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Re: **OIC comments on the "ED of Proposed Amendments to IFRS 3 *Business Combinations*"**

Dear Sirs,

we are pleased to provide our comment on the: "ED of Proposed Amendments to IFRS 3 *Business Combinations*"

Question 1

Are the objective and the definition of a business combination appropriate for accounting for all business combinations? If not, for which business combinations are they not appropriate, why would you make an exception, and what alternative do you suggest?

Answer

The definition does not clearly state if it includes true mergers and joint ventures, although we believe that the intention of the Board was to exclude them. Since there are cases of true mergers and as in such transactions the application of the acquisition method is not appropriate to reflect the reality of the combination, we believe that the Board should: a) review the definition, and b) define which accounting method should be applied to transactions where an "acquirer" cannot be identified.

Question 2

Are the definition of a business and the additional guidance appropriate and sufficient for determining whether the assets acquired and the liabilities assumed constitute a business? If not, how would you propose to modify or clarify the definition or additional guidance?

Answer

The proposed definition of a business has been broadened and we believe that this is acceptable. However, we believe that such definition should better distinguish between the case where the combination consists in acquiring a group of assets that *constitute* a business within the scope of IFRS 3, and the case where the acquisition *appears* to comply with the definition but its substance does not represent a business combination. An example might be the acquisition of assets made for the purpose of providing outsourcing services.

Question 3

In a business combination in which the acquirer holds less than 100 per cent of the equity interests of the acquiree at the acquisition date, is it appropriate to recognise 100 per cent of the acquisition-date fair value of the acquiree, including 100 per cent of the values of identifiable assets acquired, liabilities assumed and goodwill, which would include the goodwill attributable to the non-controlling interest? If not, what alternative do you propose and why?

Answer

We do not believe that the proposed method is appropriate and we concur with the dissenting opinions expressed by certain Board Members, particularly for the effect that the proposed method would generate in allocating to the minority interests a portion of the premium paid to acquire the majority.
We believe that the parent-only, cost-based method is preferable to the proposed change and should be maintained, since we doubt that the benefits to the users of the proposed approach will outweigh an increasing softness of the goodwill and the equity deriving from the new approach.
Furthermore, in our opinion, the proposed change to a "full goodwill" determination would lead to effects not representing the economic reality when applied to step-acquisitions, where the new approach requires a re-measurement of the total value of the acquired business, while no transaction has been stipulated for the portion of interest already owned by the acquirer prior to acquiring the majority interest.

Question 4

Do paragraphs A8-A26 in conjunction with Appendix E provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

Answer

In our view, the Exposure Draft does not provide sufficient guidance as to the method to gross-up the fair value of the acquired interest to the fair value of the acquiree as a whole. Since quoted market prices may not be available to measure the fair value of an acquiree, this is very often

determined by a number of other subjective and judgemental elements. As a consequence, the reliability of the calculated fair value may prove questionable.
We believe that the examples presented in ED3 are somewhat oversimplified and incomplete in comparison with the numerous and complex techniques and methods with which business combinations are carried over and the related calculations of economic convenience are made.
In addition, we believe it should be stated that the fair value of deferred tax assets and liabilities is the present value of the expected related cash flow instead of their "face" value, since there is little doubt that the acquirer does take the time value into account in its acquisition valuations. We are aware that such an approach is not consistent with IAS 12 and we recommend that the Board's agenda include its revision in order to state that deferred tax assets and liabilities are stated at their present value in those circumstances where the time period for the actual utilization/liquidation of deferred taxes is reasonably determinable.

Question 5

Is the acquisition-date fair value of the consideration transferred in exchange for the acquirer's interest in the acquiree the best evidence of the fair value of that interest? If not, which forms of consideration should be measured on a date other than the acquisition date, when should they be measured, and why?

