EFRAG

European Financial Reporting Advisory Group

FEEDBACK STATEMENT

Preparer Outreach Activities

POST-IMPLEMENTATION REVIEW

IFRS 3 – *BUSINESS COMBINATIONS*

This feedback statement has been prepared for the convenience of European constituents by the EFRAG secretariat and has not been subject to review or discussion by the EFRAG Technical Expert Group.

EFRAG
European Financial Reporting Advisory Group

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Introduction

In January 2014, the International Accounting Standards Board (IASB) published the Request for Information on its Post-implementation Review (PiR) of IFRS 3 *Business Combinations* and requested comments by 30 May 2014.

IFRS 3 was developed within the IASB's Business Combinations project. Consequently the scope of the PiR includes consequential changes made to IAS 36 *Impairment of Assets* and IAS 27 (2008) *Consolidated and Separate Financial Statements* (replaced by IFRS 10 *Consolidated Financial Statements* in 2010) which were published at the same time as IFRS 3 in 2008. The package of Standards under review is also collectively referred to in this document as "the Standards".

The objective of the PiR is to understand whether the Standards being reviewed are working as intended and to evaluate their implementation and effects in relation to costs and benefits. It also provides an opportunity for preparers, users and other stakeholders to put forward suggestions on how the Standards under review can be improved.

In May 2013, The Financial Accounting Foundation (FAF) published its post implementation review of the US Standard on business combinations. The Business Combination project was, in principle, undertaken together with the Financial Accounting Standards Board (FASB) when the FASB developed Statement 141R. IFRS 3 and Statement 141R contain similar principles; however some significant differences still remain that largely arise because of the interaction of the two Standards with other Standards in both sets of GAAP that have not yet been converged.

Other information on this project is available on the EFRAG website.

Objective of this Feedback Statement

This document summarises the feedback received from European preparers and other constituents through questionnaires received and discussions held with preparers. It also includes feedback gathered at outreach events organised by European National Standard Setters (NSS) on the PiR of IFRS 3 in which EFRAG staff participated.

Feedback reported is based on information received as at 30 May 2014. This report accompanies EFRAG's response to the IASB's Request for Information.

Outreach activities

Objective and methodology

The outreach work focused on preparers of financial statements and was carried out by EFRAG jointly with NSS from France (ANC), Germany (ASCG), Italy (OIC) and the United Kingdom (FRC) in coordination with the IASB staff. NSS from other European countries also assisted in the work by calling on companies in their jurisdictions to participate in the outreach work.

Consistent with the objective of the PiR, the outreach work aimed at obtaining evidence about whether the Standards were implemented on a consistent basis and to understand the challenges and any unintended consequences arising from their introduction and implementation. The feedback received from the outreach activities assisted EFRAG, and its partners, to develop a response to the IASB's Request for Information on the PiR of IFRS 3.

Feedback was gathered through a questionnaire that was largely based on the questions included in the IASB's Request for Information. Many preparers responded to the questions on the benefits of the Standards. This report includes this feedback. EFRAG staff also held telephone meetings with some respondents to gather additional insights on the issues reported. The questionnaire covered the following issues:

- Definition of a business
- Fair value measurement
- Separate recognition of intangible assets from goodwill and the accounting for negative goodwill
- Non-amortisation of goodwill and indefinite-life Intangible assets
- Non-controlling interests
- Step acquisitions and loss of control
- Disclosures
- Other matters
- Effects

EFRAG staff also participated in four outreach events on the PiR of IFRS 3 organised by the FRC jointly with the ICAEW in London, the ANC in Paris, and the OIC in Milan and Rome during March, April and May 2014. The feedback received at these events has been included in this report in a consolidated matter.

Level of participation in the questionnaires

EFRAG staff received 31 responses from preparers (respondents) which included three European preparer/accountant associations. Almost all preparer respondents are listed companies (or part of) European listed groups. The table below presents the number of respondents by country and by industry[1]:

[1] This table excludes preparers and other constituents that participated in the outreach events conducted by European NSS in London, Paris, Milan and Rome.

Respondents by country:

Country	Number
Austria	2
European	2
Finland	1
France	1
Germany	4
Italy	8
Luxembourg	1
Poland	5
Spain	4
Sweden	1
Switzerland	2
	31

Respondents by industry:

Industry	Number
Auditors	1
Automobile	1
Banking and insurance	5
Chemicals	1
Construction & Materials	1
Electric Utilities	3
Food & beverage	1
Industrial goods & services	2
Mining	1
Oil & gas	3
Pharmaceutical	3
Preparer organisations	3
Technology	2
Telecommunication	3
Transport	1
	31

Executive Summary

While many preparers indicated support for the overall acquisition accounting model in IFRS, most expressed significant concerns relating to the level of effort required and costs incurred to meet its requirements, and questioned whether IFRS 3 and related Standards have worked as intended in respect to all the issues that they set out to address. An important conclusion from the outreach work is that various preparers question whether the increase in costs, considered by some to be very significant, has been compensated by benefits to users, particularly given the level of complexity and high level of judgement required to meet some of the requirements.

The main comments made by respondents can be summarised as follows:

(a) **The definition of a business**

Respondents generally agree there are benefits of having a separate accounting treatment for business combinations and asset acquisitions because such transactions are conceptually and economically different.

