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A Discussion of

Economic Consequences of Purchase Price Allocation Reporting

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Overview

- Research question: Does purchase price allocation under IFRS 3 provide information useful for equity investors?
- Well motivated: an important issue with the potential to provide valuable information for post-implementation review of IFRS 3 and future standard-setting.
- Sample: German public firms, 2004-2014.

Overview

- Key findings:
  - PPAIA is negatively associated with information asymmetry.
    - Proxies for info asymmetry: bid-ask spread, cost of capital, share turnover, analyst following, analyst forecast error.
    - PPAIA: the proportion of purchase price allocated to fair valued identifiable net assets (PPAIA = 1 - Goodwill%).
  - Results appear to be concentrated in firms that are subject to less pressure for earnings management.
- Conclusion: *Diligent* implementation of IFRS 3 is beneficial to investors.

Comment 1: Diligent/diligence - meaning

- Diligent/diligence appears 39 times in the paper.
  - Authors expect a "diligent implementation of IFRS 3" to be associated with lower information asymmetry (p.19).
- What is the definition of a "diligent implementation of IFRS 3"? Does it refer to
  - Inputs, e.g., preparers' effort, or
  - Outputs, e.g., accuracy (free from errors), objectivity (free from biases), or level of disaggregation, etc.
- More elaboration can be helpful.
  - Important for preparers (providing information) and investors (processing information).
  - Important for policy implications of this study.

Comment 2: Diligent/diligence - measurement

- PPAIA ("measure of purchase price allocation *diligence"*): purchase price allocated to fair valued identifiable net assets/ total purchase price (PPAIA = 1 – Goodwill %).
- Why does higher PPAIA (lower Goodwill %) indicate higher diligence or higher purchase price information quality?
  - ➢ To what extent is this related to managers' tendency to over-allocate to goodwill, as driven the differential treatment of goodwill (impairment test) and identifiable intangible assets (amortization)? Or other arguments?
  - ➢ This should be an essential part of the conceptual analyses.
- A related question: how much of PPAIA is driven by the economics of the acquisitions, as opposed to diligent implementation of IFRS 3?
  - ➢ Acquisitions that involve targets with more identifiable assets can be naturally easier to understand and therefore cause less information asymmetry in equity markets.
  - ➢ In other words, acquisitions with more purchase price attributable to synergy or overpayment (goodwill) can be inherently more risky/uncertain in terms of future cash flow implications.

Comment 3: PPAIA and disaggregation

- The paper emphasizes the importance of disaggregation as a potential driver of the benefits of IFRS 3 purchase price allocation, which I agree with.
- But PPAIA, in itself, is an aggregated measure.
- The paper shows a positive correlation between PPAIA and two measures of disaggregation in purchase price (purchase price disaggregation and purchase price disclosure score).
  - ➢Question: if purchase price disaggregation and purchase price disclosure score are more direct measures of disaggregation or information quality, why not involve them more directly in the main analyses?
  - ➢Alternatively, if there are conceptual reasons for us to focus on PPAIA, elaboration is needed.

Comment 4: Why do results vary between firms with more/less pressure for earnings management?

- Table 9: association between PPAIA and measures of information asymmetry and cost of capital is concentrated in firms under less pressure to manage earnings.
- To what extent is this result related to the differential accounting treatment between goodwill and identifiable intangible assets?
  - As suggested in the literature, differential accounting treatment for goodwill (impairment test) and identifiable intangible assets (amortization) potentially provides an incentive to distort the fair value estimates and purchase price allocation.
  - The answer to this question can have important policy implications.

Comment 5: The setting of German firms

- Legal institutions can have important effects on financial markets (La Porta et al. 1998, etc.).
- Different aspects of legal institutions can have complementary effects on each other and on the implementation effectiveness of accounting standards.
- IFRS is in use in jurisdictions that are different in various ways: rule of law, protection of minority shareholders, efficiency of judicial system, and regulatory oversight.
  - For this paper, some discussions can help readers to use German evidence to draw inferences about potential IFRS 3 implementation effects in other jurisdictions.
  - For future studies, more evidence from other jurisdictions can be valuable.

Comment 6: Miscellaneous items

- Table 5A, value relevance analyses:
  - What are the expected coef. on FVDIF_oth, FVDIF_INT, and GW based on theories?
  - Why are the three coef. so much larger than one?
  - Why is the coef. on GW (5.167) so much larger than those on FVDIF_oth (1.878) and FVDIF_INT (1.992)?
- Table 3B, negative association between PPAIA and future goodwill impairment: how much of this is mechanical because PPAIA=1-GW%?

Thank you!

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