IFRS 3 (Revised):
Impact on earnings
The crucial Q&A for decision-makers
Adopting IFRS – A step-by-step illustration of the transition to IFRS
Illustrates the steps involved in preparing the first IFRS financial statements. It takes into account the effect on IFRS 1 of the standards issued up to and including March 2004.

Financial instruments under IFRS
High-level summary of the revised financial instruments standards issued in December 2003, updated to reflect IFRS 7 in September 2006. For existing IFRS preparers and first-time adopters.

Financial Reporting in Hyperinflationary Economies – Understanding IAS 29
2006 update (reflecting impact of IFRIC 7) of a guide for entities applying IAS 29. Provides an overview of the standard’s concepts, descriptions of the procedures and an illustrative example of its application.

IFRS 3: Impact on earnings – the crucial Q&A for decision-makers
Guide aimed at finance directors, financial controllers and deal-makers, providing background to the standard, impact on the financial statements and business, and summary differences with US GAAP.

IFRS Disclosure checklist 2007
Outlines the disclosures required by all IFRSs published up to September 2006.

IFRS Measurement Checklist 2006
Outlines the measurement bases required by all IFRSs published up to September 2006.

IFRS for SMEs (proposals) – Pocket Guide 2007
Provides a summary of the recognition and measurement requirements in the proposed ‘IFRS for Small and Medium-Sized Entities’ published by the International Accounting Standards Board in February 2007.

IFRS Pocket Guide 2006
Provides a summary of the IFRS recognition and measurement requirements including currencies, assets, liabilities, equity, income, expenses, business combinations and interim financial statements.

IFRS News
Monthly newsletter focusing on the business implications of the IASB’s proposals and new standards.

IAS 39 – Achieving hedge accounting in practice
Covers in detail the practical issues in achieving hedge accounting under IAS 39. It provides answers to frequently asked questions and step-by-step illustrations of how to apply common hedging strategies.

Illustrative Consolidated Financial Statements
• Banking, 2006
• Corporate, 2007
• Insurance, 2006
Realistic sets of financial statements – for existing IFRS preparers in the above sectors – illustrating the required disclosure and presentation.

Illustrative Interim Consolidated Financial Statements for First-time Adopters – 2005
Realistic set of interim IFRS financial statements for first-time adopters. The financial statements for the six months ended June 2005 illustrate the disclosure and presentation required by all IFRSs published up to and including December 2004.

Share-based Payment – a practical guide to applying IFRS 2
Assesses the impact of the new standard, looking at the requirements and providing a step-by-step illustration of how to account for share-based payment transactions.

SIIC-12 and FIN 46R – The Substance of Control
Helps those working with special purpose entities to identify the differences between US GAAP and IFRS in this area, including examples of transactions and structures that may be impacted by the guidance.

Similarities and Differences – a comparison of IFRS and US GAAP
Presents the key similarities and differences between IFRS and US GAAP, focusing on the differences commonly found in practice. It takes into account all standards published up to August 2007.

Understanding financial instruments – A guide to IAS 32, IAS 39 and IFRS 7
Comprehensive guidance on all aspects of the requirements for financial instruments accounting. Detailed explanations illustrated through worked examples and extracts from company reports.
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Executive summary
Acquisitions (M&A) represent a core growth strategy for many companies. Accounting considerations shouldn’t drive acquisition decisions, but accounting can have a real impact on deal structures, on the planning and process that surround deals, and on communications with the marketplace.

Accounting for acquisitions has changed again. The International Accounting Standards Board (IASB) released a revised standard on business combinations in January 2008, accompanied by a revised standard on consolidated financial statements. The Financial Accounting Standards Board (FASB), the IASB’s US counterpart, has issued an almost identical standard on business combinations and a similar standard on consolidated financial statements.

Management that is charged with planning acquisitions or that oversees acquisition activity will want to understand the impact of the standards in areas such as deal structures, financial reporting and investor/analyst communications. This publication explores the more significant provisions of the standards and their implications for transaction decision-makers.

What are the main impacts? The new standards are expected to add to earnings volatility, making earnings harder to predict. The standards are also likely to:

- influence acquisition negotiations and deal structures in an effort to mitigate unwanted earnings impacts;
- potentially impact the scope and extent of due diligence and data-gathering exercises prior to acquisition;
- require new policies and procedures to monitor and determine changes in the fair value of some assets and liabilities;
- call for the early input of accountants and lawyers, and expand the call for valuation expertise; and
- influence the ‘how, when and what’ of stakeholder communications.

