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March 30, 2015

shuru.su@ardf.org.tw
Accounting Research and Development Foundation, Taiwan
20th. Fl. No. 17 Sec. 1, Chengde Rd.
Taipei, Taiwan

RE: Outreach request to IFASS: Issue on goodwill recognition

Dear Board Members,

The Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee)1 welcomes the opportunity to respond to the Outreach request to IFASS: Issue on goodwill recognition proposed by the Accounting Research and Development Foundation, Taiwan.

We are a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies.

Background

The main shareholders of Entity B intended to re-organize the entity so they collaborated with a private equity firm C to initiate an acquisition. In July 2007, Entity A was formed by those shareholders and the private equity firm C for the purpose of acquiring Entity B, a listed company at that time. In the same month, Entity A borrowed from banks nearly 60% of the funds needed to acquire Entity B and launched a tender offer to purchase the common stocks of Entity B at a high premium. By the October of the same year, it had obtained 88% of Entity B's common stocks. In March 2008, Entity A obtained the remaining 12% of Entity B's common stocks. Subsequently, Entity B was delisted and absorbed into Entity A. In April 2008, Entity A changed its name to "B". Before the acquisition, those shareholders held 20.79% of the original Entity B's common stocks; after the acquisition, those shareholders hold 59% of the new Entity B's common stocks.

Issue

Should any goodwill be recognized from the arrangement of the acquisition in the new Entity B?

[1] The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).

COMITÊ DE PRONUNCIAMENTOS CONTÁBEIS

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View of the Accounting Research and Development Foundation

The new Entity B shall not recognize any goodwill arising from the acquisition as an asset.

The paragraph 4.6 of Conceptual Framework states that "In assessing whether an item meets the definition of an asset, liability or equity, attention needs to be given to its underlying substance and economic reality and not merely its legal form.", the paragraph B18 of IFRS 3 states that "A new entity formed to effect a business combination is not necessarily the acquirer." and the paragraph 48 of IAS 38 specifies that "Internally generated goodwill shall not be recognized as an asset."

The combined entity shall apply the concepts in Conceptual Framework when determining the appropriate accounting treatment for the acquisition transaction. That is, the combined entity shall consider substance over legal form regarding the acquisition. Although Entity A is the surviving company in terms of legal entity status, the original Entity B is the surviving company in substance. The new Entity B is a continuation of the original Entity B as evidence through the purpose of the acquisition, as well as the fact that Entity A was formed simply to effect the transaction without its own business activities and its change in name shortly after the merge. Because the new Entity B in substance is a continuation of the original Entity B, it shall not recognize any goodwill arising from itself simply because of how the acquisition or reorganization activities mentioned above were executed in form or order.

Question

Do you agree with our view described above?

We believe that more information is needed in order to have a proper response to this question. The conclusion depends on who controlled Entity B prior to the reorganization. If there is no controlling entity, being a diluted control company, which seems to be the case given that the main shareholders searched for a private equity fund and banks to finance the acquisition, we can conclude that this is a true business combination (leverage buy-out), requiring the application of the acquisition method of accounting described in IFRS 3. In the other hand, in case the main shareholders holding 20.79% of the shares already controlled the entity prior to the reorganization under the concepts of IFRS 10, we believe that there was no change in control, and thus, this transaction should be considered a business combination under common control.

We also believe that the current IFRS literature already addresses such scheme, mainly if the transaction is qualified as a true business combination under IFRS 3.

If you have any questions about our comments, please contact us at operacoes@cpc.org.br.

Yours sincerely,

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Silvio Takahashi
Chair of International Affairs
Comitê de Pronunciamentos Contábeis (CPC)