

AGENDA PAPER

IFRS Foundation Trustees meeting – Due Process Oversight Committee

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PRESENTER HUGH SHIELDS

AUTHORS LEONARDO PIOMBINO/MICHAEL STEWART

Post-Implementation Review of IFRS 3 *Business Combinations*: draft report and feedback statement

Introduction

1. The purposes of this paper are to summarise the findings of the Post-Implementation Review (PIR) of IFRS 3 *Business Combinations* and to communicate the IASB's decisions about those findings. As required by the *Due Process Handbook*, the IASB has to provide the Due Process Oversight Committee (DPOC) with a draft of the PIR report. The latest draft of the report and feedback statement is being circulated to the DPOC (but not as a public paper, given that it is still in draft) and the DPOC is asked to confirm that all necessary due process steps have been followed and that the IASB has completed the PIR and that the report can be finalised.

Background

2. As set out in the *Due Process Handbook* (paragraphs 6.52-6.63), the IASB is required to conduct a PIR of Each new Standard or major amendment. Each review has two phases. The first involves an initial identification and assessment of the matters to be examined, which are then the subject of a public consultation by the IASB in the form of a Request for Information (RfI). In the second phase, the IASB considers the comments it has received from the RfI along with the information it has gathered through other consultative activities. On the basis of that information, the IASB presents its findings and sets out the steps it plans to take, if any, as a result of the review.

Conduct of the IFRS 3 PIR

3. The PIR of IFRS 3 was first discussed by the IASB at its meeting in July 2013. At that meeting the IASB tentatively agreed:
 - (a) that the scope of the PIR would cover the whole Business Combinations project, which resulted in the issuance of IFRS 3 (2004), IFRS 3 (2008) and any resulting consequential amendments to other Standards; and

- (b) the staff's planned consultations and activities that are to be undertaken during Phase I for identifying the main implementation problems encountered with IFRS 3 (noting that Phase 1 would lead to the publication of a Request for Information, RfI).
4. Consultations as part of Phase 1 included discussions with the Interpretations Committee and the IASB's main advisory bodies (Advisory Council, Capital Markets Advisory Committee, Global Preparers Forum and the Accounting Standards Advisory Forum).
 5. The RfI was published on 30 January 2014 for a 4-month comment period. Some 93 comment letters were received, and around 30 outreach events undertaken. The feedback from that consultation¹, together with a review of the relevant academic literature², was discussed by the IASB at its meetings in September and December 2014.
 6. At its December 2014 meeting, the IASB agreed to classify the topics identified during the PIR of IFRS 3 into four groups on the basis of their significance, and at its February 2015 meeting agreed some follow-up work on topics to be added to the research agenda (see below).
 7. Details of the due process steps that have been followed can be found in the table at Appendix A. Appendix B to this report summarises the discussions with the Trustees and the DPOC on this PIR.

Findings from the PIR

8. The main findings from the PIR are summarised at Appendix C. In December 2014, the IASB discussed the feedback received and identified the most significant topics that it should consider for follow-up to the PIR of IFRS 3. The IASB assessed the significance of the topics using the following criteria:
 - (a) Have investors expressed concerns about the usefulness of the information provided by the current requirements?
 - (b) Have preparers, auditors or regulators expressed concerns about the application of the current requirements?
 - (c) Is the topic included in the issues recommended by the ASAF for further work?
 - (d) Is the topic included in the Financial Accounting Foundation's (FAF's) Report on PIR of Statement 141 (revised 2007) Business Combinations or on the agenda of the US Financial Accounting Standards Board (FASB)?

¹ The comment letter summary presented to the IASB at its September 2014 meeting (Agenda Paper, AP, 12F refers) can be accessed at: <http://www.ifrs.org/Meetings/MeetingDocs/IASB/2014/September/API2F-IFRS%20IC%20Issues-PIR%20IFRS%203.pdf>.

² The academic literature review presented to the IASB at its September 2014 meeting (AP 12G refers) can be accessed at: <http://www.ifrs.org/Meetings/MeetingDocs/IASB/2014/September/API2G-PIR%20IFRS%203.pdf>.

