FEEDBACK STATEMENT

Responses to the Discussion Paper

'Presentation of the reversal of acquisition step-ups'

EFRAG

European Financial Reporting Advisory Group

Introduction

In July 2014 EFRAG a Short Discussion Paper on presentation and disclosures of the reversal of acquisition step-ups. Comments were requested by 31 December 2014.

EFRAG received six comment letters and is now issuing a feedback statement which describes the main comments that it received.

Why was this Discussion Paper written?

The fundamental measurement principle in IFRS 3 Business Combinations is to measure the identifiable assets acquired and liabilities assumed at their acquisition-date fair value (with only a few exceptions). This may result in upward adjustments on the carrying amount in the acquiree's financial statements, which are commonly referred to as 'stepups'.

Stepping-up acquired assets affects future operating costs in the consolidated financial statements. Some users have expressed dissatisfaction with this because in normal conditions – that is, assuming that the acquired business will continue to operate in the same way as before the acquisition - they would use the margin from the post-acquisition account to predict how the acquired business will contribute to the future performance and cash flows of the Group on a continuing basis.

The Discussion Paper addresses if specific information should be provided about the reversal of step-ups in the post-acquisition consolidated financial statements, and if so, in which format.

Responses from constituents

Six comment letters were received in response to the DP. A list of respondents is in the Appendix to this feedback statement. All comment letters received are available on the website of EFRAG.

Purpose and use of this feedback statement

This feedback statement summarises the messages received from constituents and will be used by EFRAG as input for any future work on the topic.

This feedback statement should be read in conjunction with the DP, which is available on the EFRAG's website.

Key message

In general, respondents were not in favor of introducing new presentation or disclosure requirements although some recognised that the reversal of step-ups creates an issue and information may be relevant. The majority supported allowing entities to provide the information when needed.

Analysis of responses

Question 1

Do you believe that the IASB should introduce new requirements to improve the information on the reversal of acquisition step-ups? If not, why not?

Reply to the question

Four respondents did not consider necessary to introduce new requirements and were supportive of simply allowing disclosure of the effect, when relevant to users and material. One of them (the Norwegian Accounting Standards Board) noted that this should not be restricted to step-ups that arise from business combinations or to particular types of assets (such as inventories). Another (the Dutch Accounting Standards Board) was in favor of voluntary disclosure only because of the practical problems to calculate the amounts. Another (the FRC staff) noted that the issue did not seem sufficiently widespread to justify the need for a new requirement.

Two respondents considered necessary to provide the information. One respondent (CFA UK) noted that many analysts do not view the reduced profitability in the initial period following the acquisition as recurring and therefore need the information on the reversal to make adjustments to their own measure of underlying earnings. While it noted that companies are not shy to disclose non-IFRS measures, the respondent would prefer common guidance in the interest of transparency. Another respondent (Linde) noted that there is a need to correct reported figures because the effects that occur after the application of IFRS 3 requirements are counter-productive.

Other comments

One respondent (FRC staff) agreed that the inclusion of the step-ups fails to provide a fair reflection of the post-acquisition performance, because ‘fair value’, which is defined as an exit value, is not a relevant measurement basis for items such as inventory. Another respondent (Linde) noted that these effects have to be explained to users and to be ‘adjusted’ which shows that the use of fair value may not provide the most useful information. Another respondent (Mr. Chua) noted that, if there is an issue, it concerns all fair value adjustment made in accounting for the business combination and not only those on assets expected to be sold in the operating cycle.

Question 2

Which of the alternatives illustrated in the paper do you support? What is your reasoning?

Alternatives considered in the paper

The paper assessed the following alternatives to provide information:

(a) Disaggregating the cost of goods sold and presenting the impact of the step-ups in a separate line item of the statement of comprehensive income;

(b) Offsetting the revenue and cost of goods sold for the performance completed by the acquiree until the acquisition date;

(c) Presenting cost of goods sold based on the acquiree’s carrying amounts in profit or loss and the reversal of the step-ups in other comprehensive income;

(d) Disclosing the information necessary to users interested to make the adjustment;

(e) Disclosing adjusted non-IFRS measures.

No respondent supported (b) or (c). It was noted that offsetting would reduce transparency about the effects of the acquisition. The use of OCI was considered having no conceptual basis.

All the four respondents that did not support having a requirement indicated that entities could provide information in the notes, rather than in profit or loss.

Of the two respondents that supported having a requirement, one preferred alternative (d) and one suggested having a 3-column profit or loss showing the ‘before PPA effects’ reconciled to the ‘after PPA effects’ as it believes that disclosures are much less prominent that displaying the impact in the primary statement.

APPENDIX 1 – List of respondents

Respondent	*Country*	*Type*
CFA Society	UK	Professional Organisation of Users
Dutch Accounting Standards Board	Netherlands	National Standard Setter
Linde	Germany	European Company - Preparer
Mr. Kim Chiu Chua	Singapore	Individual – Accountant
The staff of FRC	UK	National Standard Setter Staff
Norwegian Accounting Standards Board	Norway	National Standard Setter