Many respondents expressed concerns with the definition of a business, and noted that the assessment of whether a business exists or not is a significant practical difficulty. Respondents generally noted that the definition in IFRS 3 is too broad and lacks guidance on what should not be considered a business. This has resulted in a number of acquisitions being treated as business combinations, when, in the view of the preparers, they should have been treated as "asset acquisitions". The broadening of the definition of a business resulted when IFRS 3 (revised 2008) added the notion of "capable of being conducted" as a business. In practice many acquisitions are "capable" of being a business, and this raises a question about whether such a "wide application" was the intention of IFRS 3. Specific challenges were noted in respect to acquisitions of "single asset" entities and acquisitions/disposals of "service and outsourcing agreements". In addition, some respondents noted that the lack of guidance in IFRS 3 on the "inputs, processes and outputs" has resulted in diversity in the way some companies interpret the definition.

Overall, the tension between an asset and a business stems from the different accounting requirements in IFRS for acquisition of assets and acquisitions of businesses.

(b) **Fair value measurement**

More than half of respondents agree that the fair value measurement in a business combination provides useful information.

However, many respondents (including those that support fair value measurement) noted significant challenges in determining the fair value of certain assets and liabilities. With respect to assets acquired, the main concerns relate to fair value measurement of intangible assets, in particular, intangibles not recognised in the financial statements of the acquiree, non-contractual intangibles, intangibles for

which there is no active market and intangible assets in the "early stage" of development such R&D intangibles. Determining the fair value of such intangibles requires the use of complex valuation models using assumptions and estimates that require a significant level of judgement. This may result in the models providing inconsistent and in some cases unreliable measurements.

Some respondents questioned the relevance of measuring certain intangible assets (such as brands) at fair value at the acquisition date if the acquirer does not intend to use it in the way same as "a market participant", and believe that expected value in use (others said "entity value") to be a more relevant basis for measuring such assets.

Reliability concerns were also expressed with regard to the measurement of loans and receivables in the banking industry, pre-existing relationships, and measurement of previously held and retained interest in step acquisition and loss of control transactions. Some respondents noted that future restructuring costs to be undertaken by an acquirer should be part of the fair value measurement on the date of the acquisition. Fair value of consideration in an equity-share transaction was also an area of difficulty.

Respondents noted that the valuations on fair value measurement are often performed by external valuators which can be a very costly process.

(c) **Separate recognition of intangible assets from goodwill**

A majority of respondents agree that recognising intangible assets at fair value separately from goodwill provides useful information, especially when it provides users with a better understanding of what has been paid for through the acquisition price.

However, many of these respondents expressed significant concerns with separately identifying specific intangible assets from goodwill.

Overall, respondents considered the process of separately recognising intangible assets to be highly complex, subjective and costly. Some viewed the purchase price allocation to identifiable intangible assets as a pure accounting exercise while the parties involved in the transaction might not have considered these assets when assessing the transaction (and agreeing the price). Similar to fair value measurement, the main concerns relate to intangibles not recognised in the financial statements of the acquiree, non-contractual intangibles, intangibles for which there is no active market and intangible assets in the "early stage" of development such R&D intangibles.

Suggestions made by respondents broadly fell in two categories:

- Some respondents suggested a less "granular" approach to separation of intangibles (for example a cluster-based approach based on classes of intangibles with similar amortisation periods).

- Others suggested a simplified allocation of the excess of the consideration paid over the fair value of tangible balance sheet items which could be amortised over a specific period.

(d) **Subsequent accounting for goodwill (impairment model)**

Some respondents supported an impairment-only model, others supported amortisation and a third category supported a combination of both (mandatory amortisation combined with impairment).

Most respondents noted the impairment test to be an area of great difficulty involving significant judgement, which has resulted in significant costs to preparers. Whilst many of these respondents do not dispute the conceptual basis of the impairment model in IAS 36 and the potential relevance of an "impairment-only" model, they argue that there are a number of practical issues that outweigh the conceptual merits and intended benefits. Requiring/allowing amortisation of goodwill would reduce the emphasis on the impairment test and ease the burden for preparers.

(e) **Contingent consideration**

Several respondents believe that adjustments to contingent consideration should be included either in goodwill or in the value of specific assets acquired.

Other areas of concern expressed can be summarised as follows:

(f) **Non-controlling interest (NCI)** – Respondents generally found the information on NCI useful. However, there were mixed views on having two different measurement options for NCI; some supported having an option and others would prefer a single measurement option. Most respondents (that responded to this question) measure NCI using "proportionate interest" mainly because of the difficulty in determining the fair value of NCI.

(g) **Negative goodwill (bargain purchases)** – Respondents (that responded to this question - more than half) had split views on the required accounting treatment. While some agree that bargain purchases should be accounted for in profit or loss, others believe that it should not always be the case. When negative goodwill results mainly from anticipated future losses (such as restructuring costs the acquirer expects to incur), the immediate recognition of negative goodwill as a gain in profit or loss is counter-intuitive and leads to a periodic mismatch when the future losses are recognised.

(h) **Step acquisitions and loss of control** – Some respondents did not believe that the remeasurement of the previously held/retained interest in the acquiree provides useful information. Specific concerns and practical difficulties noted by respondents include the following:

(i) absence of a market price for previously held/retained interest;

(ii) it was counter-intuitive to realise gains or losses before the investment is sold or impaired; and

(iii) structuring opportunities because of the different accounting between gain/loss of control (accounted for in profit or loss) and acquisition/disposal of interest whilst retaining control (accounted for in equity).

(i) **Disclosures** – Respondents stated that the currently required disclosures in IFRS 3 should not be increased, with some noting that they are already excessive and do not always provide useful information. Information should be condensed to focus on more relevant items.

Detailed findings

[Question 1 related to background information of respondents]

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?

