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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/Madam

Re: IFRS 3 Business Combination Post- Implementation Review

We are writing in response to the IASB's Request for information on its Post-Implementation Review (PIR) of IFRS 3 Business Combination, issued in January 2014.

With reference to this project, in order to obtain evidence related both to the implementation difficulties and to the effects of IFRS 3 (including related standards such as IAS 36 – impairment of assets), the OIC has conducted several outreach activities with preparers, auditors, analysts, and users.

As requested by the IASB, the participants have also provided some suggestions about the improvements that are needed.

The results of our activities are summarized, by area, below.

Definition of Business

Generally, participants agree there are benefits of having a separate accounting treatment for business combinations and asset acquisitions, because it allows them to better present such transactions that are different. In addition, it allows principles to be defined for initial recognition of the acquired goodwill and intangible assets, and to define principles for earn-out, contingent payments and step acquisition.

However, with reference to the definition of business provided by the IFRS 3, the participants have pointed out that one issue is that the IFRS 3 does not cover business combinations under common control. Another concern is related to the fact that the definition is based on the capability of the acquired assets/liabilities to produce an output under a market perspective and qualifying a business through an input, process, and output model is frequently not easy.

Finally, another relevant issue pointed out by participant is that assessing the nature of transactions, in order to determine a business, may produce some issues related to the identification of the elements characterizing the business combination, the related connecting activities, and the judgement requested in the assessment of the various components of the business combination.

Fair Value measurement

With reference to the information derived from the fair value measurement, the opinion/consensus expressed by participants is that the information and disclosure are sufficient.

The main challenges identified by participants are related to:

- The determination of the fair value of loans and the determination of the credit risk of the borrower. In particular, when a real market for loans does not exist, the fair value models are difficult to apply.
- The measurement of contingent consideration.
- The determination of the WACC rate and its components.
- The lack of standardized methodologies for calculating the whole enterprise value.
- The valuation related to real estate and operating assets, given market volatility, and the particular use of them in the railway industry.
- The identification of the fair value concession rights related to several regulatory aspects; very long useful life, assets not recognized in the financial statement of the acquirer.
- The determination of fair value of the minority interest. The issue is if the fair value will be calculated considering also future synergies.
- The determination of the fair value of unlisted equity investments recognized at cost in the acquiree's financial statements.

In addition, the majority of participants note that determining fair value in a business combination is a very challenging exercise, in particular valuing specific assets and intangibles for which no active market exists.

Separate recognition of intangible assets from goodwill

With reference to the recognition of intangible assets from goodwill, the OIC has found mixed views. The majority of participants think that the separate recognition of intangible assets is useful because it enables a better representation and measurement of each single element of the acquired business in the financial statement. However, some prefer to see all effects included in goodwill. Finally, others would prefer to recognize only the intangible assets that will be sold without the underlying business.

The main challenges identified by participants are related to:

- The difficult and the high cost of the measurement of intangible asset;

- The fact that identifiable intangible assets cannot always be measured separately from goodwill with a sufficient degree of reliability.
- The determination of useful life.
- The difficulty for users to understand the recognition of negative goodwill in P/L.
- The lack of active markets and similar transactions to benchmark.

Non-amortization of goodwill and indefinite life of intangible assets

With reference to the information obtained for annually assessing goodwill and intangible assets with indefinite useful lives for impairment, some participants think that the information is useful. However, others think that it is not useful because it is pro-cyclical and conceptually flawed. Some participants think that improvements are needed regarding the information provided by the impairment test. Finally, the majority think that the main challenges relate to the subjectivity of assumptions.

