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

May 25, 2014

Dear Mr Hoogervorst,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on the Request for Information (RfI) *Post-implementation Review: IFRS 3 Business Combinations* (January 2014).

Principal authors of this comment letter were Max Eibensteiner, Werner Gedlicka, Peter Geyer and Erich Kandler. In order to provide a balanced Austrian view on the RfI, the professional background of these authors is diverse (two auditors and two preparers).

Q 1 YOUR BACKGROUND AND EXPERIENCE

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).

As Question 1 is primarily addressed to preparers, while our comment letter takes the perspective of a privately organised standard setting body, we answer only Questions 2-10.

Q 2 DEFINITION OF A BUSINESS

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

(b) What are the main practical implementation, auditing or enforcement challenges you face when assessing a transaction to determine whether it is a business? For the practical implementation challenges that you have indicated, what are the main considerations that you take into account in your assessment?

(a): From a theoretical point of view, it might seem problematic to apply different accounting treatments to assets acquisitions and business combinations, as the same asset may then be accounted for in different ways. The two approaches – the acquisition method for business combinations as outlined in IFRS 3 and the purchase method as defined by IAS 16 for individual assets – should therefore be conceptually self-sufficient. From a preparer's point of view, it is very helpful to avoid the complexities often associated with the deferred tax considerations required for business combinations for some asset acquisitions. Also, the different accounting treatment of premiums paid – recognition as goodwill for the business combination and on a fair value basis for individual assets – seems to be justifiable.

(b): In several industries (e.g. extractive, construction) there are often transactions where a distinction between business combinations and asset acquisitions is necessary. Especially in the pre-exploration phase in extractive industries, a group of assets may be acquired where there is as yet no business in the sense of IFRS 3. In the new *IFRS 11 Joint arrangements*, the accounting treatment of asset acquisitions under IFRS 3 forms the basis for accounting for joint operations. It is clearly an advantage that in case of asset acquisitions deferred taxes are not accounted for in accordance with IAS 12 as required for business combinations, because it reduces the costs for preparers.

We see no major challenge in determining whether a transaction involves a business. The decision is usually based on the concept of an integrated set of activities (i.e., the assets and liabilities must show a clear interaction), and the process of producing outputs from inputs using those assets. A further indicator is that most businesses could survive economically if they were separated from the reporting entity, whereas a group of assets or liabilities lacks this kind of independence. Overall, we agree with the objective of improving the definition of a business, and we approve of what the IASB has done so far. However, the current status still seems to be somewhat theoretical. Preparers are often confronted with difficult special cases in joint operations and joint ventures in connection with IFRS 11. Depending on whether an acquisition is considered an asset or a business, either IFRS 3 or IAS 12 will need to be applied.

Q 3 FAIR VALUE

(a) To what extent is the information derived from the fair value measurements relevant and the information disclosed about fair value measurements sufficient?[(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: for example, specific assets, liabilities, consideration etc?

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

(a): In most cases, fair value information provides useful information about the assets acquired and liabilities assumed. Disclosure of the level of judgement applied within the FV hierarchy together with a reconciliation of pre-acquisition and post-acquisition carrying amounts (especially for assets) gives a good insight into the objectivity of the values and provides a rough basis for assessing the risk of future impairments.

(b): From a preparer's point of view, intangible assets pose the biggest challenges, because in many cases no active market exists. The valuation of customer lists, for example, is difficult, as in the absence of an active market fair values depend on knowledge of comparable transactions in the same or similar industries. Usually, such transactions are not made public. Where the values in question are substantial, preparers must therefore rely on external consultants with appropriate experience and access to relevant information.

(c): See our answer to point (b) above.

Q 4 SEPARATE RECOGNITION OF INTANGIBLE ASSETS FROM GOODWILL AND THE ACCOUNTING FOR NEGATIVE GOODWILL

(a) Do you find the separate recognition of intangible assets useful? If so, why? How does it contribute to your understanding and analysis of the acquired business? Do you think changes are needed and, if so, what are they and why?

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

(c) How useful do you find the recognition of negative goodwill in profit or loss and the disclosures about the underlying reasons why the transaction resulted in a gain?

(a): Generally, the separate recognition of intangible assets is useful. However, we are in favour of limiting the items eligible for capitalisation to those that represent either a legally enforceable right (e.g., trademarks, patents, exploration rights, customer contracts). or at least to those that can be measured reliably. A stricter measurement criterion should take into account the frequency of market transactions in such assets and the relative difficulty of finding an alternative supplier of the goods or services that the newly combined entity provides (this approach could be applied to customer lists). If there are no such rights or no reliable value can be established, it is questionable whether any future benefit (i.e., an asset) exists or whether the acquirer controls it. In this case, no intangible assets should be recognised.