Respondents agree there are benefits of different accounting treatment for business combinations and asset acquisitions

Many respondents agree there are benefits of having a separate accounting treatment for business combinations and asset acquisitions.

A few other respondents questioned whether the different treatment for acquisition of assets and businesses is justified. Some said that the different treatment is conceptually justified with respect to goodwill, but question the other differences in accounting treatment such as deferred tax, contingent consideration and transaction costs.

The following were the main reasons why the accounting for an asset and a business should be different:

There are conceptual and economic differences between the two types of transactions, and also because of the more simplified accounting for asset acquisitions compared to business combinations

- There is a conceptual difference between business combinations and asset acquisitions. Business combinations require the separation of goodwill and other intangible assets acquired in order to assist users gain a better understanding of the transaction and what was acquired for the price paid. Also, business combinations are subject to a number of specific disclosures to help users understand the nature and financial effect of such transactions.

- The objectives of undertaking a business combination and an asset acquisition are different. For "asset deals", the focus is on the "assets" acquired, so what mattered was the fair value of the underlying asset or group of assets. For example, in some cases a "business" is acquired through a legal entity primary for its assets or a strategic asset – for example intangible assets (R&D, licences, patents and service contracts) or assets (investment property).

- A number of respondents noted that the accounting for business combinations is far more complex compared to acquisition of assets, given the significant differences in accounting treatments which often involved application of

"level 2" and "level 3" measurement bases under IFRS 13 *Fair Value Measurement*. [Also see response to (b) below].

(b) What are the main practical implementation, 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?

Many respondents expressed practical difficulty when assessing whether a transaction is a business combination or an asset acquisition. The level of difficulty, and sometimes the reasons varied; although the main areas of difficulty were the following:

The definition of a business was noted as a significant area of practical difficulty for respondents from various industries

- definition of a business is too broad;
- lack of guidance on the elements of a business; and
- significant differences in the accounting treatment for acquisition of assets and businesses.

Respondents from various industries (real estate, financial services, extractive, pharmaceutical industries and, telecommunications) identified the assessment of whether a business exists to be a significant practical challenge.

Some other respondents did not encounter particular challenges in the assessment. These respondents generally said that most of their acquisitions represented businesses. For example, one respondent (airline industry) noted that the investments made were clearly separable into acquisitions of single assets (capital expenditures in the course of operating activities, i.e. expansion investments) and investments into identifiable businesses (e.g. acquisition of market share, new businesses, etc.).

The definition of a business is too broad

Definition of a business is too broad. Adding the notion of "capable of being conducted" as a business has broadened the definition of transactions that are considered a business under IFRS 3

Some respondents believe that the root cause of the problem is that the definition of a business is too broad. IFRS 3 (2008) compared to IFRS 3 (2004) has broadened the definition of transactions that are considered a business by adding the notion of "capable of being conducted" as a business. Some of these respondents noted that most acquisitions are "capable" of being a business; however there was a question about whether that was the objective of IFRS 3, particularly when what was being acquired was an "asset or a collection of assets". Respondents provided the following examples of practical implementation difficulty:

- Respondents from the pharmaceutical industry provided examples of "single asset" entity acquisitions, in which a single asset is placed into a legal entity (often for tax reasons of the vendor) and sold/acquired in that way. Following the definition of IFRS 3, these 'asset acquisitions' are sometimes treated as business combinations" instead of an acquisition of an asset. Similar "single-asset" structures were reported by other respondents (real-estate industry) where investment properties are often (in some countries almost always) sold in separate companies as "corporate wrappers".

Clarity is needed in cases when an asset deal is not an acquisition of a business but rather a service contract or a licensing agreement

- A respondent from the telecommunications industry indicated that there were cases when an asset deal is not considered to be a "real" acquisition of a business (from the perspective of the buyer) but rather a service contract to provide outsourcing services to clients. This respondent said it was necessary to differentiate between "asset deals" and "share deals" in order to make it clear that there are instances when an asset deal is not an acquisition of a business but rather a service contract or a licensing agreement.

- One respondent provided an example of an outsourcing agreement through the sale of labour contracts to a newly formed entity, which is controlled by a third party. The question was whether there was a sale of a business rather a servicing contract.

Lack of guidance on 'inputs', 'process' and 'outputs'

More than half of respondents believe that IFRS 3 lacks application guidance and practical examples on the application of the definition.

These respondents recommend the IASB to provide further clarification on the essential characteristics within the definition of a business. Some respondents highlighted that the main challenges in applying the guidance in IFRS 3 is the distinction between input and process and the assessment of the relevance of processes acquired:

- Respondents from the real estate industry mentioned practical difficulties in determining whether the processes acquired, which are often of an administrative nature, represent processes necessary to the production of outputs

or merely serve to safeguard and manage the real estate properties.

Clarify that the acquirer must have the control over the process for the integrated set of activity to qualify as a process

- Respondents from the pharmaceutical and extractive industries noted that it was not clear what makes up a "process" and what an "output" could represent. In the pharmaceutical industry, an early stage of development R&D asset may not have a commercial output for many years (if at all). Entities tend to define the output giving rise to a business based on their business model, which is then determinative of the required processes. Some respondents noted that an acquirer should have *control over the process* for the integrated set of activity to qualify as a process. The definition of a "process" should indicate that any system, standard, protocol, etc., should be controlled by the acquirer as a result of the acquisition and therefore have ability to create outputs.

