

Business combinations

The IASB completed the second phase of its business combinations project earlier this year, after considerable delay. The development of the standard has been controversial, and questions have been raised about how quickly this will be endorsed in the EU. The topic is considered critical, as business combinations are such a prominent feature of the capital markets – their annual value is equivalent to around 10% of the worldwide market capitalisation of listed securities.

The revised standard – IFRS 3 (revised) – will increase the use of fair value through the income statement and cement the ‘economic entity’ view of the reporting entity. The changes will take effect on 1 July 2009, although they can be adopted earlier.

‘Investors and their advisers have a difficult enough job assessing how the activities of the acquirer and its acquired business will combine,’

said IASB chairman Sir David Tweedie. ‘But comparing financial statements is more difficult when acquirers are accounting for acquisitions in different ways. Now the accounting requirements in IFRSs and US GAAP will be substantially the same.’

However, many commentators objected to the IASB’s proposals. The IASB pressed ahead, making only limited changes and, for the first time, published a feedback statement summarising public comments and seeking to explain how they influenced the final standard. Commentators can now consider whether this statement adequately explains the board’s rationale for rejecting adverse comment and whether this new process strengthens the board’s accountability to stakeholders.

One of the key challenges for companies will be explaining a different and more volatile income statement to

users of financial statements. Provisions in the standard that will affect the income statement at the time of acquisition and afterwards include:

- Transaction costs to be expensed
- Pre and post consolidation interests to be fair valued through income
- Changes in estimates of earn-out payments are income or expense

Mary Dolson, leader of PwC’s global business combinations IFRS team, said: ‘Companies should look at their acquisition structures and model post-acquisition earnings under the new standard. They may want to re-consider payment structures to mitigate undesirable income statement volatility.’

[The feedback statement on IFRS 3 \(revised\) is available on the IASB’s website www.iasb.org](http://www.iasb.org)