Answer

Although the fair value at the acquisition date of the consideration stipulated for the interest in the acquiree may be assumed in general as the best evidence of the fair value of such interest, in several cases this may not be the case. Therefore, we believe that the general statement that the fair value of the consideration transferred is the best evidence of the fair value of the interest acquired should only be a rebuttable presumption.
Furthermore, it would be useful if the Board could provide examples of situations where the presumption is rebutted. For example, if an entity already owns 49% of another entity and subsequently acquires an additional 2%, we do not believe that the consideration transferred for the latter 2% is an appropriate basis on which to measure the fair value of the acquiree taken as a whole.

Question 6

Is the accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?

Answer

We agree that contingent considerations, when taken into account in the determination of the negotiated acquisition price, should be measured at their fair value, as should any other acquired asset or liability.
However, we do not believe it would be appropriate for subsequent changes in the fair value of contractually stipulated contingent considerations classified as liabilities to always be recognised in profit and loss. For example, if the contingent consideration relates to an initial uncertainty as to the value of the acquired business, the subsequent changes in its fair value should be reflected in the acquisition accounting. In our opinion, this approach is even more appropriate when the changes in the fair value of the contingent considerations represent in substance a "hidden" deferral of the

payment of the acquisition cost. On the other hand, when a contingent consideration is a form of stipulating an income sharing, it should be taken into profit and loss.
Furthermore, we believe that it should be clarified that the unwinding of present value calculations should always be accounted for in the profit and loss.

<u>Question 7</u>

Do you agree that the costs that the acquirer incurs in connection with a business combination are not assets and should be excluded from the measurement of the consideration transferred for the acquiree? If not, why?

Answer

We do not agree that costs incurred by the acquirer in connection with a business combination should be excluded from the measurement of the consideration transferred to the acquiree.
First, the proposed principle is inconsistent with the treatment of direct acquisition-related costs as provided for by other existing standards, which consider transaction-related costs as an element in the measurement of the fair value of any asset acquired. Second, we do not agree that such costs are not part of the consideration transferred, given that it is generally indifferent to the acquirer whether the consideration is paid for solely for the acquisition or for the related costs.

<u>Question 8</u>

Do you believe that these proposed changes to the accounting for business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?

Answer

We agree in general with the initial recognition and measurement changes. We also believe that additional explanations on subsequent measurement of (contingent) intangible assets under IAS 38 would be useful. However, based on the assumption that the Framework cannot supersede a standard and in order to prevent uncertainty, we recommend that the Board re-instate the “reliability of measurement recognition criterion” in the revised IFRS 3.

<u>Question 9</u>

Do you believe that these exceptions to the fair value measurement principle are appropriate? Are there any exceptions you would eliminate or add? If so, which ones and why?

Answer

We do not agree with the measurement criteria pertaining to the treatment of deferred tax assets and liabilities. Please refer to the last paragraph of our answer to Question 4.
In addition, we believe that, in order to avoid uncertainty, the standard should explicitly state that assets held for sale are to be measured at their fair value less costs to sell.

Question 10

Is it appropriate for the acquirer to recognise in profit or loss any gain or loss on previously acquired non-controlling equity investments on the date it obtains control of the acquiree? If not, what alternative do you propose and why?

Answer

In addition to the concerns already expressed (see our answer to Question 3), we do not believe that the recognition in profit and loss is appropriate. Since there is not an underlying transaction with reference to previously acquired non controlling equity investment

Question 11

Do you agree with the proposed accounting for business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest? If not, what alternative do you propose and why?

Answer

We believe that very often, in practice, business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest reflect the expectation of future losses, which is taken into account in the negotiation process. Therefore, we believe that the difference between the fair value of the acquiree and the fair value of the consideration transferred, where lower, should be recognised in profit and loss of the subsequent period(s). Only in rare cases does the combination represent a bargain acquisition.
We are aware that this treatment generates a liability that does not comply with the Framework definition of liabilities, but we believe this is justified in the circumstances by the fact that both the acquirer and the acquiree negotiated a value for the future losses in the context of an arm's-length transaction.
In our opinion, the arguments set forth here above should be regarded in the general context of a transition to IFRS, in which a whole application of fair value measurement is still difficult.