A key issue is often establishing at what point a research or an exploration project becomes a business

- One respondent provided an example of an acquisition of a pharmaceutical product for which regulatory approval had already been granted. In some cases this could be treated as a business combination by one entity that has an established production capability, but as an asset acquisition by another entity (that must either establish its own production capacity or commence the process for third party production of the product). A key issue is often establishing at what point a research or an exploration project becomes a business.

Significant differences in accounting treatments

The significant differences in the accounting for business combinations and asset acquisitions is a key issue

The significant differences in the accounting for business combinations and asset acquisitions were noted by various respondents to be a key issue. This caused distorting differences in accounting for deferred taxation, contingent consideration and transaction costs, and left scope for extensive debate and potential accounting arbitrage when structuring a transaction.

Question 3 - Fair value measurement

(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?

More than half of respondents agreed that information about the fair value measurements is relevant and sufficient

More than half of respondents agreed that the information produced by IFRS 3 is relevant.

- However, some respondents noted a concern about assumptions used in fair value models as such information was considered "sensitive". Although users might find such information useful, preparers were reluctant to disclose strategic matters and commercially sensitive information. Other respondents supported providing information about the assumptions and/or the measurement techniques used to determine fair values.

- Various respondents noted that information of the carrying amount of the assets and liabilities acquired in the business combination would increase the usefulness of the information. This disclosure is currently not required by IFRS 3.

The other half of respondents considered that information derived from fair value measurement was too subjective to lead to useful information. Some respondents stated that the fair value measurement required by IFRS 13 was seen as a "hypothetical" accounting exercise and did not reflect the nature of the acquired business for the acquiring entity.

The significant valuation challenges are discussed in the response to (b) below.

(b) What have been the most significant valuation challenges in measuring fair value within the context of business combination accounting?

Fair value measurement represents a challenging exercise for some intangibles assets

A majority of respondents expressed significant challenges in determining the fair value of certain assets and liabilities.

[For more detail on the types of assets and liabilities see response to (c) below].

The most significant valuation challenges reported were:

Valuation methods

The application of different valuation techniques and the high level of judgement and assumptions made by management increase the subjectivity of the fair value measurements

The application of complex (and different) valuation methods and the determination of the respective inputs require a high level of judgement that reduced the objectivity of the valuations. One respondent said that in theory, only one fair value exists for each identified asset. However, in practice, judgement regarding valuation parameters and complex valuation models will lead to different fair values. Consistency in the application of valuation

models (and standardised models) could also affect comparability of information.

Given the level of complexity and judgement involved in the measurement of some of the assets and liabilities acquired, these respondents did not think the fair values always represented reliable measurements.

In relation to specific assets, some respondents noted that the lack of good benchmarks and data added complexity and subjectivity to the process. Practical examples and guidance on the type of valuation model to be used would be helpful to value certain assets and liabilities (customer-related intangibles, i.e. customer lists), as there was insufficient guidance in IFRS 13.

Many respondents noted that the required valuations are often performed by external valuators which can be a very costly process.

Fair value is a hypothetical number

Some respondents had concerns with the "hypothetical" market participant approach of fair value as define in IFRS 13

Some respondents considered the fair value exercise of acquired asset and assumed liabilities to be a hypothetical exercise unrelated to the economic rationale of the negotiation.

Some other respondents questioned the relevance of measuring certain intangible assets (such as brands) at fair value at the acquisition date if the acquirer does not intend to use it in the same way as "a market participant". These respondents suggested a measurement based on expected value in use to be a more relevant basis in such cases. Overall, these respondents support a more entity-based perspective to measure acquired assets and assumed in a business combination, rather than a "hypothetical" market participant approach under IFRS 13 i.e. what other companies would be willing to pay for each item leading to recognised values that sometimes are quite different from the value for the acquirer.

Level of resources and costs incurred

Undertaking valuations to meet the requirements in IFRS 3 has proved to be a costly process

A majority of respondents noted that fair value measurement requires considerable resources. Often companies do not have sufficient in-house expertise to perform some of the purchase price allocation. The use of external resources can be extremely costly and respondents raised the question of a cost-benefit balance when complying with IFRS 3.

Other matters

Non-recognition of future restructuring provisions was a concern

Some respondents noted that future restructuring costs planned to be undertaken by an acquirer should be part of the fair value

measurement on the date of the acquisition. Those liabilities were usually considered when negotiating the consideration transferred and therefore should not be treated as a post-acquisition cost.

The mixed recognition and measurement model in IFRS was highlighted as a concern

Some respondents stated that the fair value measurement of assets and liabilities creates difficulties when such measurement is inconsistent with other Standards. In particular, some respondents mentioned that, in a business combination, contingent liabilities were required to be recognised and measured at fair value according to IFRS 13 but would not meet the recognition criteria of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* in the normal course of operation.

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

A majority of respondents expressed significant challenges in determining the fair value of certain assets and liabilities.

Measurement of intangible assets without active markets (i.e. customer relationships, patents, brand names, research and development and oil and gas assets), subsequent measurement of contingent consideration and accounting for restructuring costs have been identified as the main challenges

Examples of the most significant valuation challenges included the following:

- intangible assets;
- contingent consideration (refer to response to Question 9);
- measurement of loans and receivable portfolios (banking industry);
- pre-existing contractual relationships; and
- measurement of own shares when part of the consideration paid (equity shares).

Other comments included the following:

- avoidance of double counts on initial recognition was identified as a main challenge by some respondents;
- some respondents questioned the recognition of inventory at fair value because a major part of the gross profit was added to the inventory values and led to lower future margins.

