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30 May 2014

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom
Email: CommentLetters@ifrs.org

Dear Sir/Madam

SAICA SUBMISSION ON THE REQUEST FOR INFORMATION: *POST-IMPLEMENTATION REVIEW*: IFRS 3 – *BUSINESS COMBINATIONS*

In response to your request for comments on the Request for Information: *Post-Implementation Review*: IFRS 3 – *Business Combinations,* attached is the comment letter prepared by the Accounting Practices Committee (APC) of The South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of the APC, which comprises members from reporting organisations, regulators, auditors, IFRS specialists and academics.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours faithfully,

Sue Ludolph
Project Director – Financial Reporting

cc: Prof Danie Coetsee (Chairman of the Accounting Practices Committee)

SPECIFIC COMMENTS

Your background and experience

Question 1

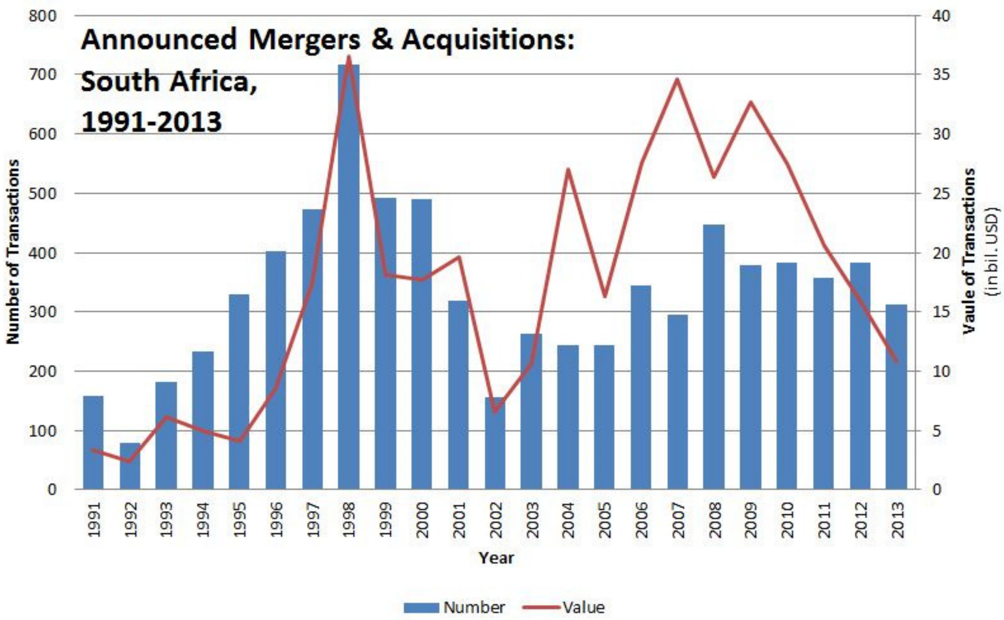
Please tell us:

(a) *about your role in relation to business combinations (i.e. preparer of financial statements, auditor, valuation specialist, user of financial statements and type of user, regulator, standard-setter, academic, accounting professional body etc.).*[1]

The APC is the technical accounting committee of SAICA which comprises members from reporting organisations, regulators, auditors, IFRS specialists and academics. We have received input from preparers from the banking industry, mining industry, academics and the Financial Reporting Standards Council (FRSC) of South Africa. Even though no valuation experts were present at the sub-committee meeting, some of the IFRS specialists from the professional services firms provided feedback from their corporate finance divisions that have been involved in the valuation aspects of business combinations.

(b) *your principal jurisdiction. If you are a user of financial statements, which geographical regions do you follow or invest in?*

The SAICA's principal jurisdiction is South Africa (SA). Based on an analysis by the Institute of Mergers, Acquisitions and Alliances (IMAA)[2] the following graph contextualises the experience with mergers and acquisitions within SA:



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

[2] http://www.imaa-institute.org/statistics-mergers-acquisitions.html#MergersAcquisitions_South Africa

(c) whether your involvement with business combinations accounting has been mainly with IFRS 3 (2004) or IFRS 3 (2008).

