

Paris, le 5 juin 2014

Mr Hans HOOGERVORST
Chairman

IASB
30 Cannon Street

LONDON EC4M 6XH
UNITED KINGDOM

n° 16

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

Dear M. Hoogervorst,

I am writing to communicate the views expressed by the Board of the Autorité des Normes Comptables (ANC) on 5th June 2014 on the above-mentioned Request for Information. These views result from the ANC's due process which has involved extensive discussions with all types of constituents within its dedicated working group, other meetings with interested parties, including an "outreach" session in Paris with the IASB and a meeting with the Accounting Committee of the French Society of Financial Analysts (SFAF), various discussions and an examination by its IFRS Commission.

Our discussions within all these groups have led to categorise our findings and analysis under the following themes of relevance and complexity.

Relevance

1. Goodwill

We note that goodwill that is currently being recognised under IFRS 3R differs from goodwill recognised under previous requirements. Also, transitional provisions and the option for the full or partial method for each business combination lead to inconsistent amounts being shown on the statement of financial position. Therefore, comparisons (both historical and amongst entities) are difficult.

The debate regarding the appropriate subsequent treatment of goodwill (amortisation + impairment vs. Impairment) was far from unanimous during the developments of IFRS 3R. In view of both the materiality of amounts involved and of the work on the topic performed by some of our fellow standard-setters, it appears that the jury is still out on this issue. We therefore encourage the IASB to further investigate the relevance of current requirements and obtain current views from constituents.

The current discussions on the Conceptual Framework, especially as regards the concept of prudence, as well as related developments as regards other standards, for example expected losses on financial instruments, would, in our view, also help in this respect.

2. Separate identification of intangible assets

We are not convinced that separate identification of all intangible assets separately from goodwill is relevant, most particularly in the case of non-contractual intangible assets or of identifiable intangible assets that cannot be sold separately from goodwill.

3. Fair values – Market participant assumption

In terms of recognising the fair value of identifiable assets and liabilities, we question the relevance of the market participant assumption which underpins the notion of fair value, in the context of a business combination, as specifically it is not often the case that there are willing market participants to perform the acquisition at such point in time. Moreover, this view differs from the way the acquirer has "constructed" its acquisition plan. In addition, this leads to a number of difficulties in the valuation of specific assets (see our answer to question 3).

We consider that the relevance of fair value in the context of a business combination should be reassessed, as we note that the revision of IFRS 3 precedes the definition of fair value as an exit value as per IFRS 13. This is particularly important in the context of the Board's consideration of the notion of business models in its work as regards the Conceptual Framework.

4. Business combinations vs. asset acquisitions

Whilst we agree that it is relevant to account for business combinations differently from asset acquisitions, we question the relevance of differing accounting treatments for some topics such as: acquisition costs, contingent payments, deferred taxation and some exceptions to recognition and measurement principles. We consider that the resolution of such issues should be dealt with on a "consistency across standards" level, if not at a conceptual level.

In addition, we understand that there is a tendency to broadening the interpretation of the notion of business which seems to capture more and more transactions which intuitively would be considered as asset acquisitions. We are not convinced of the relevance of the information ensuing from this trend and encourage the IASB to provide more clarification to this effect.

5. Accounting for step acquisitions and loss of control

We understand from all our constituents that the information resulting from the step acquisition and the loss of control guidance is considered as counterintuitive and therefore difficult to explain and understand in terms of profit and loss effects and cash flow projections.

This stems from the requirement that goodwill is recognised only upon obtaining control and derecognised in full upon loss of control, without any change relating to changes in ownership interest until control is lost. This requirement derives directly from the reporting entity perspective which has never really been discussed in the context of the Conceptual Framework. Given that our constituents do not consider that such accounting requirements produce relevant and decision-useful information, we question the appropriateness of the underlying assumptions to the accounting model for business combinations.

6. Accounting for contingent consideration

We understand from all our constituents that the information resulting from the subsequent accounting of contingent consideration is not relevant, whether in the context of contingent consideration linked to a specific asset or to the business as a whole. Given the uncertainties that come into the valuation of such contingent consideration, we consider that the IASB should reconsider these topics, either from

the relevance of the initial recognition aspect (as an exception to general IFRS principles) or in terms of the accounting treatment of subsequent changes against the related asset or goodwill.

Complexity

We recognise that business combinations are complex transactions and that as such the accounting should reflect that they are not merely asset acquisitions. However, we consider that the issues noted above under relevance aspects of the requirements are generally a source of complexity.

In addition, we have identified the following issues as regards complexity.

