Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

IASB
30 Cannon Street
London EC4M 6XH
UK

May 19, 2014

Dear Mr Hoogervorst,

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

Please find below our answers to the above mentioned request for information.

If you have any questions or a need for further information, please do not hesitate to contact us.

Yours sincerely,

ACTEO	AFEP	MEDEF
Patrice MARTEAU Chairman	François SOULMAGNON Director General	Agnès LEPINAY Director of economic and financial affairs

Question 2

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

We believe that specific treatments for business combinations are justified, provided that the scope of IFRS 3 is set appropriately (cf our answer to the next question relating to the definition of business). These include provisions relating to the identification of the acquiree's assets and liabilities, their fair value measurement, the accounting treatment of non-controlling interests and the calculation of any goodwill / negative goodwill. Indeed, these provisions are clearly specific to business acquisitions in which the Group acquires a set of identified assets and liabilities but also synergies for its future business.

However, one may wonder about the relevance of other commonly observed differences between the accounting treatment of business acquisitions and the acquisition of a single asset. Our objective is not to comment at this stage on the comparative merits of these differences but only to point out that such differences as, for example, the treatment of acquisition costs, deferred taxes, and contingent payments (see our answer to question 9) seem not justified. The IASB should deal with all of these "cross cutting issues" during this review of IFRS 3 in conjunction with the current revision of the conceptual framework.

Indeed, when there are unjustified differentiated treatments and the scope of a standard is y open to wide interpretation, the risk of arbitrage is greater and understanding of the accounting impacts of transactions made more difficult.

(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?

Our challenge today is not so much to determine whether a transaction is an acquisition of a business but more the too broad scope to which the standard seems to apply today. In fact, we believe that such a standard which is so complex and expensive to implement should be restricted to transactions that significantly impact the business and the structure of a reporting entity. Today, however, because of the very broad definition of a business, especially since 2008 with the notion of "capable of", and the very literal interpretation of this standard made by some stakeholders, companies are forced to apply it to acquisitions that should be treated much more simply (e.g. acquisition of property through a legal entity which is accompanied by a maintenance contract).

Indeed, we believe that differences in accounting treatments and disclosures are justified only in cases where the entity is clearly in the process of buying a business, ie it provides an overall price for an identified set of assets and liabilities but also for some potential future business development that is implicitly valued in its commercial offer. We therefore expect IFRS 3 to be applied to transactions that have an impact on the Group's structure and Business development. In our view, this was the original intention of the accounting pronouncements which began by focusing on the distinction between mergers and acquisitions, before evolving to today's situation. The Board should take a step back and reconsider what it is trying to capture in its standard on business combinations and whether the current state is what it intended.

If the Board concludes that the notion of business combinations is too widely applied, as we believe, then it should refocus the scope. This limitation of scope could be done either by changing / narrowing the notion of "business" or by limiting the application of IFRS 3 only to Business acquisitions representative of a strategic shift that has (or will have) a major effect on the entity's results *. We acknowledge that the first solution would also have consequences over other standards since the Board has recently expanded the use of this concept (c.f. its recent application “by analogy” to the acquisition of an interest in a joint operation).

** We are proposing here the concept developed by the FASB in order to reduce disposals of small groups of assets that are recurring in nature but qualifying for discontinued operations under the former subtopic 205-20;*

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?(*) 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?

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

Measurements at fair value are an inherent difficulty with IFRS 3. This, in our view, is sufficient in itself to justify a limitation of its scope. Nevertheless, current standards (IFRS 3 and IFRS 13) provide sufficient guidance and do not need further development to be implemented.

However, we encourage the Board to reconsider “reliability” as a main qualitative characteristic in the new framework. This which may be relevant as a limitation on the use of fair value where such measurement is too uncertain and thus unreliable. If the Board decides not to reinstate this criterion in the conceptual framework, then at the very least the characteristic should be added back to IFRS 3 as it was prior its revision.

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?

We agree that the separate recognition of intangible assets is useful since it provides users with a better understanding of what has been paid for through the acquisition price. Their measurement is

certainly difficult but companies rely on experts and are now experienced in this exercise. Nonetheless, as mentioned above, when the valuation is very unreliable, we believe that it would be better not to recognize them separately. Indeed, this unreliability in fair value measurement often reflects the difficulty in isolating cash-flows specifically attached to this intangible asset, which in many cases does not have a finite useful life. In these cases, we question the relevance of the forced recognition of an asset whose value cannot be reliably evaluated and whose frontier with goodwill is very undefined. Conversely, when the entity expects to sell this intangible asset, it would have to be separately identified in order to facilitate its future derecognition.