Question 12

Do you believe that there are circumstances in which the amount of an overpayment could be measured reliably at the acquisition date? If so, in what circumstances?

Answer

We believe that cases of overpayment do exist. However, we do not think they can be measured reliably. Examples might be the case of a business overpaid for with the aim of eliminating a competitor or the case, conceptually not different, of a business acquired in consideration of the expected synergies deriving from its combination with the acquirer's, whose fair value the standard – correctly – does not require to be measured independently.

Question 13

Do you agree that comparative information for prior periods presented in financial statements should be adjusted for the effects of measurement period adjustments? If not, what alternative do you propose and why?

Answer

We agree. Comparability is an important valuation tool for the stakeholders. We believe that the standard should define a time limit also for adjustments to the acquisition accounting deriving from contingent considerations. We suggest that such adjustments be permitted within the period ending at the first reporting period subsequent to the acquisition year, unless otherwise contractually regulated.

Question 14

Do you believe that the guidance provided is sufficient for making the assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed or incurred are not part of the exchange for the acquiree? If not, what other guidance is needed?

Answer

We believe that the guidance provided is useful, although very detailed.

Question 15

Do you agree with the disclosure objectives and the minimum disclosure requirements? If not, how would you propose amending the objectives or what disclosure requirements would you propose adding or deleting, and why?

Answer

We agree with the proposed standard except for the following:

a) § 74 (a). Disclosure of revenue and profit and loss data of the acquired business subsequent to the acquisition. If the acquired business is already integrated within the acquirer's one, such information may not be available or may be difficult to determine. Therefore, we suggest that the preceptive mode for the standard be softened.

b) § 74 (b). In addition to point a) above, we think that the standard should clarify the basis on which such information should be prepared. We assume these are the acquirer's accounting principles. However, if this is the case, it might require an uneasy and time-consuming re-formulation of the profit and loss. Consequently, we suggest that some simplification be permitted.

Question 16

Do you believe that an intangible asset that is identifiable can always be measured with sufficient reliability to be recognised separately from goodwill? If not, why? Do you have any examples of an intangible asset that arises from legal or contractual rights and has both of the following characteristics:
(a) the intangible asset cannot be sold, transferred, licensed, rented, or exchanged individually or in combination with a related contract, asset, or liability; and
(b) cash flows that the intangible asset generates are inextricably linked with the cash flows that the business generates as a whole?

Answer

We do not believe that an intangible asset that is identifiable can always be measured with sufficient reliability separately from goodwill. We believe there are intangible assets that cannot be traded or negotiated individually and do not generate separate cash flows.
Furthermore, we believe that in many instances active markets do not exist (see paragraph 78 of IAS 38). As a consequence, the determination of the fair value would be extremely difficult without using valuation techniques, and we have doubts as to whether these techniques will yield reliable information.

Question 17

Do you agree that any changes in an acquirer's deferred tax benefits that become recognisable because of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination? If not, why?

Answer

We agree that changes in the acquirer's deferred tax benefits that become recognisable because of the business combination should be accounted for separately from the business combination

Question 18

Do you believe it is appropriate for the IASB and the FASB to retain those disclosure differences? If not, which of the differences should be eliminated, if any, and how should this be achieved?

Answer
We regret that, notwithstanding the full convergence objective, some divergence still remains and that, consequently, further projects will be necessary with the potential effect of further changes to IFRS. We would dislike a step-by-step approach because of the uncertainties it may generate and its effect on comparability of financial information, both between entities and financial reporting periods.

Question 19

Do you find the bold type-plain type style of the Exposure Draft helpful? If not, why? Are there any paragraphs you believe should be in bold type, but are in plain type, or vice versa?

Answer

We do, and we have not noted cases were the style should be changed.

Yours sincerely

Prof. Angelo Provasoli
(OIC – Chairman)