The table below sets out the potential impact for gains and losses on day 1, measurement of assets and liabilities in the acquisition balance sheet and income statement volatility on day 2 and beyond.

This publication aims to help dealmakers and preparers of financial statements communicate the consequences of a business combination on the current year’s financial statements and how a business combination may affect the future years’ earnings.
**Executive summary (continued)**

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1 Transactions with minority interests resulted in income statement effects under IAS 27, depending on an entity’s policy. There will be no effect on income under IAS 27 (Revised).
Questions and answers
Scope and applicability

The business combinations standard represents some significant changes for IFRS but is less of a radical change than the comparable standard in US GAAP. IFRS 3 (Revised) is a further development of the acquisition model. The standard now applies to more transactions, as combinations by contract alone and combinations of mutual entities are brought into the scope of the standard. Common control transactions and the formation of joint ventures remain outside the scope of the standard. The definition of a business has been amended slightly. It now states that the elements are “capable of being conducted” rather than ‘are conducted and managed’ to generate a return. This change is supplemented by a significant expansion of the application guidance. This may bring more transactions into acquisition accounting. Acquisition date does not change under IFRS; US GAAP will converge to the existing requirements of IFRS.

1. When will the new standard affect the financial statements?

IFRS 3 (Revised) is applied prospectively to business combinations occurring in the first accounting period beginning on or after 1 July 2009. It can be applied early but only to an accounting period beginning on or after 30 June 2007. IFRS 3 (Revised) and IAS 27 (Revised) are applied at the same time. Retrospective application to earlier business combinations is not permitted. As with other standards, IFRS 3 (Revised) and IAS 27 (Revised) cannot be applied by entities within the European Union until they are endorsed.

2. Has the scope of the standard changed?

Yes, it now includes combinations of mutuals and combinations by contract. This change in scope is not significant for many entities. High-profile combinations of mutual entities are uncommon, and combinations by contract (staplings) occur in Australia but are rarely seen elsewhere.

3. What about common control transactions?

Common control transactions remain outside the scope of the new standard. The IASB is starting a project on accounting for them, but a new standard is not expected soon. Entities choose a policy for such transactions. The most common are either applying IFRS 3 by analogy to other business combinations or using predecessor values by analogy to US and other GAAPs with similar frameworks. Entities should continue to use their existing policy for business combinations under common control.

Consideration

Consideration is the amount paid for the acquired business. Some of the most significant changes are found in this section of the revised standard. Individual changes may increase or decrease the amount accounted for as consideration. These affect the amount of goodwill recognised and impact the post-acquisition income statement. Transaction costs no longer form a part of the acquisition price; they are expensed as incurred. Consideration now includes the fair value of all interests that the acquirer may have held previously in the acquired business. This includes any interest in an associate or joint venture or other equity interests of the acquired business. If the interests in the target were not held at fair value, they are re-measured to fair value through the income statement.
Consideration (continued)

The requirements for recognition of contingent consideration have also been amended. Contingent consideration is now required to be recognised at fair value even if it is not deemed to be probable of payment at the date of the acquisition. All subsequent changes in debt contingent consideration are recognised in the income statement, rather than against goodwill as today.

4. The selling-shareholders will receive some share options. What effect will this have?

An acquirer may wish selling-shareholders to remain in the business as employees. Their knowledge and contacts can help to ensure that the acquired business performs well.

The terms of the options and employment conditions could impact the amount of purchase consideration and also the income statement after the business combination. Share options have a value. The relevant accounting question is whether this value is recorded as part of the purchase consideration, or as compensation for post-acquisition services provided by employees, or some combination of the two. Is the acquirer paying shareholders in their capacity as shareholders or in their capacity as employees for services subsequent to the business combination?

How share options are accounted for depends on the conditions attached to the award and also whether or not the options are replacing existing options held by the employee in the acquired business. Options are likely to be consideration for post-acquisition service where some of the payment is conditional on the shareholders remaining in employment after the transaction. In such circumstances, a charge is recorded in post-acquisition earnings for employee services. These awards are made to secure and reward future services of employees rather than to acquire the existing business.