(b): In many cases, information about market prices of intangible assets (especially those related to customers) is not publicly available, and fair values can only be assessed with the help of external consultants with access to relevant information. This increases the cost of preparing financial reports.

(c): The recognition of negative goodwill – a credit side residual that cannot be otherwise explained – in profit or loss is conceptually unsatisfactory: goodwill is considered to be an asset, while negative goodwill is deemed to be a day one gain. This different treatment of two comparable unknowns is at least questionable, and even more so in the absence of regular goodwill amortisation. We also believe that negative goodwill often creates suspicion that artificial gains may have been recognised through the over-valuation of assets. We would therefore favour a cap on the recognition of intangible assets if their capitalisation leads to an excess of the net identifiable assets over the fair value of the consideration. In our opinion, the fair value of intangibles alone should not lead to a gain from a bargain purchase.

Q 5 NON-AMORTISATION OF GOODWILL AND INDEFINITE-LIFE INTANGIBLE ASSETS

(a) How useful have you found the information obtained from annually assessing goodwill and intangible assets with indefinite useful lives for impairment, and why?

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

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

(a): We are not in favour of prohibiting the regular amortisation of goodwill, because we believe that its useful life is not indefinite. Over time, the business environment and the CGUs to which goodwill is attributed change, until the circumstances at the time of the acquisition no longer exist and it is doubtful whether the related goodwill still has any economic value. Even if the business acquired may still be part of the acquirer's business, it is very likely to have changed, so that any goodwill is by then internally generated rather than an acquired asset. As IAS 38 prohibits the recognition of internally generated goodwill, it is conceptually flawed that goodwill can remain on the balance sheet for an indefinitely long period of time.

We have additional reasons for strongly preferring the reintroduction of mandatory regular amortisation of goodwill:

- The membership of corporate management bodies tends to change more frequently these days, which may be an incentive for managers to postpone recognition of goodwill impairments until their term has expired. Charges for regular amortisation of goodwill would fall at least in part in periods in which those responsible for the acquisition were still in office. This seems important, because goodwill is a form of overpayment (even if made in expectation of synergies), since all other identifiable assets have been recognised at their individual fair market values. Hence, the management responsible for the overpayment should also be held responsible for demonstrating whether their expectation of synergies has been realistic or overly optimistic.

- Admittedly, it is hard to determine a useful life for goodwill. However, the current approach of assuming an indefinite useful life and regularly testing for impairment often leads to a double burden when impairment does need to be recognised: the charge for impairment may coincide with a negative operating performance of the CGU to which it relates.

For these reasons, we would welcome the reintroduction of mandatory regular amortisation of goodwill, together with impairment tests where necessary.

The benefits of goodwill may not be realised in the period immediately following acquisition: the post-acquisition integration phase, in which measures are taken to make the synergies effective, should be taken into consideration. After this phase, goodwill should be amortised over its useful life as determined by the reporting entity. We consider 3–5 years as the maximum period before regular amortisation of goodwill should start.

(b): We think that the information required in the notes about impairment tests is sufficient.

(c): In the light of enforcement decisions in recent years, the assessment of the correct discount factor to be used in impairment tests constitutes the main challenge, at least for preparers.

Q 6 NON-CONTROLLING INTERESTS

(a) How useful is the information resulting from the presentation and measurement requirements for NCIs? Does the information resulting from those requirements reflect the claims on consolidated equity that are not attributable to the parent? If not, what improvements do you think are needed?

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

To help us assess your answer better, we would be grateful if you could please specify the measurement option under which you account for NCIs that are present ownership interests and whether this measurement choice is made on an acquisition-by-acquisition basis.

(a): The separate recognition of NCI is useful to assess the amount of control the accounting entity has over the acquiree. However, application of the full goodwill method often generates artificial values, because in the absence of publicly quoted shares for which an actual price can be used it is complex and to some extent a matter of judgement to eliminate the control premium from the fair value of the NCIs. Although in a principles-based set of accounting standards alternative treatments for the same underlying transactions should be avoided whenever possible, we support the existing option in IFRS 3 to choose between fair value and proportionate share of NCIs, as a means of mitigating the problem.