1. Full goodwill and partial goodwill

As the full goodwill method was tailored to the principles of IFRS 3 in terms of the reporting entity approach in general, some of the requirements of the partial goodwill method are at odds with such principles. This creates complexity in the accounting for NCIs in particular.

This does in no way mean that we consider that one should be given up for the other at this point in time. We were from the beginning convinced that the economic entity approach which lead to the full goodwill method would not provide useful information for the investors in the parent entity, especially in the European context where significant NCIs exist. We further understand that in Europe, companies still predominantly apply the partial goodwill method and we therefore consider that before any standard-setting initiative in one direction or the other is undertaken, further investigation is needed to understand why this is the case and for what reasons and under what circumstances (for example, was it a 100% acquisition or not) one or the other methods is selected by preparers.

2. Interaction with other standards

We note that IFRS 3 interacts with a number of other standards such as IAS 36, IAS 12, IFRS 13, IAS 37, IAS 38, IFRS 2 amongst others, and that this results in complexity either because of aspects of allocation, recognition, or exceptions, or even the principles which do not fit well with the business combination transaction.

Finally, we understand that the complexity has led to increasing use of external services such as those of valuers, who would use differing methods and lead to reduced comparability, and therefore to increasing costs. This is all the more important for smaller-sized entities.

In sum, whilst we support some of the aspects of the requirements applied under IFRS 3, we are not convinced that a number of other aspects produce relevant information. We therefore would encourage the IASB to further investigate those other aspects to assess their relevance.

Our detailed comments as regards the questions specifically asked by the IASB are set out in the attached Appendix.

Should you need further explanations, please do not hesitate to contact us.

Yours sincerely,



Gérard Gil

ANC Board Member
ANC IFRS Commission Chair

Appendix

Question 1

Please tell us:

- a) *about your role in relation to business combinations (ie preparer of financial statements, auditor, valuation specialist, user of financial statements and type of user, regulator, standard-setter, academic, accounting professional body etc).*^(a)
- b) *your principal jurisdiction. If you are a user of financial statements, which geographical regions do you follow or invest in?*
- c) *whether your involvement with business combinations accounting has been mainly with IFRS 3 (2004) or IFRS 3 (2008).*
- d) *if you are a preparer of financial statements:*
 - (i) *whether your jurisdiction or company is a recent adopter of IFRS and, if so, the year of adoption; and*
 - (ii) *with how many business combinations accounted for under IFRS has your organisation been involved since 2004 and what were the industries of the acquirees in those combinations.*
- e) *if you are a user of financial statements, please briefly describe the main business combinations accounted for under IFRS that you have analysed since 2004 (for example, geographical regions in which those transactions took place, what were the industries of the acquirees in those business combinations etc).*

(a) Type of user includes: buy-side analyst, sell-side analyst, credit rating analyst, creditor/lender, other (please specify).

The Autorité des Normes Comptables (ANC) is the French Accounting Standard Setter. It sets standards in the form of accounting regulations for the private sector, including any national standard on business combinations; it takes position on international accounting standards as part of their development process; it has a coordination role for work carried out on accounting theory and methodology.

The ANC comprises a board of 16 members with financial and accounting expertise, representing a broad spectrum of points of view. Two commissions, made up of recognised experts, are responsible for issues relating respectively to national and international standards. Several dozen working groups develop technical positions and report back to the commissions, which present drafts to the board. A great variety of technical experience, drawn from the French economic tissue as a whole, is mobilised in order to develop French accounting standards and technical positions. The ANC is also supported by staff departments composed of specialists from the private and public sectors with complementary profiles. (more on www.anc.gouv.fr)

Question 2

- a) *Are there benefits of having separate accounting treatments for business combinations and asset acquisitions? If so, what are these benefits?*
- b) *What are the main practical implementation, auditing or enforcement challenges you face when assessing a transaction to determine whether it is a business? For the practical implementation challenges that you have indicated, what are the main considerations that you take into account in your assessment?*

Accounting differences between business acquisition and assets acquisition

We are of the view that the differential accounting treatment between asset acquisitions and business combinations is justified as regards the existence of goodwill. As compared to asset acquisitions for which the consideration paid directly relates to identified assets and liabilities, we acknowledge that goodwill in a business combination identifies that the consideration paid includes not only assets and liabilities stated in the acquiree's financial statements and other assets and liabilities which are identifiable in the acquisition and recognised separately from goodwill, but also other non-easily measurable and identifiable items such as assembled workforce and synergies.