9. In that meeting, the IASB agreed to classify the topics identified during the PIR into four groups on the basis of their significance. The table at Appendix D reports this classification of the topics and the possible next steps proposed by the staff.

Follow-up work

10. At its February 2015 meeting, the IASB decided to add the following issues to its research agenda:
 - a. how to improve the impairment test in IAS 36 *Impairment of Assets* – this was the most significant finding arising from the PIR;
 - b. how to clarify the definition of a business – participants in the PIR process had raised issues about the challenges faced when determining whether an acquisition includes a business;
 - c. the subsequent accounting for goodwill (including the relative merits of an impairment-only approach and an amortisation and impairment approach); and
 - d. the identification and measurement of intangible assets such as customer relationships and brand names.
11. Nine IASB members agreed with this decision and five disagreed. A number of IASB members thought that the IASB should not add these issues to its research agenda at this time; some of these IASB members noted that the IASB will conduct an agenda consultation later this year and they would prefer to wait for the outcome of that consultation.

Finalising the PIR

12. The IASB believes that it is now in the position to finalise the PIR of IFRS 3 and to issue a final report and feedback statement, a draft of which has been circulated to the DPOC. As Appendix A shows, all the necessary due process steps have been followed.

Question for the DPOC

13. Is the DPOC content to confirm that all necessary due process steps have been followed and that its review of due process on this PIR is now complete and that the IASB can finalise the report and feedback statement?

Appendix A

Post-implementation Review of IFRS 3 – Confirmation of Due Process Steps

<i>Step</i>	<i>Required/Optional</i>	<i>Metrics or evidence</i>	<i>Evidence provided to DPOC</i>	<i>Actions</i>
Planning and development of a Request for Information(RfI)				
Timetable for PIR is established.	Required	The PIR has been discussed in a public meeting and included in the IASB work programme.	The IASB has reported on progress as part of its quarterly report at Trustee meetings.	The plan for the PIR of IFRS 3 was first presented to the IASB at its July 2013 meeting, including the proposed timeline (Agenda Paper, AP 12 for that meeting refers). The DPOC was informed in a paper for its July 2013 meeting (AP 3B refers) that preparatory for the PIR on IFRS 3 was underway. Progress on the PIR was reported in October to the Trustees (AP 2 refers) and the DPOC (AP 3B refers).
Establishment of scope, including identifying the important or contentious issues that came up during the development of the publication.	Required	The initial review should draw on the broad network of IFRS-related bodies and interested parties. Contentious issues are identifiable from the Basis for Conclusions, Project Summary, Feedback Statement and Effect Analysis. Significant issues that have come to the attention of the IASB after the document was published.	The IASB has reported on progress as part of its quarterly report at Trustee meetings, including the extent of the IASB consultation in establishing the scope of the review.	The proposed scope for the PIR was considered by the IASB at its meeting in July 2013 (AP 12 refers). At its July 2013 meeting, the IASB tentatively agreed that the scope of the PIR will entail the whole Business Combinations project, which resulted in the issuance of IFRS 3 (2004), IFRS 3 (2008) and any resulting consequential amendments to other Standards. At its November 2013 meeting considered a paper (AP 13 refers) on the input obtained from the staff's consultation activities undertaken to date, together with a tentative list of questions to ask in the RfI. A revised set of proposed questions for the RfI was presented to the IASB in a paper at its December 2013 meeting (AP 13 refers). In that paper, the staff sought the IASB's permission to publish the RfI, which was forthcoming.
After the initial assessment, one of two routes may be taken: <ul style="list-style-type: none"> • RfI published to invite public comment, with appropriate comment period; or • on the basis of its initial assessment, the IASB may decide that it would be 	Required	The RfI explains why the IASB is seeking feedback on the specified matters and includes any initial assessment by the IASB of the Standard under review. The RfI describes the process that the IASB followed to establish the scope of the review.	The DPOC has been informed that an RfI is to be released, with a summary of the extent of the IASB's deliberations.	The initial assessment confirmed that a RfI would be published, and an initial list of tentative questions was presented to the IASB at its November 2013 meeting (AP 13 refers). As noted above, a revised set of questions for the RfI was presented to the IASB at its December 2013 meeting (AP13 refers).