Intangible assets

Many respondents expressed significant valuation challenges in measuring fair value of certain intangible assets particularly:

- non-contractual intangibles (such as customer lists, customer relationships);
- intangible assets for which no active market (or observable market) exists (customer-related intangibles, marketing-related intangibles such as brands, trademarks and internet domains, technology-based intangibles software- and contract-based intangibles relating to licenses and concession rights); and
- intangible assets in their "early-stage" of development (such as R&D and assets in the mining industry).

Determining the fair value of such intangibles requires the use of complex valuation models based on assumptions and estimates that require a significant level of judgement.

For example, one respondent from the pharmaceutical industry noted that fair value of R&D intangible assets is highly judgemental and based mainly on level 3 inputs under IFRS 13. Due to the early stage of development of most R&D intangibles, and the highly specialised nature of these, it is challenging to obtain market participant inputs.

Given the level of complexity and judgement involved in the measurement of these intangibles, these respondents did not think that the fair values always produced reliable measurements.

Measurement of expected losses on loans and receivables

Some respondents from the banking industry reported a concern regarding the measurement at fair value of loan (and receivables') portfolios. The issue arises given the lack of an active market for these types of assets. Some of specific issues mentioned were:

- determining the credit risk of the borrower;
- determining the appropriate interest rate to use in the fair value calculation; and

- impairment Standard not yet available (with respect to expected credit losses to be recognised).

One respondent suggested a more aggregated level of separation (at portfolio level of assets) to resolve this concern.

Pre-existing contractual relationships

Some respondents noted that the fair value of pre-existing relationships is a challenging area. These respondents questioned the outcome of the accounting treatment when a gain on a pre-existing relationship is recognised when an acquirer had a pre-existing license agreement with the acquiree. This gives rise to the recognition of unrealised gains where the value of the asset previously held is derecognised and the asset re-recognised at fair value at the acquisition date). These respondents acknowledged the treatment to be an "anti-abuse" provision.

Measurement of own shares

Some respondents expressed concern with the accounting for consideration transferred paid in shares (often referred to as share-for-share transactions).

The issue relates to potential changes in fair value (of the underlying shares) between the date when the business combination is agreed and announced and the acquisition date under IFRS 3 (date control passes to the acquirer). Using the acquisition date instead of the date the "deal is negotiated" affects significantly the consideration amount and consequently the accounting for goodwill.

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?

A majority of respondents considered separate recognition of intangible assets (or some intangible assets) to be useful information. Some of the benefits noted were the following:

Majority of respondents considered the separate recognition of intangible assets to be useful

- increases transparency and the understanding for the acquired business and the reasons for undertaking the acquisition; and

- assists users in understanding the key value drivers of the business combination and establishes specific reference points for assessing the performance of the acquired business.

Other respondents specifically noted that they did not think the information provided by separate recognition of intangible assets was useful. The following comments were made:

- The information was difficult for users to understand, especially when the assets identified were not separable from the business or from other rights and obligations; or when the assets acquired had not been previously recognised by the acquiree in its accounts. In these circumstances, the calculation of fair value was extremely subjective.

- One respondent noted that, on the one hand, separation of intangible assets was used (for the reasons noted above) but, on the other hand, the separation and valuation of acquired intangible assets has to reflect the market view, which does not necessarily represent the motivation of the acquirer regarding the acquired business. If the acquirer is willing to pay for certain synergies, but not for certain intangible assets, this should be reflected in the accounting. Other respondents shared similar views.

One respondent did not have a view as this respondent had not encountered significant intangible assets.

(b) What are the main implementation challenges in the separate recognition of intangible assets from goodwill? What do you think are the main causes of those challenges?

The high level of subjectivity, the difficulty in obtaining accruable and timely data as well as the complexity of the valuation methods were pointed out as the main implementation challenges

A majority of respondents expressed significant practical implementation challenges regarding the “granular” level of identification and separation of intangible assets.

The practical implementation difficulty related to the same intangible assets discussed in the response to Questions 3 (b) and 3 (c). These respondents generally noted that separate recognition was highly complex and required a high of judgement.

As explained in the response to Question 3 (b), the valuation process was also a very costly process due to the requirement of using external consultants in the process.

Highly complex and requires high level of judgement

Many respondents stated that the process relied highly on judgement along with a lack of reliable benchmarks and accurate data. Judgement based on various versions of the income approach (relief from royalty, avoided cost approach, cost profits method, etc.). As mentioned in the response to Question 3, the lack of active markets for some intangibles and lack of similar transactions to benchmark against was also raised by many respondents when determining fair value for these intangibles.

Others pointed out the difficulty in receiving accruable and timely data to be used in the discounted cash flow models for determining the fair values of acquired assets and liabilities. In addition, they mentioned the complexity of valuation models and uncertainty about which models to use for which intangible assets.

In the banking industry, it is difficult to identify which are the intangible assets to be recognised (for example whether they relate to customers or to products).

Regulatory requirements

Some respondents (banking industry) noted an inconsistency between the accounting treatment for goodwill under IFRS 3 and for regulatory purposes (Basel III), given that intangible assets were subtracted directly from regulatory capital.

Respondents from the banking industry noted an inconsistency between the accounting treatment for goodwill under IFRS 3 and for regulatory purposes (Basel III)

In addition, some noted that there might be another inconsistency in terms of tax effects. If companies impaired the full amount of goodwill they would only impact 70% their regulatory capital due to the fact that a deferred tax asset would be recognised for deductible goodwill (in some jurisdictions).