The comments expressed in this comment letter stem from experience in the application of 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

The jurisdiction is not a recent adopter of IFRS. The jurisdiction previously applied local Statements of Generally Accepted Accounting Practice (GAAP). A decision was taken in 1995 to harmonise local GAAP with IFRS and in 2003 the decision was taken to issue IFRS as Statements of GAAP. The JSE made it mandatory for listed entities to comply with the requirements of IFRS from January 2005. When the Companies Act was revised and effective in May 2011 this gave legal backing to accounting standards and required companies to comply with IFRS as issued by the IASB or IFRS for SMEs if the scope requirements are met. As a country our business community has a wealth of experience in implementing IFRS. [3]

(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.

The preparers present at the working sub-committee meeting have had the following material business combinations accounted for under IFRS 3 (2008):

- An international packaging and paper manufacturer had material business combinations in 2010 (resulting in negative goodwill) and 2012 (resulting in goodwill).
- A mining entity had a business combination in 2012 for a cost of US$ 335 million.
- A banking entity had 4 material business combinations since 2004 where all acquirees were part of the banking industry.
- An insurance entity had one material acquisition since 2005 which was in the life insurance industry and a few less material acquisitions in 2008 in the health services industry.
- Although not within the scope of IFRS 3 (2008) it is notable that some preparers within the banking industry had significant common control transactions. Thus, please refer to our comments under question 9(a).

[3] http://www.ifrs.org/Use-around-the-world/Documents/Jurisdiction-profiles/South-Africa-IFRS-Profile.pdf

(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).

Not applicable.

Definition of a business

Question 2

(a) Are there benefits of having separate accounting treatments for business combinations and asset acquisitions? If so, what are these benefits?

If there are benefits, they must arise from the differences between the two treatments. The following differences have been identified:

In an asset acquisition there is:

1. no recognition of goodwill or negative goodwill.

This means that the assets (and liabilities) acquired in an asset acquisition are recognised *based* on their relative fair values, rather than *at* their fair values as is generally required for business combinations, with any resulting difference being goodwill or negative goodwill.

Accounting for goodwill and negative goodwill in a business combination could be simplified, especially in the context of issues surrounding amortisation or impairment, by following the accounting model currently applied to asset acquisitions to business combinations. However, most commentators are of the view that separate accounting for goodwill and negative goodwill provides useful information and is a key benefit of the different accounting treatments. One concern with not recognising goodwill separately and simply allocating the purchase price to the identifiable assets and liabilities acquired on a relative fair value basis is where the goodwill relates to synergies or other benefits that cannot be recognised separately and that relate to other parts of the business and not the business that has been acquired. In these instances, the purchase price allocated to the identifiable assets and liabilities acquired would result in the recognition of higher carrying values than would be the case if goodwill was recognised separately. This could impact negatively on the impairment assessments of the identifiable assets and liabilities acquired since this is not where the synergies are anticipated.

2. *no recognition of contingent liabilities assumed*

The consequence of not recognising contingent liabilities assumed in an asset acquisition is that the allocation of the lower purchase price, adjusted to reflect this risk, results in lower carrying values of the assets and liabilities recognised than would be the case in a business combination.

Many preparers expressed concern about the complexity of measuring and recognising the fair value of contingent liabilities in a business combination because they contend that, in most instances, this amount is not explicitly considered in the negotiation of the purchase price. Prices are generally negotiated for the business as a whole by using price-earnings multiples or other similar income-based valuation approaches.

