

## Proposed amendments to IFRS 3

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) recently issued Exposure Drafts (EDs) proposing changes that will significantly affect accounting for business combinations. The EDs are the result of the standard setters' first major joint project and reflect the Boards' objective to create a single high-quality standard for business combinations that can be used for both domestic and cross-border financial reporting. The EDs have recently ended the comment period and have generated substantial discussion around the world. Respondents have suggested that the comment period be extended and have also pointed out that the EDs propose fundamental changes to the Standards, which were already recently revised.

The proposed joint Standard would apply to a wider range of business combinations than the current Standards and include combinations achieved by contract alone or involving only mutual entities. The fundamental requirements of IASB's IFRS 3 and FASB's Statement 141 to account for all business combinations using a single method (with one party always identified as acquiring the other) remain the same in the ED. However, the EDs propose numerous controversial changes to current practices under both IFRS and U.S. GAAP.

One of the principal changes being proposed would require the acquiree to be measured at full fair value, even if the business combination is achieved in stages or if less than 100% of the equity of the acquiree is acquired. Both IFRS and US GAAP currently require measurement on the basis of accumulated cost. The EDs propose recognition of all goodwill, including the amount attributable to non-controlling interests (previously called minority interests). This would bring IFRS into line with the current US GAAP position. At present IFRS 3 requires calculation of goodwill as the difference between the cost to the acquirer and the acquirer's proportion of the fair value of the assets acquired and liabilities assumed. Also proposed in the ED are fewer exceptions to measuring the assets acquired and liabilities assumed in a business combination at fair value. Only three groups of assets are excluded, namely:

- Goodwill
- Assets held for sale, deferred tax and employee benefit plans; all of which are measured in accordance with other IFRS
- Operating leases on market terms

Direct costs of the acquisition such as consulting, legal, audit, and similar services would in general be expensed under the new Standard rather than capitalised. This is a change to both IFRS 3 and US GAAP which currently allow direct costs to be included in the cost of the acquiree.

The EDs also propose changes to the treatment of negative goodwill; that is when the fair value of assets acquired exceeds the consideration. In this instance, it is proposed that US GAAP adopts the IFRS position with any excess being taken to profit. Currently, under US GAAP, the fair values of assets acquired are reduced pro rata by any excess.



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The IASB and FASB have also issued related Exposure Drafts that propose (a) the classification of non-controlling interests as equity within the consolidated financial statements and (b) accounting for acquisitions of non-controlling interests as equity transactions. In addition, joint work on the business combinations project has resulted in a new perspective regarding contingent assets and liabilities. An Exposure Draft of proposed changes to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* has been issued, with one of the alterations a suggested modification in title to be IAS 37 *Non-financial Liabilities*.

Based on the proposed effective date in the ED, changes in accounting for business combinations would affect most entities beginning in 2007. However, considering early reactions to the proposed content, the IASB and FASB will need to respond to constituent concerns and pursue an aggressive schedule in order to meet the goal of issuing a joint final Standard in 2006.

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