Beyond the recognition of goodwill, we note that, whilst the IASB has listed some differences between the accounting treatments of asset acquisitions and business combinations, there are more differences than those listed, some of which may be significant (e.g. contingent payments, consideration paid in equity instruments...).

In addition, we are not convinced that all such differences are justified on a conceptual basis, for example those on: acquisition costs, contingent payments, badwill, deferred taxation and some exceptions to recognition and measurement principles. We consider that these topics should be looked at from a "consistency across standards" level, if not at a conceptual level, to clarify how such differential accounting treatments are justified.

For instance, as regards acquisition costs, we understand from the Basis for conclusions (BC 365 to BC 370) that the differential treatment is justified by the measurement basis applied to the individual items (fair value in business combinations and cost-type basis in the case of asset acquisitions). However, as mentioned in our answer to question 3, we question the relevance of the fair value approach applied to all identifiable assets and liabilities.

Another differential treatment that is questionable is the accounting for an acquisition with consideration paid in the acquirer's equity instruments. Such transaction would be within the scope of IFRS 2 if it relates to assets that do not constitute a business and therefore measured at the fair value of the assets acquired. Should it fall within the scope of IFRS 3, the transaction would be measured at the fair value of the equity instruments issued. The rationale for such a difference is not obvious.

We note also that the Board, in recent projects, has been leaning towards increasing the accounting differences between business combinations and asset acquisitions. We have expressed our opposition to such evolution (ED 2012-6 and ED 2012-7).

Boundary between business and group of assets

We note also that the existence of a differential accounting treatment, combined with the definition of a business as per IFRS 3 in the sense of “*an integrated set of activities and assets that is **capable of being conducted and managed**...[.]*” (**emphasis added**) and the fact that accounting for business combinations is more complex than accounting for asset acquisitions, creates a tension, if not a "cliff effect", as regards the acquisition of some specific assets or of groups of assets. Indeed the boundary between a business and a group of assets that does not constitute a business appears to be unclear, very thin and is often subject to various interpretations.

We first note that assessing whether an acquired set is capable of being conducted and managed as a business by a market participant might depend on the type of market participant, for example depending on whether the acquirer already has part of the process to complement the acquired set such as an existing industry participant (in which case according to BC 18(d), it would qualify as a business combination), or not, such as a financial buyer. This could lead to falling on one or the other side of the fence, with significant accounting consequences.

As regards the acquisition of specific assets, we understand that there are issues, and therefore diversity in practice, in the case of acquisitions of licenses in the pharmaceutical industry, of exploration/production assets as well as for the acquisition of investment property or ships, especially when such investment property or ship is the sole asset of an entity (qualified as a “corporate wrapper”). We understand that the question arises also in the context of the acquisition of portfolios of financial instruments.

Some of these issues seem to additionally be complicated by the fact that IFRS 3 is a converged standard with US GAAP, under which there appears to be a broader interpretation of the notion of “business” and therefore inconsistency in practice.

We wonder whether such was the original intention of the Board when the standard was issued, even though we note that in BC 20, the Board had considered whether to expand the scope to all acquisitions of groups of assets to avoid having to distinguish between asset acquisitions and business combinations but noted that that would require further research. We caution the Board into pursuing in this direction because we have a number of issues as regards IFRS 3 as detailed in other answers to the Board's questions. We would therefore welcome clarification.

Question 3

- a) *To what extent is the information derived from the fair value measurements relevant and the information disclosed about fair value measurements sufficient?^(a) If there are deficiencies, what are they?*
- b) *What have been the most significant valuation challenges in measuring fair value within the context of business combination accounting? What have been the most significant challenges when auditing or enforcing those fair value measurements?*
- c) *Has fair value measurement been more challenging for particular elements: forexample, specific assets, liabilities, consideration etc?*
 - a)

(a) According to the Conceptual Framework information is relevant if it has predictive value, confirmatory value or both.

From the discussions we have had with our constituents, two main issues arise regarding fair value measurements: the relevance of a market participant approach and the complexity of valuation for some specific items.

Relevance of the market participant approach

The market participant approach is the underlying principle of IFRS 13, in other words, it takes the view that there are active market participants to trade those assets. The ANC has always considered that fair value as proposed under IFRS 13, i.e. “*defined as an exit price; should be used only when it reflects the manner in which the assets will be realised and the liabilities extinguished in accordance with the business model of the entity*”¹ was not necessarily relevant in all situations where fair value is the measurement basis.