Step	Required/Optional	Metrics or evidence	Evidence provided to DPOC	Actions
<p>premature to undertake a review at the time.</p>		<p>The IASB sets a comment period for the response, normally a minimum of 120 days. If outside the normal comment period, an explanation has been provided from the IASB to the DPOC, and the decision has been approved.</p> <p>If the second option is appropriate, the IASB has informed the DPOC of its intention to defer the PIR and explain why this conclusion was reached and when it expects to resume the review.</p>		<p>The RfI was published on 30 January 2014 with a 120-day comment period.</p> <p>Extent of the IASB’s deliberations are summarised in this table and the extent of consultations were summarised in an accompanying table in AP 13 referred to above.</p>
<p>The IASB considers whether it is necessary to supplement the RfI with other evidence, such as an analysis of financial information, a review of academic or other related research to the implementation of the Standard being reviewed, or consultations with relevant parties.</p>	<p>Optional</p>	<p>Staff Paper has been provided to the IASB analysing its assessment of academic and other research.</p>	<p>The IASB has reported on progress as part of its quarterly report at Trustee meetings.</p>	<p>The plan for the conduct of the PIR presented to the IASB at its July 2013 meeting (AP 12 refers) outlined the proposed consultation to be undertaken in advance of the publication of a RfI, together with the proposed liaison with the US Financial Accounting Standards Board (FASB) and Financial Accounting Foundation (FAF), given the PIR on business combinations that had been undertaken by the FAF. The IASB agreed with the staff proposals.</p> <p>The proposal for the conduct of the PIR was discussed with the IFRS Advisory Council at its October 2013 meeting.</p> <p>The proposal was also discussed at the October 2013 meeting of the Capital Markets Advisory Committee (CMAC) and the November 2013 meeting of the Global Preparers Forum (GPF).</p> <p>At its meeting in November 2013 (AP 13 refers) the IASB considered the input received from the consultative activities to date, including a preliminary review of the relevant academic literature.</p> <p>This input was discussed with the Accounting Standards Advisory Forum (ASAF) at its December 2013 meeting. It was reported to the IASB at its December 2013 meeting that noted that the ASAF members generally agreed</p>

<i>Step</i>	<i>Required/Optional</i>	<i>Metrics or evidence</i>	<i>Evidence provided to DPOC</i>	<i>Actions</i>
				with the areas covered and with the tentative questions suggested.
Planning and development of a Request for Information(RfI)				
Project teams analyse and summarise comment letters for the IASB's consideration. IASB posts all comment letters in relation to the RfI online.	Required	Analysis provided and discussion of comments received and any additional analysis for any supplementary undertakings that may have been conducted has been made in public.	The IASB reports on progress as part of its quarterly report at Trustee meetings	<p>Closing date for IFRS 3 RfI was 30 May 2014. 93 comment letters received – all posted to the IASB website. 30 outreach events held. Summary of comments received presented to IASB at its September 2014 meeting (AP 12F refers). A summary of the relevant academic literature was also presented to the Board (AP 12 G refers). At that meeting the IASB considered the feedback received and an overview of the academic literature relevant to the PIR. The IASB directed the staff to prepare a Feedback Statement.</p> <p>In December 2014, the IASB discussed the feedback on the most significant areas and compared it with the findings of the relevant academic literature (AP 12A and AP 12B refer).</p> <p>In February 2015, the IASB discussed what follow-up work it should on the findings of the PIR (AP 13 refers).</p> <p>The PIR was discussed with the ASAF in September 2014 and March 2015.</p>
IASB meetings are held in public, with papers being available for observers. All decisions are made in public session.	Required	<p>Number of meetings held to discuss the PIR.</p> <p>Project website contains a full description with up-to-date information.</p> <p>Meeting papers have been posted in a timely fashion.</p>	<p>The IASB and the DPOC discuss progress on the PIR, in relation to the due process being conducted.</p> <p>The IASB and the DPOC review its due process as appropriate.</p>	<p>Discussions at the IASB meetings held in September and December 2014, and February 2015 were in public session. Meeting papers posted within required deadlines.</p> <p>Regular reports provided to DPOC (as outlined in Appendix B).</p> <p>Project website kept up to date.</p>
Public report.	Required	Once deliberations are complete, the findings are presented in a public report.	<p>The IASB must inform the DPOC when it has completed its review and provide the DPOC with a draft of the report.</p> <p>When the DPOC believes that the review has been satisfactorily completed, the report can be finalised.</p>	Draft of the public report and feedback statement currently being balloted by the IASB. DPOC considering a draft and whether the report can be finalised at this meeting.
Implementation of PIR findings.	Required	Minor amendments have been added to the IASB work programme.	The IASB reports on progress as part of its quarterly report at Trustee meetings.	IASB agreed at its February 2015 meeting on issues arising from the PIR to be added to the research agenda,