Other commentators believe that it is important that all liabilities assumed (even if they are only contingent liabilities) should be recognised in a business combination. This is particularly so when not recognising them would give rise to an immediate gain (negative goodwill). The question is therefore whether contingent liabilities should be recognised in asset acquisitions? Conceptually, there does not appear to be a compelling argument against it. It would add complexity, which could be justified on a cost vs. benefit basis.

3. *no recognition of some intangible assets acquired (potentially)*

The accounting treatment for asset acquisitions does not contain the explicit requirements contained in IFRS 3 (2008) for business combinations with regard to recognising intangible assets acquired, especially those that do not appear on the statement of financial position of the acquiree. Therefore, in practice, intangible assets (for example favourable contracts and licences) which might be acquired as part of an asset acquisition are generally not recognised.

Many preparers question the complexity of identifying, recognising and measuring the fair value of intangible assets acquired in a business combination because the negotiated purchase price was not potentially determined using this information. Prices are generally determined using price-earnings multiples or other income based valuation methods. This is similar to the concern expressed under point 2 above.

Conceptually, there does not appear to be a compelling argument against the recognition of intangible assets acquired in a business combination. Failure to do so would result in these items being subsumed into goodwill, which was the practice before IFRS 3 included the requirement to recognise all intangible assets. Assuming the amounts are material, most commentators acknowledge the benefits of separate recognition of intangible assets acquired. However, many preparers have expressed concern over incurring significant time, effort and expense only to determine that some of these items are not significant.

4. *no deferred tax is recognised in respect of temporary differences existing at the date of acquisition to the extent neither accounting nor taxable profit is affected.*

Most commentators believe that the accounting treatment for asset acquisitions is simpler than for business combinations. However, having different treatments does create a risk of arbitrage. Some acquisitions which should be business combinations are structured as asset acquisitions to avoid some of the complex business combination accounting and the recognition of additional deferred tax.

In conclusion, even though there are practical application challenges as well as additional costs involved with the acquisition method, the majority of the commentators believe that conceptually the benefit of having separate accounting treatments for business combinations and asset acquisitions is the additional useful information for business combinations derived from the recognition of goodwill and the identification of previously unrecognised intangible assets.

(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?

The main practical implementation, auditing or enforcement challenges faced when assessing a transaction to determine whether it is a business are:

1. *Applying the guidance in B8*

IFRS 3 (2008) paragraph B8 states: "However, a business need not include all of the inputs and processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes." The biggest challenge is determining whether sufficient inputs and processes have been acquired in order for the acquisition to be a business.

Some follow the view that this statement means that any group of assets could be a business if the assets could be integrated with inputs and processes of the acquirer. Others follow the view that, to be a business, the key processes need to be acquired. These key processes would be the activities that significantly affect the returns of what is acquired.

Our constituents identified the following sectors within which these implementation challenges are more prevalent. We also present examples in order to present various interpretations of the above-mentioned challenges:

- Financial services sector (example 1);
- Property sector (example 2);
- Mining sector (example 3);
- Pharmaceutical sector (example 4); and
- Forestry sector (example 5)

We do acknowledge that principle-based accounting standards in concept require professional judgement to be applied, but experience a *lack in common factors* to consider when judgements are made, especially about a market participant's ability to fill the void where processes are missing.

Financial services sector
Example 1: Acquisition of a mortgage loan book

Background
Bank A acquires the mortgage loan book from Bank B, rather than buying Bank B or the mortgage loan division of Bank B. Is this an acquisition of an asset or a business?

Implementation challenge:
- What processes are required for the mortgage loan book to be capable of generating a return?
  - Some think that it would be the relationships with the borrowers, and knowledge about their payment history, so that the loans can be managed when in default.
- If these are the necessary processes, what if Bank A does not acquire these relationships, i.e. what if Bank A does not retain Bank B as the servicer of the mortgage loans?
  - Some believe that as long as Bank A has a mortgage loans division, the acquisition of the mortgage loan book is a business combination.
  - Others are of the view that because Bank A does not acquire these relationships, the mortgage loan book is not a business by itself, it is simply an asset.