5. Is it true that some business combinations will result in gains in the income statement?

Yes, it is. Any previous stake is seen as being ‘given up’ to acquire the business. A gain or loss is recorded on its disposal. If the acquirer already held an interest in the acquired entity before acquisition, the standard requires the existing stake to be re-measured to fair value at the date of acquisition, taking any movement to the income statement (together with any gains previously recorded in equity that relate to the existing stake). If the value of the stake has increased, there will be a gain to recognise in the income statement of the acquirer at the date of the business combination. A loss would only occur if the existing interest has a book value in excess of the proportion of the fair value of the business obtained – and no impairment had been recorded previously. This loss situation is not expected to occur frequently.

The standard also requires any gain on a ‘bargain purchase’ (negative goodwill) to be recorded in the income statement. This is not a change from previous requirements.

6. Some of the payments for the business are earn-outs. How are these accounted for?

It is common for some of the consideration in a business combination to be contingent on future events. Uncertainty might exist about the value of the acquired business or some of its significant assets. The buyer may want to make payments only if the business is successful. Conversely, the seller wants to receive full value for the business. Earn-outs are often payable based on post-acquisition earnings or on the success of a significant uncertain project.
Consideration (continued)

The acquirer should fair value all of the consideration at the date of acquisition including the earn-out. If the earn-out is a liability (cash or shares to the value of a specific amount), any subsequent re-measurement of the liability is recognised in the income statement. There is no requirement for payments to be probable, which was the case under IFRS 3. An increase in the liability for strong performance results in an expense in the income statement. Conversely, if the liability is decreased, perhaps due to under-performance against targets, the reduction in the expected payment will be recorded as a gain in the income statement.

These changes were previously recorded against goodwill. Acquirers will have to explain this component of performance: the acquired business has performed well but earnings are lower because of additional payments due to the seller.

7. Does it make a difference whether contingent consideration (an earn-out) is payable in shares or in cash?

Yes, it does make a difference. An earn-out payable in cash meets the definition of a financial liability. It is re-measured at fair value at every balance sheet date, with any changes recognised in the income statement.

Earn-outs payable in ordinary shares may not require re-measurement through the income statement. This is dependent on the features of the earn-out and how the number of shares to be issued is determined. An earn-out payable in shares where the number of shares varies to give the recipient of the shares a fixed value would meet the definition of a financial liability. As a result, the liability will need to be fair valued through income. Conversely, where a fixed number of shares either will or will not be issued depending on performance, regardless of the fair value of those shares, the earn-out probably meets the definition of equity and so is not re-measured through the income statement.

8. A business combination involves fees payable to banks, lawyers and accountants. Can these still be capitalised?

No, they cannot. The standard says that transaction costs are not part of what is paid to the seller of a business. They are also not assets of the purchased business that are recognised on acquisition. Transaction costs should be expensed as they are incurred and the related services are received.

The standard requires entities to disclose the amount of transaction costs that have been incurred.

9. What about costs incurred to borrow money or issue the shares used to buy the business. Do these also have to be expensed?

No, these costs are not expensed. They are accounted for in the same way as they were under the previous standard.

Transaction costs directly related to the issue of debt instruments are deducted from the fair value of the debt on initial recognition and are amortised over the life of the debt as part of the effective interest rate. Directly attributable transaction costs incurred issuing equity instruments are deducted from equity.
Questions and answers (continued)

Goodwill and non-controlling interests

The requirement to recognise ‘full goodwill’ in a business combination where the acquirer obtains a controlling interest but not 100% of the acquired business was one of the more controversial proposals in the exposure draft.

The revised standard gives entities the option, on a transaction-by-transaction basis, to measure non-controlling interests (previously minority interest) at the fair value of their proportion of identifiable assets and liabilities or at full fair value. The first will result in measurement of goodwill little different from existing IFRS 3; the second approach will record goodwill on the non-controlling interest as well as on the acquired controlling interest. The ‘bargain purchase’ guidance remains the same with the requirement to recognise ‘negative goodwill’ immediately in the income statement.

10. Does the type of consideration affect how much goodwill is recognised?

No, it does not. Regardless of how payments are structured, the consideration is recognised in total at its fair value at the date of the acquisition. Paying the same amount in today’s values in different ways will not make a difference to the amount of goodwill recognised.

The form of the consideration will not affect the amount of goodwill but the structure of the payments will have a significant effect on the post-acquisition income statement.