<i>Step</i>	<i>Required/Optional</i>	<i>Metrics or evidence</i>	<i>Evidence provided to DPOC</i>	<i>Actions</i>
				as reported to this meeting.
Implementation of PIR findings.		More substantial concerns have been considered as part of the research programme and a project proposal has been developed, if appropriate.	The IASB reports on the progress as part of its quarterly report at Trustee meetings.	Possible next steps on wider issues considered by the IASB at its December 2014 meeting, as reported to this meeting. Other than the research topics referred to above, still to be determined.
Implementation of PIR findings.		Recommended changes to due process have been discussed by the DPOC.	Staff prepare and present the paper to the DPOC, recommending appropriate actions.	Still to be determined if this is necessary.

Appendix B

**PIR IFRS 3: REPORTING TO THE TRUSTEES AND THE DUE PROCESS
OVERSIGHT COMMITTEE (DPOC)**

Date	Trustees/DPOC	Paper
Jul 2013	DPOC	<i>Technical Projects – Update</i> (Agenda Paper, AP, 3B): noted that preparatory work had begun on the PIR of IFRS 3.
Oct 2013	Trustees	<i>Report of the IASB Chair</i> (AP 2) reported that the PIR was currently in its first phase of gathering information about unexpected implementation challenges and costs. This would be followed by the publication of a Request for Information (RfI) for public comment. The responses to that document would be used in the second phase of the review.
Oct 2013	DPOC	<i>Technical Projects – Update</i> (AP 3B): as per the report above to the Trustees. The <i>Report</i> of the meeting noted that the PIR was in its first phase with outreach being undertaken to identify implementation problems or unexpected costs that had arisen in the application of IFRS 3, together with academic or other studies about the Standard. The DPOC was reminded that there was no presumption that a PIR would lead to any changes in a Standard.
Jan 2014	Trustees and MB	<i>Report of the IASB Chairman</i> (AP MB3) noted that the review would include both IFRS 3 (2004) and IFRS 3 (2008) as well as all the amendments made to other Standards (eg IAS 36 Impairment of Assets, IAS 38 Intangible Assets etc) as a result of the Business Combinations project. The IASB had considered (in both of its November and December 2013 meetings) the tentative questions to be included in the RfI and sought the advice of the Accounting Standards Advisory Forum (ASAF) at its December 2013 meeting.
Jan 2014	DPOC	<i>Technical Projects – Update</i> (AP 3B): as per the report above to the Trustees and the MB. <i>PIR of IFRS 3: forthcoming publication of RfI</i> (AP 3B Supplement) noted that the issue of the RfI was scheduled to take place on 30 January. The AP contained a summary of the due process steps that had been taken in preparing the RfI, together with a summary of the consultations undertaken in the first phase of the PIR. The <i>Report</i> noted that the IASB was about to issue a RfI on the PIR and that the IFRS 3 PIR would be a larger review than that conducted for IFRS 8.
Apr 2014	Trustees	<i>Report of the IASB Chairman</i> (AP 2) reminded the Trustees that the first phase of the PIR was the issue of the RfI.
Apr 2014	DPOC	<i>Technical Projects – Update</i> (AP 3B): as per the report above to the Trustees, also noting that the RfI was open for consultation until 30 May 2014.
Jul 2014	Trustees	<i>Report of the IASB Chairman</i> (AP 2) reported progress on the project and noted that the RfI had generated over 90 comment letters. The IASB would consider a summary of the comment letters in the third quarter of 2013.
Jul 2014	DPOC	<i>Technical Projects – Update</i> (AP 3B): as per the report above to the Trustees.