Taking the market participant view is fundamentally at odds with how an acquirer actually considers and manages the process of a business combination. Each potential acquirer has its own objectives resulting from its existing position on the market and from its strategy and we doubt that, because of that, two potential acquirers would ever come up with the same fair value for a specific acquiree². Indeed, an acquirer does not only determine its pricing solely on the basis of the acquiree's value but also on other aspects which are not mutually exclusive: the synergies it may be the only acquirer to expect, its existing market share, its intention to achieve market leadership, its intention to eliminate competition or its decision to enter a new market. In the case of business combinations, it is also often not the case that there are other market participants available and willing to acquire control of the acquiree at that particular point in time.

Therefore, the price paid for the interest acquired cannot be seen as the price any market participant would have paid.

Fair value of identifiable assets and liabilities

1

http://www.anc.gouv.fr/files/live/sites/anc/files/contributed/Normes%20internationales/IASB/2009/1er%20octobre%202009_IASB%20CNC%20letter%20ED%20FVM%20final.pdf

2

http://www.anc.gouv.fr/files/live/sites/anc/files/contributed/Normes%20internationales/IASB/annees%20anterieures/200510_26_as37_19_cl16.pdf

As regards identifiable assets and liabilities, IFRS 3 requires these items to be measured at fair value, as part of allocating the transaction price.

This first poses a unit of account issue as the business is acquired and measured in terms of the consideration paid as a whole whilst the identifiable assets and liabilities are measured at fair value, ie as if they were acquired separately.

Secondly, depending on how those individual assets and liabilities acquired are subsequently used, in terms of the acquiring entity's business model, while the exit price may be considered a reasonable proxy for some items, we are not convinced that this would necessarily be the case for all items (for example, as regards share-based payments). In particular, the concept of "highest and best use" in IFRS 13 is still a matter of debate, especially in the following cases:

- an acquired brand that the acquirer will not use subsequently,
- a land or a building used to operate the business, but with greater value if changing its function, which is not intended by the acquirer,
- financial instruments which the acquirer will hold to maturity.

We have identified a third issue in our recent discussions with analysts, whose observations are shared by preparers : the valuation of the acquiree's inventory at fair value poses difficulties in terms of assessing and explaining the operating margin of the new group over the immediately subsequent years. This is also valid as regards the identification and measurement of backlog. Analysts expressed their need for pro-forma information without valuation step-up on these elements, should the current requirement be maintained. This questions the usefulness of measuring the acquiree's inventories and backlog at fair value at acquisition date.

In view of these issues, we consider that the Board should further look into the relevance of fair value measurement for identifiable assets and liabilities and especially of the market participant assumption.

Fair value of previously held interests and of retained interests

We note that IFRS 3 requires that previously held interests as well as retained interests are required to be measured at fair value. As these interests are not part of the transaction, we question the relevance of such measurement and of its counterpart in profit or loss. Moreover, it is sometimes difficult to measure their fair value: the price paid for obtaining control is not necessarily a relevant basis for measuring the interests that are not part of the transaction.

In addition, for the fair value of the previously held interest in step-by-step acquisitions and loss of control, we note that IFRS 13 disallows taking into account any control premium if the underlying instrument is quoted on an active market, which puts into question the relevance of the value attributed to those interests. This is an issue which we consider to be problematic as the value derived from IFRS 13 will be different from the value which would be obtained in a transaction on these interests as a whole. We have always commented on as being an issue in the context of measurement at fair value.

Complexity of valuation

In relation to the first part of our answer to this question, we understand that there are a number of difficulties in measuring items at fair value, in particular for items:

- a) For which the level of uncertainty is high,
- b) For which there exists a direct link between the measurement of an asset and a liability,
- c) Which are themselves complex (such as some financial instruments),

d) For which there is no active market

We consider however that, beyond the fact that they relate to standards other than IFRS 3, these difficulties are inherent to making use of judgment and would not warrant specific additional guidance.

To illustrate a) above, we believe that measuring the fair value of a contingent consideration is overly complex considering the level of uncertainty and the reasons why a seller and an acquirer have agreed on such clause. Contingent consideration usually exists when there are significant uncertainties or disagreements regarding the fair value of the acquiree and its ability to generate cash flows. In those circumstances it appears difficult and arbitrary, if not unreliable, to measure the fair value of the contingent consideration, and use it as a definitive input for accounting for goodwill.

To illustrate b) above, we would like to point out the following specific issue relating to the valuation of contingent consideration which is dependent on assets identified separately from goodwill. This occurs, for example, in the context of in-process research and development or in exploration/production. For instance, in the pharmaceutical industry, the contingent consideration will depend on reaching specific milestones in research and development projects. Acquired research and development is subject to high rates of attrition which render the evaluation of the asset and the liability complex.