Property sector
Example 2: Acquisition of a shopping mall[4]

Background
The acquisition of property, for example, retail shopping malls, varies significantly in terms of the nature of the underlying assets and the services that are acquired. Services could include the following: property management services (i.e. unique knowledge related to properties in that area, tenant strategy and active marketing of a branded shopping experience) and ancillary services, such as security, cleaning, building maintenance, and rent administration (i.e. sending out statements and collecting the rentals). There appears to be a spectrum within which property transactions fall. At the one extreme no services are acquired, and at the other extreme is a an acquisition which includes all these services.

Interpretation challenge
What factors need to be considered to evaluate whether sufficient processes are acquired for an investment property to be a business?

Main factors considered
- Some evaluate the services in light of the guidance on ancillary services provided in IAS 40 – *Investment Property*. If the services are not significant in terms of IAS 40 to the output produced by the property, the acquisition will be accounted for as an acquisition of assets. If the services are significant to the output in terms of IAS 40, the acquisition will be accounted for as a business combination.
- Others have developed lists of key activities. If those key activities are present, the

[4] The interpretive challenges with shopping malls equally apply to other types of investment property, for example hotels.

property will be classified as a business. If those key activities are not present, the property is an asset. Many believe that without the property management services being acquired, the acquisition cannot be a business. The ancillary services are not relevant to the assessment of whether it is a business or not.

Mining sector
Example 3: Acquisition of exploration mining company

Background
Mine A acquires an exploration company. The main asset within the exploration company is the mineral rights. The exploration company has done some drilling and has accumulated information about the extent of the mineral reserves and the associated geology.

Interpretation challenge
Is the acquisition of the exploration company a business combination or an asset acquisition? What if the exploration company had not started any exploration activities yet?

Main factors considered:
- Some would consider the exploration company as a business even if it had not started exploration activities. This is on the basis that a market participant would have the necessary inputs and processes to conduct the necessary exploration activities so that the exploration company can generate outputs.
- Others would consider the exploration company not to represent a business, especially if it had not started exploration activities yet.

Pharmaceutical sector
Example 4: Acquisition of rights to produce branded products

Background
Pharmaceutical Company A acquires the right (and the formula) to manufacture a range of branded medicines from Company B. Company A does not acquire any of the employees, equipment or manufacturing facilities from Company B because it has its own.

Interpretation challenge
Is this acquisition a business combination or an asset acquisition?

Main factors considered:
- Some will argue that the branded products acquired have inherent processes attached to them, namely the regulatory approval and registration of the branded products in relevant territories, approval to market the products in specific territories and access to customers. The missing process (manufacturing) could easily be obtained by a market participant and would not be significant enough to conclude that the acquisition of the branded products is not a business. The key element is having the formula and the brand.
- Others would argue that the manufacturing process is a significant process and if not acquired together with the branded products, would result in the acquisition to be treated

as an asset acquisition.

Forestry sector
Example 5: Acquisition of a plantation

Background
Paper Producer A acquires a plantation from Company X that is also a paper producer. It does not take over any of the staff, processes or any other assets of Company X because it owns other plantations very close to the one acquired from Company X and plans to use its own staff and equipment.

Interpretation challenge
Is this acquisition a business combination or an asset acquisition?

Main factors considered:
- Some would consider the plantation a business because market participants with a paper producing division would be capable of conducting and managing the plantation as a business by integrating it with its own inputs and processes.
- Others would consider the plantation not to represent a business because no processes have been acquired.

Fair value

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?*[5] *If there are deficiencies, what are they?*

Generally the information derived from the fair value measurement and the related disclosure of the identifiable and recognisable assets and liabilities of the acquiree is relevant to an understanding of the business combination.