Payments that are contingent and deemed to be part of the acquisition price will be measured at fair value and included in the business combination accounting on day 1. Equity instruments that are contingent consideration are not subsequently re-measured. Debt instruments are subsequently re-measured through the income statement.

Changes in the carrying amount of contingent consideration will often not be offset by profits and losses of the acquired subsidiary. A substantial payment to the previous owners may be required if an in-process research and development (IPR&D) project meets key approval milestones. The successful IPR&D project may generate substantial profits over 20 years. The increased amounts due under the contingent consideration arrangement are likely to be recognised as an expense in the income statement before the project generates any revenue at all.

11. How is goodwill measured?

Goodwill continues to be a residual. It may well be a different residual under IFRS 3 (Revised) compared to the previous standard. This is partly because all of the consideration, including any previously held interest in the acquired business, is measured at fair value. It is also because goodwill can be measured in two different ways.

The first approach is similar to the method under current IFRS: goodwill is the difference between the consideration paid and the purchaser’s share of identifiable net assets acquired. This is a ‘partial goodwill’ method because the non-controlling interest is recognised at its share of identifiable net assets and does not include any goodwill. Goodwill can also be measured on a ‘full goodwill’ basis, described in the following question.
### Goodwill and non-controlling interests (continued)

#### 12. What is ‘full goodwill’?

Full goodwill means that goodwill is recognised in a business combination for the non-controlling (minority) interest in a subsidiary as well as the controlling interest. Under IFRS 3, minority interest was recognised at the minority’s share of net assets and did not include any goodwill. Full goodwill means that non-controlling interest and goodwill are both increased by the goodwill that relates to the non-controlling interest.

#### 13. When can full or partial goodwill be recognised?

The standard gives a choice for each separate business combination. An acquirer may either recognise non-controlling interest in the subsidiary at fair value, which leads to 100% of goodwill being recognised (full goodwill), or the acquirer can recognise non-controlling interest measured at the non-controlling interest in net assets excluding goodwill. This leads to goodwill being recognised only for the parent’s interest in the entity acquired, the same as under current IFRS 3 (partial goodwill).

This is one of the major differences with the US GAAP standard: under US GAAP, the non-controlling interest must be measured at fair value, and full goodwill is always recognised.

This choice only makes a difference in an acquisition where less than 100% of the acquired business is purchased. Few acquisitions of listed entities are for less than 100% of the equity shares. Business combinations where the entire business is acquired will result in goodwill being calculated in much the same way as it is under IFRS 3.

#### 14. What is the effect of recognising full goodwill?

Recognising full goodwill will increase reported net assets on the balance sheet. The potential downside is that any future impairment of goodwill will be greater. Impairments of goodwill should not occur with greater frequency, as the current impairment test is adjusted for a less than wholly owned subsidiary.

Measuring non-controlling interest at fair value may prove difficult in practice. However, goodwill impairment testing may be easier under full goodwill, as there is no need to gross-up goodwill for partially owned subsidiaries.

A company planning a cash buy-out of the non-controlling interest in a subsidiary at a future date may want to record non-controlling interest at fair value and recognise full goodwill in a business combination. If the non-controlling interest is later purchased, there will be a lower difference between the consideration paid for the non-controlling interest and its recorded value, and thus a smaller percentage reduction of equity.
Questions and answers (continued)

**Asset and liability recognition**

The revised IFRS 3 has limited changes to the assets and liabilities recognised in the acquisition balance sheet. The existing requirement to recognise all of the identifiable assets and liabilities of the acquiree is retained. Most assets are recognised at fair value, with exceptions for certain items such as deferred tax and pension obligations.

15. Have the recognition criteria changed for intangible assets?

No, there is no change in substance. Acquirers are required to recognise brands, licences and customer relationships, amongst other intangible assets. The IASB has provided additional clarity that may well result in more intangible assets being recognised, including leases that are not at market rates and rights (such as franchise rights) that were granted from the acquirer to the acquiree.

16. What happens to the contingent liabilities of the acquired business?

Many acquired businesses will contain contingent liabilities – for example, pending lawsuits, warranty liabilities or future environmental liabilities. These are liabilities where there is an element of uncertainty; the need for payment will only be confirmed by the occurrence or non-occurrence of a specific event or outcome. The amount of any outflow and the timing of an outflow may also be uncertain.

There is very little change to current guidance under IFRS. Contingent assets are not recognised, and contingent liabilities are measured at fair value. After the date of the business combination contingent liabilities are re-measured at the higher of the original amount and the amount under the relevant standard, IAS 37. US GAAP has different requirements in this area.

