executive Officer
Institute of Chartered Accountants in Australia

Question 1—Your background and experience

Please refer to our opening paragraphs in the cover letter.

Question 2—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?

There is benefit in having separate accounting treatments for business combinations and asset acquisitions as it provides users with a better understanding of the underlying transactions. If acquired assets were accounted for in the same way as a business combination, this would not provide users with relevant and useful information.

The main implementation issue that our members have identified arises when applying the definition of a business, including what constitutes the boundaries of a business. We consider that this definition is not sufficiently clear and we suggest additional implementation guidance and examples to address this issue. This could include considering the amendment of paragraph B10 to clarify that an acquired set of inputs and processes in the development stage should be capable of producing the intended outputs and outcomes in order to satisfy the definition of a business. We also suggest examination of the existing implementation guidance and examples provided to ensure any interpretative issues are properly addressed. This will help reduce variability and difficulties encountered when assessing whether or not a business exists.

Question 3—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? If there are deficiencies, what are they?

(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?

Fair value information is generally considered relevant and sufficient. We acknowledge there has been improvement in valuation techniques and experience since the IFRS 3 requirements were first introduced.

Some of the challenges that have been identified in measuring fair value in business combinations include:

- the re-measurement of acquired assets and liabilities on day two for provisions, uncertain tax positions and inventory, because of the limited guidance provided
- measuring intangibles, as many of them are not valued for any other purpose and are unlikely to be traded
- whose credit risk to use when measuring the fair value of acquired debt
- the removal of guidance on fair value measurement that was in the previous version of IFRS 3, which many members found useful and would like to see it added in the guidance accompanying the standard
- the fair value measurement of contingent liabilities is extremely challenging as a valuation involves significant subjectivity that could give rise to a range of values.

Question 4— 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?

We support the separate recognition of what is actually bought (in terms of all assets, including intangibles) as the conceptually correct approach in a business acquisition. Users find useful information on the values attributed to components that make up the purchase price of a business. Accordingly, intangible assets that are acquired as part of a business that meet the definition of an asset should rightly be recognised in the balance sheet at the date of acquisition.

The main challenges in recognition are in relation to non-contractual customer relationships, reacquired rights and accounting for an unfavourable contract that isn't onerous. Further guidance on these areas would be useful.

In relation to negative goodwill, our members' experience suggests that often it is a result of a transaction that is priced at a discount because a restructure will take place afterwards. Although recognising this gain isn't ideal, we do not consider there to be any other alternative that would be more acceptable.

Question 5— 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 mixed views about the usefulness of the information obtained from an annual impairment test. Those who support impairment testing consider amortisation to be arbitrary and not useful to users. Those who support amortisation believe that the impairment test can be easily manipulated to get the desired result and that the cost to perform the test outweighs any benefit. Also, as acquired goodwill is eventually consumed and replaced with internally generated goodwill, it is better to amortise over a fixed period so that goodwill is completely written off over a period after which it is no longer relevant to be recognised. Under the impairment testing model, if a goodwill balance still exists after a certain period (e.g. 15+ years) after the transaction occurred, there is a possibility that it has been replenished by internally generated goodwill and should therefore no longer be recognised.

Although returning to amortisation appears to solve many of the issues with impairment testing, we do not see any benefit in further diverging from US GAAP, given that it currently requires impairment testing. We therefore recommend that the IASB work with the FASB to improve the current impairment model.

Question 6—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.

The feedback we have received from our members, in relation to NCI, is that the percentage allocation method is the preferred measurement option. Therefore, we suggest removing the option to just requiring the percentage allocation method.

An issue that requires clarification is whether or not the mandatory purchase of any remaining NCI is a liability.

Question 7— 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.

The gains currently recognised in step acquisitions do not always provide useful information. We consider that this accounting treatment is giving rise to a mixed measurement model, given the choice available in respect of measuring NCI, which is not available for stepped acquisitions. The cost accumulation model was a better method to account for step acquisitions and we would prefer to see this added back and the current guidance removed.

Question 8—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?

Feedback we have received indicates that analysts are interested in information on the net impact of the business combination on the acquirer's balance sheet.

The disclosure often cited as not being useful is the predictive number that is required under paragraph B64(q)(ii), as it is an arbitrary number that does not benefit users.

Some clarification would be useful about the extent of comparative information needed.

As the IASB is currently working on the disclosure framework project, we recommend that any additional disclosures should be considered as part of the overall project.

Question 9—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.

We believe the fundamental principles and concepts that form the basis for IFRS 3 remain sound. However, the impact of other accounting standards (IAS 12 *Income Taxes*, IAS 16 *Property, Plant and Equipment*, IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*) on IFRS 3 and its application remain problematic. Question 5 specifically discusses IAS 36. We suggest an examination of the relationships between these standards and IFRS 3 to identify and address inconsistencies.

Further, we consider that the classification differences as to whether payments to a former owner are called contingent consideration or remuneration continue to cause difficulties in the consistent application of the standard.

We would suggest that any amendments are considered jointly by FASB and IASB, in order to keep the standard as internationally comparable as possible.

Question 10—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)?

As noted earlier, the main costs to users are in relation to fair value measurement and impairment testing. We have seen more independent experts involved in these calculations over time, which has increased costs.