Date	Trustees/DPOC	Paper
		The <i>Report</i> noted that the DPOC was informed on the progress of the PIR.
Oct 2014	DPOC	<i>Technical Activities - Update (AP 3B)</i> reported progress on the project and that the IASB would have discussed the feedback received in response to the RFI with ASAF and the IASB in September.
Jan 2015	DPOC	<p><i>Technical Projects – Update (AP 2B)</i>: the AP noted that, in December 2014, the IASB had discussed a comparison of the feedback from the RFI and the results of the review of academic literature. The paper noted that the IASB expected to publish its Feedback Statement in the PIR in Quarter 2 of 2015,</p> <p>The <i>Report</i> noted that the DPOC received an update on the progress of the PIR and that the main issue that had been flagged up in the PIR concerned the accounting treatment for goodwill..</p>

MAIN FINDINGS FROM THE PIR OF IFRS 3

Summary of the feedback received

- C1 The feedback revealed that **investors** have mixed views on the following topics.
- (a) Subsequent accounting for goodwill: some investors supported the current requirements, because they think that the non-amortisation of goodwill helps them to understand whether an acquisition is working as expected. Other users support the amortisation of goodwill, because goodwill acquired in a business combination is supported and replaced by internally generated goodwill over time.
 - (b) Separate recognition of intangible assets: some investors support the current practice, because it provides an insight on why a company purchased another company. Other investors do not support the current practice of identifying additional intangible assets (eg brands, customer relations, etc) beyond goodwill, because it is highly subjective. They think that these intangible assets should be recognised only if there is a market for them.
 - (c) Measurement of non-controlling interests (NCIs): some investors think that NCIs should be measured using the proportionate method, while other investors prefer the fair value method, and others did not have a preference.
 - (d) Subsequent accounting for contingent consideration: some investors think that the current requirements are counterintuitive, because the acquirer recognises a loss if the acquiree is performing better than expected. Other investors support the current requirements, because they help the investors to know how the acquirer is performing.
- C2 Some investors do not support the current requirements on step acquisitions and loss of control and are asking for additional information about the subsequent performance of the acquired business.
- C3 Many **preparers** think that there are some areas in which implementation challenges have arisen and where further clarification would be useful. These areas are the following.
- (a) The definition of a business: many preparers think the definition of a business is too broad and that more guidance is needed to determine whether a transaction is a business combination or an asset acquisition, especially when the processes acquired are not significant and when the entity acquired does not generate revenues.
 - (b) Fair value measurement: many preparers think that contingent consideration, contingent liabilities and intangible assets, such as brand names and customer relations, are difficult to measure at fair value.

- (c) Impairment test for goodwill: many preparers think that the impairment test is complex, time-consuming and expensive and involves significant judgements, especially in determining the assumptions used in the value in use calculation and in allocating goodwill to the cash-generating units.
- (d) Contingent payments to selling shareholders who become employees: Many preparers ask the IASB to revisit the accounting for these payments. In their view, the fact that contingent payments are forfeited if employment terminates should not be a conclusive rule, but should instead be one of the indicators that should be considered in assessing whether such contingent consideration should be treated as part of the consideration transferred or as a post-acquisition expense.

- C4 Some participants in the PIR expressed concerns regarding the level of effort required and costs incurred to meet the requirements of IFRS 3. They think that these costs may, in at least some cases, have exceeded the benefits to users.
- C5 Many participants in the PIR think that the IASB should try to work together with the Financial Accounting Standards Board (FASB) if future changes are considered, in order to mitigate the risk of divergence on business combination accounting. Many noted that the FASB has recently decided to reconsider the post-acquisition accounting for goodwill and they would support a similar effort by the IASB.