Measurement of contingent liabilities after the date of the business combination is an area that may be subject to change in the future (see question 25).

17. If consideration paid and most assets and liabilities are at fair value, what does this mean for the post-combination income statement?

Fair valuation of most things that are bought in a business combination already existed under IFRS 3. The post-combination income statement is affected because part of the ‘expected profits’ is included in the valuation of identifiable assets at the acquisition date and subsequently recognised as an expense in the income statement, through amortisation, depreciation or increased costs of goods sold.

A mobile phone company may have a churn rate of three years for its customers. The value of its contractual relationships with those customers, which is likely to be high, will be amortised over that three-year period.

There may be more charges in the post-combination income statement due to increased guidance in IFRS 3 (Revised) on separating payments made for the combination from those made for something else. For example, guidance has been included on identifying payments made for post-combination employee services and on identifying payments made to settle pre-existing relationships between the buyer and the acquiree.

With contingent consideration that is a financial liability, fair value changes will be recognised in the income statement. This means that the better the acquired business performs, the greater the likely expense in profit or loss.
18. Can a provision be made for restructuring the target company in the acquisition accounting?

The acquirer will often have plans to streamline the acquired business. Many synergies are achieved through restructurings such as reductions in head-office staff or consolidation of production facilities. An estimate of the cost savings will have been included in the buyer’s assessment of how much it is willing to pay for the acquiree.

The acquirer can seldom recognise a reorganisation provision at the date of the business combination. There is no change from the previous guidance in the new standard: the ability of an acquirer to recognise a liability for terminating or reducing the activities of the acquiree in the accounting for a business combination is severely restricted.

A restructuring provision can be recognised in a business combination only when the acquiree has, at the acquisition date, an existing liability, for which there are detailed conditions in IAS 37, the provisions standard.

Those conditions are unlikely to exist at the acquisition date in most business combinations. A restructuring plan that is conditional on the completion of the business combination is not recognised in the accounting for the acquisition. It is recognised post-acquisition, and the expense flows through post-acquisition earnings.

19. What might adjust goodwill and over what period?

An acquirer has a maximum period of 12 months to finalise the acquisition accounting. The adjustment period ends when the acquirer has gathered all the necessary information, subject to the one year maximum. There is no exemption from the 12-month rule for deferred tax assets or changes in the amount of contingent consideration.

20. The seller will be giving an indemnity on a tax exposure. How will this be accounted for?

An indemnity is a promise by the seller to reimburse the buyer for liabilities of uncertain amount or likelihood. The indemnity is recognised as an asset of the acquiring business. It is measured according to the terms of the contract and it is limited to the amount of the indemnified liability. This applies to all indemnities for specific contingencies or liabilities.
Other issues

There is additional guidance on accounting for employee share-based payments in the revised standard. It provides additional specificity on valuation as well as determination of whether replacement share awards are part of the consideration for the business combination or may be compensation for post-combination services.

The revised standard includes additional guidance with regard to contracts and arrangements of the acquired business at the balance sheet date. Leases and insurance contracts are assessed based on the facts at the time they were entered into (or subject to substantial modification). All other contracts are assessed for classification at the date of the acquisition.

Current guidance requires deferred tax assets of the acquired business that are not recognised at the date of the combination but subsequently meet the recognition criteria to be adjusted against goodwill. The revised standard will only allow adjustments against goodwill within the one-year window for finalisation of the purchase accounting.

21. Are there any changes to deferred tax accounting?

Yes. The main change relates to the recognition of acquired deferred tax assets after the initial accounting for the business combination is complete; this will have an impact on the income statement.

Adjustments to deferred tax assets will only affect goodwill if they are made within the 12-month period for finalising the business combinations accounting and if they result from new information about facts and circumstances that existed at the acquisition date. After the 12-month period, adjustments are recorded as normal under IAS 12, through the income statement or the statement of changes in equity, as appropriate.

22. Is there more clarity around classification and reassessment of contracts and other arrangements?

Yes, there is. IFRS 3 was silent on what to do with leases, purchase and sale contracts, insurance contracts and hedges. The new standard clarifies that all assessments such as the determination of, for example, embedded derivatives are made based on the facts at the date of the business combination. The only exceptions are leases and insurance contracts. These are generally assessed and classified based on conditions at the inception date of the contract.
### Other issues (continued)

**23. Will the financial statements grow through additional disclosures?**

The financial statements will be longer than before and even more detailed. An acquisitive company might be adding three pages per transaction.