Beyond the described complexity and given the differing subsequent accounting treatments of the asset and the liability, there is an accounting mismatch: the contingent payment and therefore liability subsequently increases and is recorded as an expense when the probability of success increases, whilst neither the related asset nor the goodwill are modified. We do not consider that it is relevant to account for the increase of the liability against profit or loss.

Therefore, in the context of a) and b) above, because of the uncertainties of measurement, we would propose that an alternative accounting treatment would be:

- in the case of contingent payments linked to an asset (such as IPR&D), that any subsequent changes be accounted for against the value of the asset;
- in the case of contingent payments linked to the business as a whole (such as on the performance of EBITDA), the subsequent changes be accounted for against goodwill.

Complexity as regards points c) and d) are self-evident. The ANC has always been of the view that fair value is not appropriate when there is no active market.

Question 4

- a) *Do you find the separate recognition of intangible assets useful? If so, why? How does it contribute to your understanding and analysis of the acquired business? Do you think changes are needed and, if so, what are they and why?*
- b) *What are the main implementation, auditing or enforcement challenges in the separate recognition of intangible assets from goodwill? What do you think are the main causes of those challenges?*
- c) *How useful do you find the recognition of negative goodwill in profit or loss and the disclosures about the underlying reasons why the transaction resulted in a gain?*

Separate recognition of intangible assets from goodwill

There is acceptance that separately identifying intangible assets is generally relevant as it enables users to better understand the business acquired. It also enables to account for any subsequent sale of some of the intangible assets recognised at acquisition date.

However, we understand from our discussions with users the following as regards intangible assets:

- There is diversity in terms of the nature and the valuation of separately recognised intangible assets. The sources of such diversity could be further investigated (difficulties in valuation? arbitrage?). This illustrates also that the “market participant” view is diversely applied when measuring identifiable intangible assets;
- Users question the separate recognition of assets that cannot be sold separately nor amortised (in many cases for brands); this is a unit of account issue which would merit further investigation ;
- Users also have issues with intangible assets for which there is no active market;
- Non contractual assets such as customer relationships are the ones which seem to pose the most difficulty, especially in terms of relevance.

b)

c) In view of the above and since valuation of intangibles generally requires expert opinions, we consider that the Board should reassess the cost/benefit aspects of these requirements.

d)

e) Recognition of negative goodwill

We understand the immediate recognition of negative goodwill in profit or loss in the context of bargain purchases.

However, we note that analysts are ill at ease with such accounting when it is followed, on subsequent financial periods, by the recognition of restructuring expenses or other expenses which were identified at the date of control and included in determining the price paid. This puts into question the relevance of such an “automatic” (if not to say “anti-abuse”) accounting treatment. The ANC has always been of the view that, subsequent to double-checking the identifiable assets and liabilities, a careful analysis should be performed of the reason for the negative goodwill and that the ensuing accounting treatment should be more in line with practices prior to IFRS 3³. Such requirements were, in our view, more in line with the way the acquirer intends to manage the new integrated business as a whole.

³ To the extent that it relates to expected future losses and expenses that are identified in the acquirer's acquisition plan, the negative goodwill is recognised as income when the future losses and expenses are recognised. [IAS 22.61]

An excess of negative goodwill to the extent of the fair values of acquired identifiable nonmonetary assets is recognised in income over the average life of those nonmonetary assets. [IAS 22.62(a)]

Any remaining excess is recognised as income immediately. [IAS 22.62(b)]

Negative goodwill is presented as a deduction from the assets of the enterprise, in the same balance sheet classification as (positive) goodwill. [IAS 22.64]

Question 5

- a) *How useful have you found the information obtained from annually assessing goodwill and intangible assets with indefinite useful lives for impairment, and why?*
- b) *Do you think that improvements are needed regarding the information provided by the impairment test? If so, what are they?*
- c) *What are the main implementation, auditing or enforcement challenges in testing goodwill or intangible assets with indefinite useful lives for impairment, and why?*

Goodwill

The ANC remains unconvinced of the relevance of not annually amortising goodwill because of it having an indefinite (and not infinite) useful life.

We are convinced of the fact that acquired goodwill is consumed over time. If nothing is done to maintain it, it will deteriorate. In addition, over time, we note that not amortising goodwill in effect is akin to capitalising internally generated goodwill, which is contrary to the principles of IFRS. The amount that remains in the balance sheet is meaningless some years later as hopefully the value of the business acquired will have increased, as per the purpose of the acquisition. If that is not the case, we note that analysts consider that impairment of goodwill arrives too late as they generally have already anticipated it: it therefore only has a confirmatory and not a predictive value, with the risk of impairing the credibility of management.