In particular, the main challenges underlined by participants include:

- Difficulties in determination of WACC;
- Difficulties for users of financial statements to understand the information obtained from annual impairment tests;
- Difficulties in assessing the appropriate growth rate in the discounted cash flow model;
- Allocation of corporate assets in cash-generating units;
- Reconciling value of the subsidiaries in separate and consolidated financial statements;
- Several costs attributable to testing for impairment (e.g. review in each period, data gathering, and so on);
- Possibility to calculate impairment due only to a temporary increase in interest rate or in a period of particular market turbulence;
- Compensation effects at single cash-generating unit; no impairment is recognized because such difference is compensated by the profitability of the net assets already held by the acquirer.
- Difficulties in matching the internal consistency between internal and external changes. In particular, the impairment test requires the factoring in of negative changes to the business, whereas it limits the possibility to account for the benefits of future actions, which are strictly linked to such negative changes. As an example, IAS36 does not allow accounting for the benefit of future restructuring plans for which the entity is not committed (i.e. the related liability has not been provided for at the balance-sheet date) even if the entity is not subject to any constraints when launching the plan (for example because the plan is related to jurisdictions where no agreement of employees or trade unions is required).

Therefore, the most relevant suggestions from participants include:

- Allowing amortization of goodwill to reduce emphasis given to GW impairment test and the pro-cyclical effect;

- Elimination of separate recognition of intangible assets from goodwill;
- Systemic amortization of such assets to provide a better representation of the economic results;
- Reduce subjectivity;
- Utilize more analytic information about cash flows.
- The disclosure of some assumptions of the test specific to the entity may be commercially sensitive for listed companies.

Non-controlling interests (NCI)

With reference to the accounting for non-controlling interests, the majority of respondents think that information resulting from the presentation and measurement requirements for NCIs is useful because it reflects the claims on consolidated equity that are not attributable to the parent.

However, some have pointed out that there are different views about "company view" and "economic entity view" and this might create some comparability problems.

Finally, the most important concerns with NCI measurement that participants have highlighted regard:

- The determination of the "minority discount" to be applied to the fair value of the NCIs;
- The subjectivity of the calculation of the goodwill through the full goodwill approach.

For these reasons, some participants suggest removing the option.

Step acquisition and loss of control

On the bases of the OIC's activities, it seems that the information resulting from the step acquisition guidance and from the accounting for a parent's retained investment upon the loss of control in a former subsidiary is useful. However, some believe that there is no economic reason for having a different size of goodwill in step acquisition and in acquisition realized in one single transaction. In addition, in the case of loss of control, this recognition is merely hypothetical and does not represent the effects of any transaction.

Disclosure

The participants have underlined that disclosure is too broad, and adding too much disclosure to the financial statements creates problems in the way people understand the financial statements. Sometimes, much of the information is useless. Sometimes, prospective details or subsequent detailed information on the outcome of the transaction may be extremely difficult to obtain. Another issue that is pointed out is related to how determine the value in P/L for the future period. In summary, the consensus is that there is a need to reduce disclosure.

Finally, some participants suggest integrating disclosure with more information regarding the main items of fair value of the intangible assets (i.e. significant inputs, valuation techniques).

Other matters

The main other matters highlighted by respondents include:

- Impairment test of CGUs when recoverable amount is less than carrying value and the difference exceed goodwill;
- Inconsistence between treatment of pre-existing relationships in business combinations (IFR3) and as onerous contracts (IAS 37);

Effects

With reference to the areas of IFRS 3 that have resulted in considerable unexpected costs to preparers of financial statements, the participants have identified the following:

- Very time-consuming especially when the accounting principles applied by the acquiree are different from IAS/IFRS;
- Information can sometimes be misleading, due to estimation of goodwill impairment and impairment changes;
- Lots of costs in preparing financial information and doing the impairment test due to: development of model, review in each period, data gathering, sharing the outcome of the model between all interested parties, frequency of impairment. These costs affect users, preparers and auditors.
- Valuation of intangibles assets other than goodwill.

Please note that most of the effects noted relate to the fact that the absence of amortization has been a great incentive to inflate acquisition prices in recent years.

OIC Conclusion

On the basis of our activities, we believe that there are some areas of the standards that have created considerable implementation difficulties for preparers. In particular, in some cases the information required by the standards is considered difficult and costly to provide, especially if compared with the benefits that the information produces for users.

If you would like to discuss our comments further, please do not hesitate to contact us.

Yours sincerely,

Angelo Casò

OIC Chairman