Some of the new disclosure requirements are:
- the amount of acquisition-related costs expensed and the income statement line item in which that expense is reported;
- the measurement basis selected and the recognised amount of non-controlling interests in the acquiree;
- where non-controlling interest is measured at fair value, the valuation techniques and key model inputs used for determining that value;
- details of transactions that are separate from the acquisition of assets and assumption of liabilities in exchange for the acquiree;
- in a step acquisition, disclosure of the fair value of the previously held equity interest in the acquiree and the amount of gain or loss recognised in the income statement resulting from remeasurement; and
- information about receivables (fair value, gross contractual amounts receivable and best estimate of cash flows not expected to be collected at the acquisition date).

**24. Do previous transactions need to be restated?**

No. Business combinations and transactions with minorities that occurred prior to the adoption of IFRS 3 (Revised) and IAS 27 (Revised) are not restated. The standards are to be applied prospectively to all transactions for which the transaction date is on or after the first accounting period beginning on or after 1 July 2009 or the date of early adoption, if elected.

Some future accounting related to previous business combinations will change once the standard is adopted. Deferred tax assets that are recognised relating to a previously acquired business will be accounted for under the new standard. Instead of affecting goodwill, they will be recognised in profit or loss (see question 21). The purchase or sale of a non-controlling interest that existed at the date of adoption of IFRS 3 (Revised) and IAS 27 (Revised) may also be different (see question 29).

**25. Are there more changes to come?**

Possibly, although the timing of any change is uncertain. The IASB has added a project to its agenda to address the treatment of business combinations involving entities under common control.

The Fair Value Measurement Project (a discussion paper was released in December 2006) is still in progress and might affect the definition of fair value as currently contained in IFRS 3 (Revised). There are other ongoing projects on some standards that are linked to business combinations (notably IAS 37 on provisions and IAS 12 on deferred tax) that may affect either the recognition or measurement at the acquisition date or the subsequent accounting.
Questions and answers (continued)

Changes to IAS 27 (Revised) - new proposals on minority interests and disposals

The revised consolidation standard moves IFRS to a mandatory adoption of the economic entity model. Current practice under IFRS is overwhelmingly the parent company approach. The economic entity approach treats all providers of equity capital as shareholders of the entity, even when they are not shareholders in the parent company. The parent company approach sees the financial statements from the perspective of the parent company shareholders.

A partial disposal of an interest in a subsidiary in which the parent company retains control does not result in a gain or loss but in an increase or decrease in equity under the economic entity approach. Purchase of some or all of the non-controlling interest is treated as a treasury transaction and accounted for in equity. A partial disposal of an interest in a subsidiary in which the parent company loses control but retains an interest (say an associate) triggers recognition of gain or loss on the entire interest. A gain or loss is recognised on the portion that has been disposed of; a further holding gain is recognised on the interest retained, being the difference between the fair value of the interest and the book value of the interest. Both are recognised in the income statement.

26. What happened to minority interest?

All shareholders of a group – whether they are shareholders of the parent or of a part of the group (minority interest) – are providers of equity capital to that group. All transactions with shareholders are treated in the same way. What was previously the minority interest in a subsidiary is now the non-controlling interest in a reporting entity.

There is no change in presentation of non-controlling interest under the new standard. Additional disclosures are required to show the effect of transactions with non-controlling interest on the parent-company shareholders.

27. What happens if a non-controlling interest is bought or sold?

Any transaction with a non-controlling interest that does not result in a change of control is recorded directly in equity; the difference between the amount paid or received and the non-controlling interest is a debit or credit to equity. This means that an entity will not record any additional goodwill upon purchase of a non-controlling interest nor recognise a gain or loss upon disposal of a non-controlling interest.

28. How is the partial sale of a subsidiary with a change in control accounted for?

A group may decide to sell its controlling interest in a subsidiary but retain significant influence in the form of an associate, or retain only a financial asset. If it does so, the retained interest is remeasured to fair value, and any gain or loss compared to book value is recognised as part of the gain or loss on disposal of the subsidiary. Consistent with a ‘gain’ on a business combination (see question 5), the standards take the approach that loss of control involves exchanging a subsidiary for something else rather than continuing to hold an interest.
29. How does the new standard affect transactions with previously recognised non-controlling interests?