However, we have concerns with the following aspect of the fair value measurement approach:

The acquisition method in IFRS 3 (2008) requires the measurement date to be the acquisition date. The following example was presented by a preparer to illustrate the issue:

- Company A, a listed company, acquired Company B that had previously issued listed debentures.
- As required by the regulator in South Africa, the transaction needed to be communicated to the market once it was legally concluded and a purchase price had

[5] According to the Conceptual Framework information is relevant if it has predictive value, confirmatory value or both.

been negotiated (the announcement date). The effective date (acquisition date) of the transaction was only a significant time later.

- In response to the announcement, the quoted price of the listed debentures issued by Company B increased materially between the announcement date and the acquisition date. The increase was attributed to the acquirer's (Company A) perceived favourable credit rating, even though the acquirer was not guaranteeing the debentures.
- As a result of the increase in the fair value of the debentures, the fair value of the identifiable net assets acquired at the acquisition date was materially lower than the agreed purchase price. This resulted in the recognition of a substantial amount of goodwill, which the preparer believes does not provide a fair reflection of management's decisions when the transaction was concluded. At face value it could be interpreted that management overpaid. However, this was not the case since the price was agreed to take into account the fair value of the debentures at the date the purchase price was established.
- The preparer suggests that the measurement date should be the date on which the price was agreed if the price is a fixed price. This is to avoid having to reflect subsequent changes in the fair values of the assets and liabilities acquired (which have a consequential impact on goodwill) that are not reflected in the purchase price.

(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?

The following valuation challenges in measuring fair value within the context of business combinations have been identified:

1. *Working capital*

The acquisition method requires that working capital of the acquiree should be measured at its acquisition date fair value. The valuation challenge exists in that the cash flow estimations used to calculate the fair value of the related non-current assets could double-count for the effects of working capital. Perhaps guidance, similar to the guidance provided in IAS 36 – *Impairment of Assets* paragraph 79 on working capital can be provided to ensure consistent treatment.

2. *Long-term provisions*

The acquisition method requires that long-term provisions, for example, material decommissioning and rehabilitation provisions in the mining industry, should be measured at its fair value at acquisition date. However, the subsequent measurement is in terms of IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets*, which is not fair value. The subsequent measurement is likely to give rise to significant 'day 2' adjustment in instances where the entity plans to settle the obligation itself, rather than to outsource it. This has given rise to issues in practice. Some have simply measured the provision using IAS 37 at acquisition date and not fair value. Others have used fair value at the date of acquisition and have then applied IFRIC 1 - *Changes in Existing Decommissioning, Restoration and Similar Liabilities* for the 'day 2' adjustment if the provision relates to an asset. A suggestion is to require these provisions to be measured using IAS 37 and not fair value at the date of acquisition.

3. *Unfavourable contracts that are not onerous (as defined in IAS 37)*

Unfavourable elements of contracts are required to be recognised at fair value at acquisition date and recognised as a liability. However, there is no specific guidance on the subsequent measurement. Some are of the view that to the extent they are not onerous contracts, as defined in IAS 37, the liability should be reversed to profit or loss on 'day 2' because IAS 37 does not permit the recognition of a liability for an executory contract that is not onerous. Subsequent measurement should therefore be addressed by IFRS 3.

4. *Recognition of deferred tax in respect of assets that have a tax base of zero*

It is generally accepted that fair value is a post-tax value. In other words, if assets acquired in a business combination were expected to generate pre-tax inflows of R100, and is subject to tax of R20, the fair value would (simplistically) be R80. If this R80 is then used as the fair value, it gives rise to a temporary difference of R80 (assuming that the assets will be realised through use). Since the deferred tax exemption on initial recognition does not apply in a business combination, a deferred tax liability of R16 is then recognised (assuming a tax rate of 20%). The result on the statement of financial position is net assets of R64 (R80 – R16). We believe that this is an understatement of the assets acquired and a double-counting of the tax effects because the fair value of R80 already reflects the post-tax value of the assets. This double-counting effectively then gives rise to goodwill of R24 (if we were to assume the purchase price was equal to the fair value of the business acquired). We request that the IASB address this issue perhaps by considering the exclusion of the initial recognition exemption of transactions arising from business combinations.