Regarding the impairment test itself, i.e. under IAS 36, we understand that difficulties arise from the difference between the level at which goodwill is tested and how it is effectively managed by the entity. Moreover, the testing becomes more complex over time following reorganisations within the group which then entail further reallocations of goodwill, when the acquisition is not for 100% of the interest.

Analysts also point out that the impairment-only regime increases the sensitivity of the balance sheet and of the profit or loss to discount rates which some consider counter-intuitive in view of the "over the cycle" management of business operations. We also understand from them that they usually disregard goodwill and its impairment in their analyses because the calculation can, in their view, easily be manipulated with disclosures in the notes not being able to compensate this or appropriately inform readers of financial statements.

In addition, analysts consider it possible for themselves and the preparers to reasonably determine the period over which goodwill should be amortised for instance based on the business model or the expected return (or "pay-back" period) of the investment. From the preparers' perspective, taking into account the way they have conceived the business combination, it should be possible to determine a reasonable period for the transaction to have achieved the effect intended, represented by the amount of initially capitalised goodwill that the acquirer has accepted to "sacrifice" to obtain control of the acquiree.

We note the research projects undertaken by our colleagues at the OIC, the ASBJ and EFRAG, as well as recent developments at the FASB. We consider that the IASB should engage in more research to appropriately ascertain the relevance of today's requirement regarding the subsequent measurement of goodwill.

Intangible assets with indefinite useful life

There are questions around whether the assessment that an intangible asset has an indefinite useful life is properly performed. Such assessment requires a high level of judgement and the consequences of

determining a useful life or not may be consequential. We understand from some users that, should the current accounting treatment be maintained, they would question such assets being identified and treated separately from goodwill.

Question 6

- 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?*
- f) *If not, what improvements do you think are needed?*
- g)
- b) *What are the main challenges in the accounting for NCIs, or auditing or enforcing such accounting? Please specify the measurement option under which those challenges arise.*
- h)
- i) *To help us assess your answer better, we would be grateful if you could please specify the measurement option under which you account for NCIs that are present ownership interests and whether this measurement choice is made on an acquisition-by-acquisition basis.*

We understand from users that the existence of two methods (full and partial goodwill), available on a case by case basis leads to financial information providing data, for example in terms of net assets and impairment testing, that are on mixed recognition bases, thus making their analysis more difficult. We also understand that some entities have in fact applied both methods. In addition, we note that information based on differing recognition bases also has occurred due to the transition provisions which did not require the restatement of goodwills related to business combinations effected prior to the effective date of IFRS 3.

We recall also that the full goodwill method was tailored to the principles of IFRS 3 in terms of the reporting entity approach in general and that therefore some of the requirements of the partial goodwill method are at odds with such principles:

- in particular, the reporting entity approach would generally distinguish its owners between controlling and non controlling interests. The consequence of that is that assets and liabilities are accounted for at 100% at the date of control. The partial goodwill method is therefore at odds with this as by definition goodwill would not be accounted for at 100% at the date of control.
- in addition, in subsequent step acquisitions, the difference between the price paid and the carrying value of NCIs is directly recorded in equity with no additional goodwill recognised. Therefore, the goodwill is not representative of the group interests anymore, nor is it when interests is subsequently transferred to NCIs.
- this also is conducive to complexity in impairment testing as it is necessary to gross up the amounts.

However, we understand that there are challenges to the full goodwill method also:

- how to measure the fair value of NCI at initial recognition? A proportionate basis is not always relevant.
- how to determine the fraction of previously recognised goodwill to be "reallocated" to NCIs in case of transactions with NCIs? Allocating it on a proportionate basis would not portray the way synergies which are subsumed in the goodwill are actually shared between group companies.

- users consider that the method does not provide very useful information as to the actual value of the NCIs. There might be quite different situations resulting in NCIs in a business combination: for instance some shareholders may have considered that the offer received as insufficient or the local regulation may not have required an offer to be made to NCIs.

This does in no way mean that we consider that one method should be given up for the other at this point in time. We were from the beginning convinced that the economic entity approach which led to the full goodwill method would not provide useful information for the investors in the parent entity, especially in the European context where significant NCIs exist. We further understand that in Europe, companies still predominantly apply the partial goodwill method and we therefore consider that before any standard-setting initiative in one direction or the other is undertaken, further investigation is needed to understand why this is the case and for what reasons and under what circumstances (for example, was it a 100% acquisition or not) one or the other methods is selected by preparers. We do however note that an option on a case by case basis rather than on an accounting principle basis is a rarity under IFRS. The Board may consider bringing this option on an accounting principle basis for more consistency.