Suggestions put forward

The following two broad suggestions were made by respondents:

- some respondents propose less “granular” separation of intangibles and proposed a cluster-based approach based on classes of intangibles with similar amortisation periods based on the company’s business strategy; and

Some respondents propose less “granular” separation of intangibles

- a few respondents suggested a simplified allocation of the excess of the consideration paid over the fair value of tangible balance sheet items which could be amortised over a specific period.

(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?

Respondents had split views on whether bargain purchase gains should be recognised in profit or loss

Respondents that responded to this question (more than half) had split views on the required accounting treatment. While some agree that gains arising from bargain purchases should be accounted for in profit or loss, others believe that it should not always be the case.

Some respondents believe that the recognition of negative goodwill could indicate the presence of structural problems in the acquiree that could result in a future liability for restructuring costs. This liability should be recognised at the acquisition date. In cases where negative goodwill results mainly from anticipated future losses, the immediate recognition of negative goodwill as a gain in profit or loss leads to a periodic mismatch when the future loses are recognised, which is often difficult to explain to users.

Another respondent noted that a "gain" generated by the fair valuation of items such as intangible assets (which are inherently judgemental) should not be recognised on the date of the acquisition. There is a risk that the company could recognise a "bargain purchase" at the acquisition-date based on judgemental values and in future years recognise an impairment loss if the "fair value" estimated was not correct.

Some respondents considered that as negative goodwill only happens in rare occasions the recognition through other comprehensive income (OCI) could be justified.

A few respondents considered that negative goodwill should be recognised as a decrease in the value of assets and not as a gain in profit or loss and that the treatment granted to bargain purchases was difficult for users to understand.

One respondent thought that disclosures about the underlying reasons that give rise to negative goodwill would be useful as they increase transparency and the understanding for the acquired business.

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?

Some respondents supported an impairment-only model, for goodwill and indefinite–life intangibles; others supported

Some respondents supported an impairment-only model, for goodwill and indefinite–life intangibles, others supported amortisation and a third category supported a combination of both (mandatory amortisation combined with impairment)

amortisation and a third category supported a combination of both (mandatory amortisation combined with impairment).

Just under half of respondents supported the existing impairment model. The main reasons included:

- it was useful to understand the dynamics of value of a business combination and helped review the performance of the value drivers in the business and assessing changes in business assumptions considered when the business combination took place;
- it provided a better understanding of the economic results over time, compared to an amortisation model; and
- given the special nature of goodwill, information reported through an impairment test is more relevant than the one provided through systematic amortisation of goodwill. Amortising the goodwill on a regular basis did not permit a fair representation of the business trend.

Supporters of the actual model argued that impairment test allows a proper review of the performance of the value drivers in the business and of the changes in business assumption considered in an initial stage of the business combination

Just over half of respondents believe that the IASB should reconsider the amortisation model for goodwill (also see response to (c) below).

- the impairment model was pro-cyclical and conceptually flawed; and
- the information derived from an impairment test was not useful;

Some respondents did not comment on this question or did not indicate a preferred view.

(b) Do you think that improvements are needed regarding the information provided by the impairment test? If so, what are they?

Some respondents did not identify any relevant improvement.

Others did not answer this question.

Suggestions for improvement are discussed in (c) below.

(c) What are the main implementation challenges in testing goodwill or intangible assets with indefinite useful lives for impairment, and why?

A majority of respondents indicated practical implementation challenges in impairment testing goodwill or intangible assets with indefinite useful lives.

Impairment test has been identified as a complex, subjective and costly process

Some respondents noted that the impairment test is one of the most complex processes within an organisation requiring a lot of resources, time and a stringent set of internal controls.

The main concerns noted were:

- Challenging and judgemental exercise - these respondents cited various challenges in performing an impairment test. It created irregular volatility in the profit or loss, and resulted in "double dips" in profit or loss. Some of the practical complexities included:

  (i) determining the WACC;

  (ii) assessing the appropriate growth rate to include in the discounted cash flow model; and

  (iii) allocation of corporate assets in cash-generating units (CGU).

Some respondents argued that due to the complexity, irregular volatility in profit and loss, "double-dip" effects and the inherent assumption of "never-ending" synergies amortisation model should be revisited

- Goodwill is difficult to track - some respondents noted that goodwill consisted mainly of synergies which were often difficult to demonstrate in subsequent periods. In many cases, synergies moved to different parts of the group, through reorganisations, and it was hard to "track" the goodwill.

- Internally generated goodwill - some respondents questioned whether IAS 36 always provided an appropriate surrogate for amortisation. For example, whether it was reasonable for assets to be carried on the balance sheet for a very long period of time with no or marginal impairment charges during that period. These respondents thought that the main reason these assets do not require impairment is that externally acquired goodwill become internally generated over time, so that the asset that then "passes" the impairment test is no longer the one initially recognised.

- An accounting exercise - some noted that the testing of goodwill and intangible assets with indefinite useful lives for impairment (annually or triggered) is a mere accounting exercise, but is not used by management or other users of financial statements for assessing the performance of a CGU/ business. The impairment-only approach has various weaknesses of which one is the room for judgement when

determining the fair value or value in use of a CGU. Overall, this respondent believes that the impairment-only approach does not properly reflect the consumption of goodwill over its useful life. Other respondents had similar views.

- Internal processes: some respondents expressed concerns regarding the requirements included in IAS 36 when entities carry out the impairment test because IFRS 3 does not fit the internal planning and control processes of entities involved in business combinations. The concerns raised were the requirement to use pre-tax discount rates (when for management purposes post-tax rates are used) and disregarding planned restructuring.

