



International Accounting Standards Board®

Press Release

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IASB completes the second phase of the business combinations project

The International Accounting Standards Board (IASB) has completed the second phase of its business combinations project by issuing today a revised version of IFRS 3 *Business Combinations* and an amended version of IAS 27 *Consolidated and Separate Financial Statements*. The new requirements take effect on 1 July 2009, although entities are permitted to adopt them earlier.

The project was undertaken jointly with the US Financial Accounting Standards Board (FASB). The objective was to develop a single high quality accounting standard that would ensure that the accounting for business combinations is the same whether an entity is applying International Financial Reporting Standards (IFRSs) or US generally accepted accounting principles (GAAP).

Business combinations are an important feature of the capital markets. Over the past decade the average annual value of corporate acquisitions worldwide has been the equivalent of 8-10 per cent of the total market capitalisation of listed securities.

In publishing its equivalents to IFRS 3 and IAS 27, the FASB has made fundamental changes to its accounting for business combinations, most of which bring US accounting into line with the existing IFRS 3 and IAS 27. Other improvements will change both IFRSs and US GAAP. The revised IFRS 3 reinforces the existing IFRS 3 model but remedies problems that have emerged in its application.

Commenting on today's announcement, Sir David Tweedie, IASB Chairman, said:

Investors and their advisers have a difficult enough job assessing how the activities of the acquirer and its acquired business will combine. But comparing financial statements is more difficult when acquirers are accounting for acquisitions in different ways, whether those differences are a consequence of differences between US GAAP and IFRSs or because IFRSs or US GAAP are not being applied on a consistent basis.

Now the accounting requirements in IFRSs and US GAAP will be substantially the same, thanks largely to the changes that the FASB has made to US GAAP. The changes to IFRSs have, in contrast, been relatively small.

The IASB is also publishing a *Project Summary and Feedback Statement* and an assessment of the likely effect of the new requirements. These innovations are designed to help those who sent comments to the IASB to understand how their comments affected the IASB's thinking and to assist regulators that undertake impact assessments when IFRS requirements change. The new requirements will also be the subject of the IASB's recently introduced post-implementation review process.

The revised IFRS 3 and the amended IAS 27 are available for eIFRS subscribers from today. Those wishing to subscribe to eIFRSs should visit the online shop at www.iasb.org or contact:

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30 Cannon Street, London EC4M 6XH, United Kingdom.
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Printed copies of IFRS 3 and IAS 27 (ISBN for the set 978-1-905590-44-5) are available, at £18.00 plus shipping, from the IASC Foundation Publications Department.

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Notes for editors

History

The business combinations project became part of the initial agenda of the IASB when it was formed in 2001. The project was split into two phases. The first phase was short-term, addressing pooling of interests and goodwill impairment and amortisation in a replacement of

IAS 22 *Business Combinations*. The second phase took a broader look at business combination accounting and was undertaken with the FASB.

The FASB issued its equivalent standards SFAS 141(R) *Business Combinations* and SFAS 160 *Noncontrolling Interests in Consolidated Financial Statements* on 4 December 2007.

Changes to IFRSs

The revised IFRS 3 and amended IAS 27 incorporate many changes from the exposure drafts as a result of the IASB debating the proposals in the light of comments received during its consultations. The main changes that the revised IFRS 3 and amended IAS 27 will make to the existing requirements or practice are described below.

Step and partial acquisitions

The requirement to measure at fair value every asset and liability at each step in an acquisition that is achieved in stages (ie when an acquirer has an existing holding and acquires additional shares to achieve control) has been removed. These valuations were necessary to calculate goodwill. Instead, goodwill is now measured as the difference at the acquisition date between the value of any investment in the business held before the acquisition, the consideration transferred and the net assets acquired.

For a business combination in which the acquirer achieves control without buying all of the equity of the acquiree, the remaining (non-controlling) equity interests are measured either at fair value or at the non-controlling interests' proportionate share of the acquiree's net identifiable assets. Previously, only the latter was permitted. Allowing this choice was a change from the proposal that was made in response to concerns expressed by many respondents and allows entities either to continue to measure non-controlling interests as they are calculated in the original IFRS 3 or to measure them at fair value, which is the requirement in US GAAP.