Question 7

- 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.*

We understand from all our constituents that the information resulting from the step acquisition guidance and the loss of control guidance is considered as counter-intuitive and therefore difficult to explain and understand in terms of profit and loss effects and cash flow projections. At the heart of this issue, is the constraint imposed by IFRS 3 R that goodwill is only recognised when control is obtained (as mentioned in our answer to the previous question), and derecognised upon the loss of control.

In step acquisitions, the derecognition of the previously held investment in an entity by the acquirer in its consolidated financial statements when it achieves control is obviously to be done to reflect the change in circumstances. However, the profit or loss consequences fail to reflect the fact that these transactions differ from the immediate acquisition of an entity in which no previous investment was held. Obviously, the reverse is true for loss of control.

In the case of a significant increase in value of the previously held interests since the initial investment the accounting requirements lead to an increase in the amounts of goodwill recognised, compared to the previous requirements where goodwill was representative of the sum of the investments made. This, in turn, increases the amounts to be recognised when an impairment is required. Accounting for such an impairment loss in a situation where the overall investment is profitable is questionable, as was the accounting for a revaluation profit when control is taken.

Moreover, in the case of a subsequent acquisition of NCIs when the subsidiary was largely developed since the business combination, the accounting treatment leads to a material decrease in the parent's

equity at the date an additional interest in a successful business is acquired, whilst at the same time that transaction gives the parent company the right to access to future economic benefits that were previously attributed to the NCIs. This is considered counterintuitive.

If indeed previous guidance may have been extremely complex to implement and possibly to understand, we consider that there may have been other ways to account for such transactions, without adding complexity or recognising profit or loss on a deemed transaction. For instance, the revaluation of the previously held interests in the acquiree could be accounted for through OCI and recycled to P&L when the investment is sold. Or, the business combination could be accounted for on the basis of the sum of the carrying amount (instead of fair value) of the previously held interest and the consideration paid.

In the context of the financial crisis and of share prices going down, some preparers have indicated that the requirement to revalue the previously held share in an investee (and therefore account for a loss on the previously held investment if control is taken over the acquiree) has discouraged some entities from obtaining control through further investments.

Question 8

- 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) *(c) What are the main challenges to preparing, auditing or enforcing the disclosures required by IFRS 3 or by the related amendments, and why?*

Aside from common themes relating to disclosure overload and quality/relevance versus quantity of information (which we are all tackling at our own levels), we have not been made aware of significant issues as regards disclosures other than the difficulty going forward of following the cash flows generated by the business combination for significant business combinations.

We also understand that analysts would find useful to be provided with historical data/background information regarding the acquiree, especially on the profit or loss, but consider that such information should not be considered as being part of the financial statements for a number of reasons such as: the acquiree was not part of the group, the accounting applied may have been under different principles, audit-related issues, etc.

In this context, we note that some preparers continue to voluntarily provide the disclosure, which was required under the first version of IFRS 3 and eliminated in the latter one, about the acquiree's carrying amounts in accordance with IFRSs for each class of its assets and liabilities immediately before the combination.

Question 9

Are there other matters that you think the IASB should be aware of as it considers the PiR of IFRS 3? The IASB is interested in:

- a) *understanding how useful the information that is provided by the Standard and the related amendments is, and whether improvements are needed, and why;*
- b) *learning about practical implementation matters, whether from the perspective of applying, auditing or enforcing the Standard and the related amendments; and*
- c) *any learning points for its standard-setting process.*

Restructuring plans

We understand both from users and from preparers that the recognition of restructuring provisions/expenses after the acquisition date when these were identified and taken into account in the transaction taken as a whole is considered to not provide useful information. This is especially the case when a negative goodwill is recognised, but not only.

In our answer to phase 1 of IFRS 3⁴, we disagreed with the Board's proposal as regards the accounting for restructuring plans:

"We believe that, as the acquirer's restructuring program for the acquiree is part of the acquisition plan, it would be more relevant, in order to reflect the actual conditions of the acquisition, to include those costs in the determination of the cost of a business combination.