(b): In the accounting for NCIs, we view critically the recognition of the acquisition of further interests in equity. This accounting treatment affects neither goodwill nor profit and loss (former IAS 27, now IFRS 10.23). This is likely to create structuring opportunities, with acquirers inclined to pay less for the controlling share in order to minimise goodwill and considerably more for the remaining minority share so as to recognise the excess payment directly in equity. Even though the gain of control is an important economic event, a subsequent enlargement of the holding can confer additional important rights (e.g., the elimination of a blocking minority, or the possibility of enforcing a squeeze-out). It should, therefore, be reflected in the consolidated balance sheet – ideally in the form of an increase in goodwill.

Q 7 STEP ACQUISITIONS AND LOSS OF CONTROL

(a) How useful do you find the information resulting from the step acquisition guidance in IFRS 3? If any of the information is unhelpful, please explain why.

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

(a): Adjusting previously acquired interests in the acquiree to actual fair value when control is achieved generates artificial values (gains/losses in profit or loss, with a corresponding impact on goodwill). The implied assumption is that today's values are valid indicators of the value of past transactions. Moreover, it remains questionable whether the control premium included in the control stake should be used to remeasure previously held shares. We do not therefore think that the information generated by this valuation exercise is helpful. It may be noted that other assets are not being revalued on a regular basis except in case of hyperinflationary accounting.

The closer the acquisition steps are together, the more likely it is that the current price paid is a valid indicator for the older interest. Moreover, the smaller the gap between the current shareholding and the controlling interest, the smaller the control premium should be, as existing interest almost constituted control (of course depending on the size of interests held by other parties). However, these are assumptions that may be hard to support with market facts. If comparable transactions were available, the consideration paid might be taken as providing objective values for the own acquisition process. Nevertheless, in the absence of such market values, the method generally chosen is to remeasure using current prices.

(b) The arguments advanced in (a) above also apply here. Transferring control of an entity involves a premium that is reflected in the price received for the shares that are given up. It is doubtful whether the same value per share can be used for a remaining non-controlling interest.

Q 8 DISCLOSURES

(a) Is other information needed to properly understand the effect of the acquisition on a group? If so, what information is needed and why would it be useful?

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

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

Almost all business combinations involve contractual confidentiality agreements, which are in conflict with the disclosure requirements of IFRS 3. It would be helpful if this direct disclosure of the consideration paid were not required, especially in situations where the consideration paid in individual transactions that had not been previously disclosed either voluntarily or because of legal requirements could be identified simply on the basis of this IFRS disclosure. Full disclosure of the reconciliation of pre-acquisition carrying amounts to fair values plus goodwill for each major acquisition and the information contained in the statement of cash flows should be enough to evaluate the impact of a business combination on the combined financial statements.

Q 9 OTHER MATTERS

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

The IASB is interested in:

(a) understanding how useful the information that is provided by the Standard and the related amendments is, and whether improvements are needed, and why;

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

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

As the interval between signature of a contract and the closing date (which is generally taken as the date on which control is achieved) can be material (sometimes more than a year), it often happens that between the two dates the acquiring company publishes quarterly or even annual financial information – usually without including the acquiree in the published figures. Although this is formally correct, a requirement for pro forma comparative information about the target company in annual financial statements following the date on which control has been achieved would be helpful. However, in cases where the interval between signing and closing is no longer than three months (or perhaps six months), such a requirement would not be necessary. As this information is already requested by analysts and other users, large public companies typically provide such pro forma statements as a matter of course.

We are critical of the treatment of acquisition-related costs as an expense. Although these costs are not directly part of the exchange transaction, they would not occur in the absence of the acquisition. The basic question is what should be included in the consideration paid. At the moment, IFRS 3 includes only items which are exchanged, while we would prefer a more inclusive view of what the acquirer is paying for the acquiree.

Q 10 EFFECTS

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

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

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

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

(a) and (b): The requirement to identify and account for intangible assets other than goodwill separately benefits users of financial statements. However, the benefits are subject to the reservations expressed under Question 4 above. From a preparer's point of view, the revised step acquisition process and the treatment of transactions relating to non-controlling interests have lowered the costs associated with following up such transactions, while there are considerable increases in costs in assessing fair values, especially for intangible assets, because of the need to use external consultants to provide the information on which estimates of fair value are based.

(c): We refer to our comments under Question 6 on the accounting for transactions involving non-controlling interests after control has been achieved. A number of cases involving potential acquisitions or strategic decisions regarding the timing and scope of transactions have been significantly affected by the IFRS accounting requirements. In our view, structuring opportunities are not only present but are widely used in practice.

Kind regards,

Romuald Bertl

Chairman