Transparency and comparability

Acquisition-related costs—such as fees paid to investment banks—must be accounted for separately from the business combination, which usually means that they are recognised as expenses (rather than included in goodwill).

An acquirer must recognise at the acquisition date a liability for additional consideration (contingent consideration). Changes in the value of that liability after the acquisition date are recognised in accordance with other IFRSs, as appropriate, rather than by adjusting goodwill. The disclosures required to be made in relation to contingent consideration have been enhanced.

New guidance to address diverging practice

New requirements have been included to specify that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions, remedying a deficiency in the existing IAS 27 that has resulted in up to six methods being applied in practice.

The requirements have been clarified for how the acquirer accounts for some of the assets and liabilities acquired in a business combination that had been proving problematic—

replacing the acquiree's share-based payment awards; being indemnified by the seller; embedded derivatives; cash flow hedges; and operating leases.

Other improvements

Business combinations involving only mutual entities and business combinations achieved by contract alone are now within the scope of IFRS 3. This ensures that the accounting for an important part of M&A activity for which there have been no IFRS requirements will be consistent with the accounting for other M&A activity.

An entity must attribute a share of any losses to the non-controlling interests even if this results in the non-controlling interests having a deficit balance. Previously, any deficit in the non-controlling interests was allocated to the other equity interests.

Requirements have been added to specify how, upon losing control of a subsidiary, an entity measures any resulting gain or loss and any investment retained in the former subsidiary.

Eliminating the differences between IFRSs and US GAAP

The changes described above were also changes that the FASB made to US GAAP.

Changes to US GAAP

The changes made by the FASB to US GAAP are more fundamental than the changes the IASB has made to IFRSs. Among the more significant of the changes made by the FASB, all of which bring US GAAP into line with existing IFRSs, are:

- classifying non-controlling interests as equity.
- requiring restructuring charges to be accounted for as they are incurred, rather than allowing these to be anticipated at the time of the business combination.
- requiring in-process research and development (IPR&D) to be recognised as a separate intangible asset, rather than immediately written off as an expense.
- aligning the acquisition date with the date control is achieved (at present US GAAP uses the agreement date).
- recognising a gain on a bargain purchase in income (rather than by allocating it to some of the assets acquired).

Remaining differences

The boards were not able to eliminate all differences between the existing IFRS 3 and IAS 27 and their US GAAP equivalents.

Different conclusions

The IASB reached decisions different from those reached by the FASB in relation to two matters—the measurement of non-controlling interests and three disclosure items. The revised IFRS 3 permits an acquirer to measure the non-controlling interests in an acquiree either at fair value or at their proportionate share of the acquiree's identifiable net assets whereas SFAS 141(R) *Business Combinations*—the US equivalent of IFRS 3—requires the non-controlling interests in an acquiree to be measured at fair value.

Legacy differences between other IFRSs and US GAAP

Other differences remain because of the boards' decision to provide guidance for accounting for business combinations that is consistent with other IFRSs or US GAAP. Many of those differences are being considered in current projects or are candidates for future convergence projects, which is why the boards allowed those differences to continue at this time.

The boards have different definitions of control, because of differences between their consolidations standards. As a consequence it is possible that a transaction that is a business combination in accordance with the revised IFRS 3 might not be a business combination in accordance with SFAS 141(R). The IASB has a separate project in which the definition of control is being examined. It expects, as a first step, to publish a discussion paper in 2008.

The revised IFRS 3 carries forward the definition of *fair value* from the existing version, which is based on an exchange value. US GAAP defines *fair value* as an exit value. The IASB has a separate project in which it is considering the definition of fair value and related measurement guidance.

The boards have very similar requirements for recognising and measuring assets and liabilities arising from contingencies, both initially and after the acquisition. However, differences between the criteria for initial recognition (IFRS 3 has a 'reliable measurement' threshold whereas SFAS 141(R) has a 'more likely than not' threshold for non-contractual liabilities) might lead to some differences in application. The IASB has an ongoing project to amend or replace the relevant IFRS—IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.