These respondents noted that given the above significant concerns, the IASB should reconsider the annual impairment test requirement. Some of the main suggestions include:

- allow/require amortisation of goodwill to reduce the emphasis on goodwill impairment and the pro-cyclically it causes;
- reconsider which intangible assets could be recognised within goodwill;
- post-tax discounts rates should be used as this was in line with the way management assessed impairment; and
- some respondents mentioned that disclosure of real impairment test drivers and key information should be required by IAS 36. In addition, they mentioned that information on cash flows should be more analytical. However, the same number of respondents mentioned that disclosure requirements should be reduced as the information reported was not useful for users.

Question 6 – Non-controlling interests (NCI)

(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?

NCI information was useful and reflects claims on consolidated equity not attributable to the parent

A majority of respondents noted that the information resulting from the presentation and measurement for NCI was useful and reflects claims on consolidated equity not attributable to the parent.

Most of the respondents considered "proportionate interest" of NCI as the option that better reflects "reality of the business"

Most of the respondents that provided a view on the measurement option in IFRS 3 for NCI measure NCI using the "proportionate interest" method. Two main reasons were:

- the entity has not acquired the goodwill attributable to the NCI, and therefore it should not be recognised; and
- difficulty in measuring NCI at fair value.

Only a few respondents supported measurement of NCI at fair value. These respondents noted that the acquirer is a unique economic entity and therefore the goodwill should be accounted for in relation to the whole entity.

(b) What are the main challenges in the accounting for NCIs? Please specify the measurement option under which those challenges arise.

Around half of respondents responded to this question.

Some of these respondents supported having an option and others indicate a preference for a single measurement option

Some of these respondents supported having an option and others indicate a preference for a single measurement option.

The main challenges noted in the accounting for NCI relate to measurement of NCI. The acquisition of a majority shareholding includes a "control premium" that should not be considered in the value of the NCI.

Respondents identified lack of guidance on the impairment test on goodwill when NCI are measure at fair value

Some respondents also noted a concern with valuation and impairment in relation to NCI given the lack of guidance on how to develop the impairment test on goodwill if the "full goodwill" method is applied. There was also a lack of guidance on how to treat the control premium and whether adjustments to the measurement of NCI were needed.

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.

Views over the usefulness information resulting from the step acquisition guidance were split. Some found it useful because it sets guidance for all

Around half of respondents replied to this question.

Some respondents considered the information resulting from the step acquisition guidance in IFRS 3 to be useful because it

entities and removed unnecessary complexity

provides guidance for all entities and removed the unnecessary complexity included in IFRS 3 (2004).

A majority of these respondents disagreed with the accounting treatment for step acquisitions and loss of control under IFRS 3/IFRS10.

The main concerns expressed were as follows:

- Results in the recognition of hypothetical gains and losses that do not reflect the effects of the transactions, as there is no payment made or received (no effect on cash flows).

Others respondents considered that step up process creates artificial values that increases the value of the intangibles and was not part of the performance of the business

- There is no economic reason for having a different goodwill number in a step-acquisition and an acquisition realised in a single transaction.
- Absence of a market price for previously held/retained interest. Some respondents stated that adjusting previously held interests in the acquiree generates artificial values as acquiring control implies a premium which was reflected in the price paid.
- Others noted that it was counter-intuitive to realise gains or losses before the investment is sold or impaired, and such accounting was difficult to explain to users.
- A few respondents mentioned that step-up of previously held interest increases goodwill or intangibles, without adding significant information to the reader.

(c) Have you encountered any operational (practical) difficulty in remeasuring any previously held equity interest at acquisition-date fair value?

(d) Have you encountered any operational (practical) difficulty in remeasuring any retained equity interest at fair value upon loss of control in a former subsidiary?

Measurement of the “control premium” incorporated in the business combination and complexity of valuation techniques were identified as major challenges

About one third of respondents responded to these two questions. About half of these respondents did not report operational difficulties.

The other half noted that the main operational challenge was to determine the control premium incorporated in the transaction price in order to determine the NCI value. It was also difficult to determine the fair value of NCI when the shares were not quoted.

Some respondents from the banking sector observed possible unintended consequences of IFRS 3 when accounting for steps

acquisitions and loss of control (e.g. in a first step from 100% to 70% and in a second step from 70% to 30%) as they can be made with the only objective of raising regulatory capital. Such "structuring" could arise when multiple steps are used to achieve a desired accounting outcome. The question is whether the multiple steps represent a linked transaction or separate transactions, which lead to different accounting outcomes.

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 the disclosures required by IFRS 3 or by the related amendments, and why?

The majority of respondents considered current disclosures to be sufficient

A majority of respondents considered the current disclosure requirements to be sufficient and offered useful information.

Some respondents indicating that there was a need to reduce disclosures, rather than increase them.

The main challenges expressed by respondents were the following:

- difficulties when confidentiality clauses are included in business combination agreements. General terms disclosures should not penalise or put companies at a disadvantage; and
- difficulty in providing pro-forma information. Guidance on how to determine pro-forma information was required.

Respondents acknowledge the disclosure of confidential clauses and pro-forma information as the main challenges

Some of the main suggestions by respondents were:

- few respondents noted that there should be a specific requirement to disclose additional information relevant to the bargain purchase;
- if users find information on pro-forma revenue and net income useful, it may be appropriate for the IASB to provide further guidance on the preparation of pro-forma information since current IFRS 3 does not explain, what adjustments, if any, should be made in combining the results of the acquirer and the acquire for the period before the acquisition.