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

The IFRS specialists of some of the professional services firms (auditors) presented feedback from their corporate finance departments that in many cases the identified intangible assets have a possible range of fair values that in essence means that the resulting goodwill also have a possible range of values. Examples of such intangible assets are patents in the pharmaceutical sector and mining rights in the mining sector.

A preparer (from the banking industry) who recently went through a costly and time consuming valuation exercise of identifying and measuring the intangible assets noted that after the process was complete, the value of the intangible assets was immaterial compared to the other assets acquired. We acknowledge that this result might be transaction and industry specific, but it does indicate the challenge with the identification and measurement of intangible assets that, in some cases, requires significant cost and effort and eventually does not produce beneficial information. It is true that in some business combinations, based on the nature of the underlying assets acquired, it is reasonable to assume at the outset that to undergo the process of identifying and measuring the intangible assets will not lead to additional beneficial information. We suggest that IFRS 3 could allow for a cost vs. benefit exemption in such cases.

Separate recognition of intangible assets from goodwill and the accounting for negative goodwill

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?*

Conceptually, the separate recognition of intangible assets is useful particularly when the individual items have different useful lives, and hence generate economic benefits over different periods. The information does provide relevant information (especially predictive value) of how the acquired business will contribute to the net cash flow of the acquirer.

A user (standard-setter) commented that the identification of intangible assets aligns to the developing concept of integrated reporting that supports reporting on all sources of capital. Even though not all sources of capital as identified per the integrated reporting framework are currently recognisable assets under IFRS, removing this requirement would further remove IFRS from the goal of integrated reporting.

The challenge is assessing whether the intangible assets are going to be significant enough to warrant the cost of performing a valuation. As noted in our answer to question 3, there have been instances where the values are not significant, but a costly valuation exercise had to be performed.

(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?*

As pointed out above (refer to our response to question 3(b)) the main implementation challenge is the valuation of some of the intangible assets. Another challenge is the distinction in practice between definite and indefinite life intangible assets. There is an incentive to recognise more indefinite life intangible assets so as to avoid a negative impact on future earnings, by avoiding amortisation.

(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?*

No concern was expressed by our constituents regarding the usefulness of the current accounting treatment of negative goodwill. The focus of the discussion, as set out below (refer to our response to question 5(a)), revolved around the apparent inconsistency between the treatment of negative goodwill and goodwill and the question of whether all goodwill numbers that are identified through the acquisition method actually meet the definition of an asset.

Non-amortisation of goodwill and indefinite-life intangible assets

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?

Before one can assess whether the information obtained from annually assessing goodwill and intangible assets with indefinite useful lives for impairment, it is important to determine whether recognising goodwill as an asset is appropriate.

A user (standard-setter) and some IFRS experts from professional services firms expressed concern that in IFRS 3 (2008) paragraphs BC313 to BC318 the Board believed that only two out of a possible six components of what was then recognised as goodwill conceptually meet the definition of goodwill as an asset. BC323 justifies the recognition of these two components of goodwill as an asset through the application of control, even though it appears that control could only be established indirectly, i.e. the acquirer cannot directly control a component like the workforce of the acquiree, but because the workforce cannot generate cash flow independently and the acquirer controls the operating decisions of the business as a whole, control was established. Adding to the concern is the fact that goodwill is measured as a residual which implied that it many times contains components mentioned in BC313 that does not conceptually represent goodwill. These constituents believe that goodwill should be expensed immediately or allocated to the acquired assets and liabilities using the accounting model applicable to asset acquisitions.