Review of academic research and related literature

- C6 An important part of the PIR has been the review of academic research and other available literature (as presented to the IASB at its September 2014 meeting). This review considered evidence from relevant studies on the value relevance of goodwill, other intangible assets and impairment. It also reports findings of studies investigating application issues and compliance with IFRS 3 and IAS 36. The evidence in this review was drawn from publicly available published papers, located via Google Scholar and other databases of academic studies. Evidence from working papers that are not yet published was generally not included, because the results of these studies may change prior to publication.
- C7 The staff think that this review provides evidence that generally supports the current requirements, particularly in relation to the usefulness for firms using IFRS 3 and IAS 36 of reported goodwill, other intangible assets and goodwill impairment. As expected, some studies showed the impact of managerial incentives on impairment recognition. Nevertheless some authors pointed to an association between impairment and economic factors, market indicators and firm earnings and concluded that impairment recognition was conveying relevant information. Other studies identified areas for improvement, particularly in relation to disclosure practices.

APPENDIX D

CLASSIFICATION OF TOPICS IDENTIFIED DURING THE PIR OF IFRS 3

Topic	Assessed significance agreed by IASB	Possible next steps proposed by the staff
1. Ineffectiveness and complexity of testing goodwill for impairment.	Higher	Review IAS 36 <i>Impairment of Assets</i> (IAS 36 is not converged with US GAAP). Consider improvements to the impairment model; in particular consider the scope for simplification.
2. Subsequent accounting for goodwill (ie the benefits of an impairment-only approach compared with an amortisation and impairment approach).	Higher	<p>The IASB could investigate whether and how the costs of accounting for goodwill can be reduced without losing the information currently being provided by the impairment-only approach, and which our review of academic studies suggested was value-relevant. This could include considering:</p> <ul style="list-style-type: none"> • how improvements to the impairment-only approach (in particular to the impairment test) could address some of the concerns that have been raised; and • whether a variation on an amortisation and impairment model might be developed with an amortisation method that does not undermine the information currently provided by the impairment-only approach.
3. Challenges in applying the definition of a business.	Medium/high	Clarifying the definition of a business and the related application guidance.
4. Identification and fair value measurement of intangible assets such as customer relationships and brand names.	Medium/high	<p>Assessing whether certain intangible assets (eg customer relationships) should be subsumed into goodwill.</p> <p>Considering what additional guidance could be given to assist in the identification of customer relationship intangibles, and their associated measurement.</p>

Topic	Assessed significance agreed by IASB	Possible next steps proposed by the staff
5. Information about the subsequent performance of the acquiree.	Medium	Further analysis, eg investigate how practicable it would be to prepare this information, and for how many reporting periods post-acquisition this information should be provided.
6. Usefulness of the subsequent accounting for contingent consideration.	Medium	Further analysis. Some participants suggest investigating whether in some circumstances changes in the fair value of contingent consideration should be recognised against the assets acquired.
7. Fair value measurement of contingent consideration and contingent liabilities.	Medium	Further analysis. Some participants suggest investigating whether contingent consideration and contingent liabilities should be recognised only if they can be measured reliably.
8. Usefulness of the accounting for step acquisitions and loss of control.	Medium	Further analysis. Some participants suggest investigating whether remeasurement gains should be recognised in Other Comprehensive Income (OCI).
9. Measurement of non-controlling interests.	Lower	Further analysis. Some participants suggest investigating whether the measurement of Non-Controlling Interests (NCI) should be a one-time accounting policy choice for all business combinations (ie it should not be a transaction-by-transaction choice).
10. Pro-forma prior year comparative information.	Lower	Further analysis, eg investigate how practicable it would be to prepare this information.
11. Usefulness of the recognition of negative goodwill in P&L.	Lower	Further analysis. Some participants suggest investigating whether negative goodwill should be recognised in OCI.
12. Accounting for contingent payments to selling shareholders who become employees.	Lower	Further analysis. Some participants suggest revisiting the guidance for contingent payments to selling shareholders in circumstances in which those selling shareholders become, or continue as, employees. In their view, this guidance should be one of the indicators to consider in assessing whether such payments should be treated as consideration or as a post-acquisition expense.