Question 9 – Other matters

Are there other matters that you think the IASB should be aware of as it considers the Post-implementation Review 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 the Standard and the related amendments; and*

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

The other main matters mentioned by respondents, and not included in the other questions, were the following:

Contingent consideration

Various respondents expressed concerns regarding the measurement of contingent consideration paid in a business combination. Difficulties arose particularly when it was based on technical accomplishments or future business achievements (especially for early stage or transactions with multiple targets).

Several respondents expressed concerns regarding the measurement of contingent consideration. It was challenging to fair value these contingent payments at the acquisition date based on the probability of success of each milestone

Respondents from the pharmaceutical industry pointed out that the fair value of contingent consideration (especially those linked to R&D compounds) was highly judgemental and difficult to determine. Some of these respondents noted that acquisition deals have multiple success-based contingent consideration payments based on the research and development period of a drug, being on average 12-20 years to get a preclinical compound. Therefore it was challenging to fair value these contingent payments at the acquisition-date based on the probability of success of each milestone.

In addition, some respondents noted that when contingent consideration liabilities are directly linked to a particular intangible asset acquired (for example a progress research), the values of the liability and related intangible asset respond equally to the related changes in the development of the project. However, the subsequent measurement of the liability is at fair value whereas the intangible asset is subsequently measured at amortised cost, which resulted in an “accounting mismatch”. These respondents noted that this issue could be solved if changes in fair value of the liability could be recognised as an adjustment to the related intangible asset.

Separate transactions

Other respondents found difficulties in determining whether a particular transaction or arrangement was part of what the acquirer and acquiree exchanged in the business combination or was a separate transaction (i.e. when an acquirer obtains control over an indirect subsidiary of the acquiree because the latter has an agreement with a third party that is enforceable due to a change in the subsidiary's ownership). Those respondents argued that guidance in IFRS 3 could be improved to clarify similar issues.

Capitalisation of transaction costs and lack of guidance regarding valuation techniques were other matters raised by respondents

Transaction costs

Some respondents argued that transaction costs involved in a business combination should be included in the cost of the business combination (capitalised).

Lack of guidance

Some respondents stated that IFRS should provide more guidance regarding several topics:

- business combinations under common control;
- the treatment of a customer relationship of the acquiree with the acquirer; and
- provisions for onerous contracts of the acquiree related to the acquirer or trade receivables.

Question 10 - Effects

From your point of view, which areas of IFRS 3 and any consequential amendments to other Standards:

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

The main benefits identified by respondents were:

Price purchase allocation process and separation of intangibles represented the main benefits for respondents

- price purchase allocation represents a major benefit to readers of financial statements and provides a comprehensive understanding of the real substance of acquired assets and liabilities and the meaning of the purchase price;
- the separation of goodwill and some intangible assets provides valuable information on the value drivers and a benchmark;
- some respondents indicated that any benefits would be best addressed by users of financial statements; and

- one respondent noted that a positive effect was the recognition of transaction costs in profit or loss.

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

More than half of respondents stated that fair value measurement, separation of intangible assets and the impairment test process resulted in considerable unexpected cost

More than half of respondents pointed out that the most considerable unexpected costs arose from the fair value measurement, separation of intangible assets and the impairment test.

Costs arose due to the need to use external valuation experts or, if conducted internally, the significant effort required, the management's judgement, uncertainty in inputs and assumptions.

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

Differences in accounting for assets and business combinations and rewording of financial covenants were identified as the main effects

Some of the main effects noted were:

- definition of a business (refer to response to Question 2);
- differences between accounting for the acquisition of a business and a single asset, in particular regarding the accounting for contingent consideration and deferred taxes. In this regard, the difficulty in establishing whether a group of assets constitutes a business combined with the significant differences in accounting between the acquisition of assets as opposed to the acquisition of a business led to deals being structured in a different manner;
- as a result of the changes introduced in IFRS3 (2008), financial covenants calculation had to be reworded to avoid confusion and unexpected doubts on accounting; and
- the absence of amortisation has created a significant incentive to inflate acquisition price in the past years.

APPENDIX A – List of participants

Participant	Country	Industry
ArcelorMittal S.A.	Luxemburg	Industrial goods & services
A.S.A.	Austria	Electric utility
Auditor	Austria	Auditor
Novartis International AG	Switzerland	Pharmaceutical
SEAG	Sweden	Preparer organisations
KGHM Polska Miedź	Poland	Mining
Repsol, S.A.	Spain	Oil and gas
Kemira Oyj	Finland	Chemicals
Asseco Poland, S.A.	Poland	Technology
Ferrovial, S.A.	Spain	Construction
PZU Group	Poland	Insurance
Polska Grupa Energetyczna	Poland	Electric utility
AmRest	Poland	Food & beverage
Sanofi, S.A.	France	Pharmaceutical
Business Europe	European	Preparer organisations
Telefonica, S.A.	Spain	Telecommunication
Deutsche Telekom AG	Germany	Telecommunication
Anonymous Italian	Italy	Banking
Ferrovie dello Stato Italiane Group	Italy	Transport
Anonymous Italian III	Italy	Oil and gas
Anonymous Italian IV	Italy	Banking
Anonymous Italian V	Italy	Telecommunication
Hoffmann-La Roche AG	Switzerland	Pharmaceutical
Deutsche Lufthansa AG	Germany	Industrial goods & services
Linde Group	Germany	Gases and engineering
Anonymous Italian VI	Italy	Banking
Anonymous Italian VII	Italy	Technology
Enel S.p.A.	Italy	Electric utility
Daimler AG	Germany	Automobile
FEE	European	Preparer organisations
Banc Sabadell, S.A.	Spain	Banking