Concerning negative goodwill, our participants did not frequently encounter these cases. Nonetheless, we agree with the presumption stated in the standard that such an outcome should lead entities to question their previous assessments.

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?

Although we agree that an annual impairment test may be useful, we would ask the IASB to consider whether there are ways of simplifying the procedures, by, for example, providing an option to qualitatively assess whether it is more likely than not that the fair value of the CGU is less than its carry amount.

We also like the Board to solve some inconsistencies we have observed concerning the allocation of the impairment loss: whereas the allocation of a portion of the full goodwill to NCI is initially based on relative fair values, the subsequent allocation of the impairment loss is then based on the same basis as that on which P&L is allocated, which could be different. We encourage the board to allow an alternative allocation if the entity can demonstrate that it is more relevant.

We would also draw the attention of the Board to the disclosures required concerning the impairment test. We are particularly concerned about the excessive demands that can be made on the grounds of the IAS 36 requirements, and especially the commercial sensitivity of key assumptions which could cause significant commercial harm to an entity.

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?

(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.

First, some few observations: in general for past transactions, our members have used the so-called partial goodwill method and applied the same treatment to all their business combinations. For those who opt for the full goodwill method, the reason for doing this is often linked to the new (IFRS 3 2008) accounting treatment for subsequent changes in ownership interests.

Some may consider the goodwill to be like all others assets of an entity and therefore agree that it should be recognized in its entirety. Others believe that the goodwill is unlike other assets since is a residual amount derived from the consideration the acquirer has agreed to pay for a transaction to which the non-controlling interests were not a party. As far as determining the most appropriate model is concerned, we believe that the Board should first finalise its work on the reporting entity concept but also clearly define what the goodwill is supposed to represent. In the meantime, the two models should be retained.

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.

Accounting for step acquisitions, loss of control and other changes in ownership interests are the aspects about which we have the most concerns. The IASB developed all these new provisions from an "entity perspective" without proper debate and justification of its decision, since the chapter relating to the reporting entity is not yet finalised.

It appears that the accounting outcomes resulting from these transactions are most often judged to be counter-intuitive, both by the management who implement the transactions and by the external users who are struggling to understand and to forecast their impact. Indeed, the recognition in net income of the effect of remeasuring previously held or partially retained investments is not relevant, as this is not part of the group's performance over the period: gains and losses on investment should be recognized in profit or loss only when the investment is sold (or impaired). Conversely, not to recognise any impact when interests are sold but the subsidiary remains controlled is not relevant as it does not reflect the real transactions and cash exchanges that have really occurred. Moreover,

amounts recognised directly in equity due to “transactions between stakeholders” are never recognized through net income even when the group loses control.

In consequence, we ask the Board to take advantage of this post-implementation review to ensure that these provisions really do improve the quality of reporting, that they respond to some needs clearly expressed by users and that they are not merely the outcome of conceptual thinking based on the notion of the “entity perspective” that has still not been validated in the conceptual framework.

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

We wonder whether all the mandatory disclosures are useful in any context other than a significant change to the scope or operations of the entity, as discussed above.

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.

Contingent considerations

One of the main divergences between a business acquisition and an asset acquisition is the treatment for contingent consideration. We believe that the IASB should build on the recent Interpretation Committee’s view and on some preliminary decisions in the “lease project” which both conclude that variation of contingent / variable consideration should not always be recorded immediately in net income but instead may be considered as an adjustment to an asset’s value as long as this variation reflects an increase in the [potential] future cash-flows arising from the asset.

Single asset entities

Sometimes, in particular for tax purposes, a group acquires a single asset through a separate legal structure. Even if this acquisition is not qualified as a business combination, because of the legal form, all future variations are accounted for through equity in accordance with IFRS 10 because they are considered to be transactions between stakeholders.

As mentioned in response to question 7, we believe that accounting for variations in interests in such a way does not make sense. This impression is further exacerbated when it comes to changes in a subsidiary that is not a business that holds only one asset. It might be more appropriate to ignore the legal form and consider that the group holds a single asset directly rather than an interest in a subsidiary. It would be then possible to recognise a gain on partial disposal.