A number of preparers and other commentators disagreed with the above view as most business combinations are the result of extensive negotiations. They believe that if management agreed to a certain purchase price after properly performing its fiduciary duties in making decisions regarding the business combination, the reasonable assumption should exist that the purchase price will be recovered through the future cash flows generated by the acquired business, similarly to the assumption for acquired intangible assets in IAS 38 – *Intangible Assets*. Thus, they do not believe any element of the purchase price should be expensed at acquisition.

Assuming that we agree that goodwill should be recognised as an asset, two views were expressed regarding the amortisation of goodwill and intangible assets with indefinite useful lives:

- The first view was to amortise goodwill and intangible assets with indefinite useful lives. The reason provided was that these assets do require continuing reinvestment to maintain the economic benefits. In order to be consistent with the current requirement in IAS 38 that internally generated (excluding qualifying development costs) intangible assets should not be capitalised, the amortisation will reflect how the acquired goodwill and intangible assets with indefinite useful lives are replaced with their internally generated counterparts. We do acknowledge that the decision not to amortise these assets was partly based on concerns regarding choosing an arbitrary useful life and also the limitation on the total number of years that may be used. A suggestion to overcome this practical obstacle is to amortise the goodwill and intangible assets with indefinite useful lives with reference to the useful life of the cash generating units to which they belong. This will align the amortisation period to the period of the value in use calculation that the current annual impairment test would require, i.e. a finite useful life is imposed on goodwill and intangible assets with indefinite useful lives through the impairment test and as such one can argue that a useful life does exist. If goodwill and intangible assets with indefinite useful lives are amortised, an impairment test should only be performed when an indicator exists.

- The second view supports the current treatment of goodwill and intangible assets with indefinite useful lives, but would only require an impairment test when an indicator exists so as to reduce the costs associated with performing the impairment test annually.

A comment was raised that, from experience, some investors' decisions would not be impacted no matter what method (impairment vs. amortisation) is followed as both accounting entries are added back in order to determine the operational cash flow earning potential of the business.

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

Nothing specific was identified.

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

Preparers raised concerns around the costs of performing annual impairment tests, even if there are no indicators of impairment. Other challenges relate to the appropriate allocation of goodwill to the relevant cash-generating units. Often this is not done correctly, which means that goodwill is tested at a much higher level than what it should be. As a result, fewer impairment losses are likely. Other challenges relate to valuation aspects such as the discount rate, the treatment of tax effects, etc.

Non-controlling interests

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?
If not, what improvements do you think are needed?

In our jurisdiction it is very uncommon for companies to apply the fair value model to measure NCI at the date of acquisition. The proportionate interest method is generally used. This measurement method is generally used consistently for all acquisitions, i.e. alternative measurement methods are not applied to different acquisitions. The consensus was that the proportionate interest method for measuring NCI adequately reflects the claims on consolidated equity that are not attributable to the parent.

It was noted that the standards could be improved to clarify that NCI is meant to reflect the claims on consolidated equity that are not attributable to the parent, rather than simply the claims on the equity of the subsidiary on a stand-alone basis, i.e. before elimination of unrealised inter-company profits and losses.

(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.

One of the main challenges is the accounting for NCI put options themselves, as well as how NCI attribution should be done when liabilities have been recognised in respect of NCI put options. Some are of the view that NCI attribution continues regardless of the measurement of the put option liability, others are of the view that attribution ceases once the put option liability is recognised, and others are of the view that that one needs to consider the interaction of the measurement of the liability and the NCI attribution such that the profits attributable to the shareholders of the parent are fairly stated.

Other challenges relate to subsequent changes in holding when control is maintained. It is not clear how the adjustments to NCI should be calculated. Also, in the context of changes in shareholding where control is retained, there appears to be uncertainty whether a parent's net investment hedge reserve related to an investment in a foreign subsidiary should be allocated to the NCI or not.

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.

Please refer to our comments under question 6(a).