Arguments in favor of that accounting are the followings:

- the acquiree's restructuring costs are taken into account by the acquirer in the determination of the purchase price and are triggered by the business combination;*
- they should be considered as unavoidable costs directly attributable to the combination.*

As those costs are usually incurred within a limited time after the acquisition, they should be accounted for as an adjustment of the cost of acquisition at the date they meet the recognition criteria of IAS 37 (i.e. when the acquirer has developed the main features of the plan into a detailed formal plan). For those reasons, we recommend that an acquirer should recognise, as part of the cost of acquisition, a provision that was not a liability of the acquiree at the date of acquisition if, and only if, the acquirer has:

- a) at, or before, the date of acquisition, developed the main features of a plan that involves terminating or reducing the activities of the acquiree;*
- b) by announcing the main features of the plan at, or before, the date of acquisition, raised a valid expectation in those affected by the plan that it will implement the plan to reorganise the acquiree; and*
- c) within 12 months of the date of acquisition, developed those main features into a detailed formal plan to terminate or reduce the activities of the acquiree.*

To avoid abuses and to ensure a complete transparency, a full disclosure of such provisions should be required and provisions that are not used in the manner or periods originally expected should be re-allocated to the cost of acquisition accordingly."

In addition, we note that such restructuring plans are more likely to be incurred than some of the contingent liabilities which are recognised in accordance as identifiable liabilities in a business combination.

Contingent consideration

Two aspects regarding contingent consideration warrant mentioning in our view.

- **Accounting for subsequent changes to contingent consideration in profit or loss.** We understand that this results from the principle of fair valuing the contingent consideration at acquisition date and therefore taking into account that any subsequent changes do not relate to the acquisition. As mentioned in our answer to question 3, this leads to counterintuitive outcomes as for instance, an increase in the liability due to achievement of a milestone in research and development will be accounted for against an expense whilst the value of the related asset will remain unchanged. This creates an accounting mismatch which we consider to be unjustified. We propose that such changes in the value of the contingent consideration be recognised against the related asset.
- **Contingent consideration conditioned by the presence of the seller.** Current IFRS 3 does not leave any room for analysis and consider that whatever the specific circumstances, contingent consideration is post-acquisition employee compensation if it is subject to vesting service conditions. This issue give rise to a number of discussions between preparers and auditors and have been brought to the IFRS IC's attention. We would encourage the Board to consider allowing for an allocation of the contingent consideration between what really would correspond to the remuneration of such an employee at market rates, which would be expensed as the service is rendered, and what corresponds to contingent consideration in the context of the business combination. For this latter part of such consideration, we would propose, in accordance with our proposals in our answer to question 3, that the subsequent changes in such contingent consideration be recorded against goodwill.

Transactions in equity

We understand that there are concerns in terms of relevance of the information as regards transactions in equity due to the changes in the value of equity between the date the deal is disclosed and the date when control is actually obtained. Reasons for those concerns are the following:

- these changes may be significant and considering the fair value of the shares at the date at which the control is transferred would in such context significantly affect the purchase price accounting, especially in terms of the amount of goodwill or negative goodwill recognised;
- measurement of equity securities issued as consideration at fair value at the acquisition date does not reflect the values taken into account in negotiations (which would generally be based on projections of cash-flows or relative market values at the date of negotiation);
- the changes between the two dates may be caused by factors which are unrelated to the business combination.

In addition we understand that analysts usually assess the return on an acquisition against the share value at the date of the announcement of the deal rather than at the date when control is actually obtained.

Measurement period of identifiable assets and liabilities of one year

We understand from preparers that they consider the period of one year to be short in the context of the current accounting treatment for contingent consideration.

Question 10

From your point of view, which areas of IFRS 3 and related amendments:

- a) represent benefits to users of financial statements, preparers, auditors and/or enforcers of financial information, and why;*
- b) have resulted in considerable unexpected costs to users of financial statements, preparers, auditors and/or enforcers of financial information, and why; or*
- c) have had an effect on how acquisitions are carried out (for example, an effect on contractual terms)?*

As mentioned throughout our answers to previous questions, we note that the accounting requirements as regards business combinations are complex, such complexity not necessarily being driven by IFRS 3 requirements in isolation. Some of the complexity stems from the requirements being at odds with how the acquirer has designed the combination, others from the calculations involved. We note from our discussions that the requirements have led to companies increasingly resorting to external valuation experts, which in turn has increased the costs associated with such transactions. This is more particularly significant for medium-sized entities.

We also understand from preparers that internally accountants are more directly involved than previously in the appraisal of the acquiree or in negotiating the share purchase agreement. We understand this to occur earlier in the acquisition process, as in the pre-acquisition process to be able to subsequently more “easily” do the purchase price accounting. Another reason for such involvement is to provide management in charge of the acquisition with an understanding of the accounting consequences of the transaction, which as we have underlined in our answers to previous questions, will differ from the way management is considering the business combination, with some of those effects being additionally considered as counterintuitive.