Step acquisitions and loss of control

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.*

The majority of our constituents found the information resulting from the step acquisition guidance in IFRS 3 (2008) useful because the business combination accounting is the same regardless of whether control is achieved in stages or in a single transaction.

(b) *How useful do you find the information resulting from the accounting for a parent's retained investment upon the loss of control in a former subsidiary? If any of the information is unhelpful, please explain why.*

The majority of our constituents found the information resulting from the accounting for a parent's retained investment upon the loss of control in a former subsidiary useful because it achieves the same result upon loss of control whether an interest was retained or whether no interest was retained.

Disclosures

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?*

IFRS specialists from one of the professional services firms provided the following other information they deem necessary to properly understand the effect of the acquisition on a group:

- Business combinations do not fall within the disclosure requirements of IFRS 13 – *Fair Value Measurement*, but some of the disclosures required in IFRS 13, specifically regarding the valuation techniques used and the most significant assumptions applied, could be useful to better understand how the fair values disclosed were calculated.

(b) *Is there information required to be disclosed that is not useful and that should not be required? Please explain why.*

Nothing specific was identified.

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

The disclosures required in terms of IFRS 3 (2008) paragraph B64(q)(ii) present challenges from an auditing perspective. There are concerns that often the disclosures that are provided are very generic based on industry practice as to not provide too much confidential information.

Other matters

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;

The following other matters were identified:

- The IFRS specialists from one of the professional services firms suggested that additional guidance on the application of the value in use model in IAS 36 should be provided, in order to annually test goodwill and intangible assets with indefinite useful lives for impairment. They specifically raised an example of additional guidance on what assets should be included in the carrying amount of a cash generating unit in order to ensure a true comparison between the carrying amount and value in use. Currently, many of the professional services firms develop their own guidance on the treatment of, for example, working capital. An example of additional guidance could be provided to clarify, for example, where the future cash inflows from the sale of inventory on-hand at the measurement date is included in the value in use calculation, if the carrying amount of the inventory to be included in the carrying amount of the cash generating unit should be the carrying amount of the inventory as per the statement of financial position, or should the carrying amount be adjusted to include a profit margin that will be earned on sale in the future.

- Also, in terms of IAS 36, the value in use calculation should be done on a pre-tax basis. In practice, however, the calculation is performed on an after-tax basis due to discount rates being after tax. There are practical challenges of doing the calculation on a post-tax basis, given that in IFRS the specific tax effects of assets and liabilities are reflected separately by virtue of deferred tax. Much needed guidance should be provided on how to deal with tax in the post-tax calculation, including tax amortisation benefits.

- Currently IFRS 3 (2008) does not address common control transactions. Guidance in this area is much needed as such transactions are common in our jurisdiction and practice is significantly diverse.

- Practical challenges are encountered with regard to the determination of the acquisition date, especially when there are suspensive conditions and when there is a delay between the satisfaction of those conditions and the actual transfer of the shares. Some are of the view that the date of acquisition cannot be before the date that the shares are transferred since the acquirer has no rights prior to this date. We suggest more guidance be provided by including a cross-reference to IFRS 10 – *Consolidated Financial Statements* which emphasises the ability to direct the relevant activities.

- Reverse acquisition accounting can be challenging in practice. Errors are sometimes made in the determination of the purchase consideration and hence the determination of goodwill. Additional guidance, beyond the example in Appendix B, might be helpful.

- Determining what is part of the business combination can also be challenging in practice. This includes whether certain consideration is for the business combination or whether it is for a separate transaction.

(b) learning about practical implementation matters, whether from the perspective of applying, auditing or enforcing the Standard and the related amendments; and

Nothing specific was identified.

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

Nothing specific was identified.

Effects
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;

Please refer to our responses to the questions 1 to 9.

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

Please refer to our responses to the questions 1 to 9.

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

A user (standard-setter) cited that the requirements in IFRS 3 (2008) compel, in a positive sense, a company to truly understand what they are purchasing, and hence paying for.

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