An entity might purchase a non-controlling interest recognised as part of a business combination under the previous version of IFRS 3 – that is, where only partial goodwill was recognised. Alternatively, an entity might recognise partial goodwill under the new IFRS 3 (Revised) and might purchase a non-controlling interest at a later date.

In both cases, no further goodwill can be recognised when the non-controlling interest is purchased. If the purchase price is greater than the book value of the non-controlling interest, this will result in a reduction in net assets and equity. This reduction may be significant.
Differences between IFRS and US GAAP
Differences between IFRS and US GAAP

The business combinations standards (IFRS 3 (Revised) and FAS 141 (Revised)) are very close in principles and language, with two major exceptions: full goodwill, and the requirements around recognition of contingent assets and contingent liabilities. This will eliminate almost all of the current differences in the initial accounting for business combinations. Significant differences will remain in subsequent accounting. Different requirements for impairment testing and accounting for deferred tax are among the most significant.

The consolidation standards (IAS 27 (Revised) and FAS 160) are converged in the broad principles, but the standards have not been developed using the same language. Differences are expected to remain mainly from the operation of de facto control and consolidation of special purpose entities.

This section lists the most significant differences. Differences in subsequent accounting and disclosure requirements are not covered in this section.

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<tr>
<th>IFRS guidance</th>
<th>US GAAP guidance</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets and liabilities arising from contingencies</td>
<td></td>
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</tr>
<tr>
<td>Recognise contingent liabilities at fair value if fair value can be measured reliably. If not within the scope of IAS 39, measure subsequently at higher of amount initially recognised and best estimate of amount required to settle (under IAS 37). Contingent assets are not recognised.</td>
<td>Liabilities and assets subject to contractual contingencies are recognised at fair value. Recognise liabilities and assets subject to other contingencies only if more likely than not that they meet definition of asset or liability at acquisition date. After recognition, retain initial measurement until new information is received, then measure at the higher of amount initially recognised and amount under FAS 5 for liabilities subject to contingencies, and lower of acquisition date fair value and the best estimate of a future settlement amount for assets subject to contingencies.</td>
<td>Significant recognition and measurement differences at acquisition date. Some differences in subsequent measurement.</td>
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<tr>
<td>Employee benefit arrangements and deferred tax</td>
<td></td>
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</tr>
<tr>
<td>Measure in accordance with IFRS 2 and IAS 12, not at fair value.</td>
<td>Measure in accordance with SFAS 123 and SFAS 109, not at fair value.</td>
<td>Share-based payments guidance similar in principle, with differences in application detail. More differences in deferred tax but subject of a convergence project by IASB.</td>
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<tr>
<td>Non-controlling interest (NCI)</td>
<td></td>
<td></td>
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<tr>
<td>Measure at fair value or at NCI share of fair value of identifiable net assets.</td>
<td>Measure at fair value.</td>
<td>Significant difference to goodwill asset recognised in business combination accounting if IFRS entities elect not to measure NCI at fair value. Subsequent differences limited to amount of goodwill impairment.</td>
</tr>
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<tr>
<td>Contingent consideration</td>
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<tr>
<td>If not within scope of IAS 39, account for subsequently under IAS 37. Measure financial asset or liability contingent consideration at fair value, with changes recognised in earnings or other comprehensive income.</td>
<td>Measure subsequently at fair value, with changes recognised in earnings if classified as asset or liability.</td>
<td>Differences between expected settlement amount and fair value until consideration paid for non-financial contingent consideration.</td>
</tr>
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<tr>
<td>Lessor operating lease assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value of asset includes terms of lease.</td>
<td>Value lease separately from asset.</td>
<td>No effect on goodwill. Asset and liability classification difference.</td>
</tr>
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<tr>
<td>Early application</td>
<td></td>
<td></td>
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<tr>
<td>Permitted</td>
<td>Prohibited</td>
<td>Significant GAAP differences for IFRS early adopters.</td>
</tr>
</tbody>
</table>
The standard does not explicitly require additional systems and processes. However, there are a number of features of the standard that could have implications for systems and controls and the level of expertise required within an entity. Some of these are considered below:

- The standard requires any existing stakes in entities acquired to be re-measured to fair value; any resultant gain plus any previously recorded fair value movements taken to reserves are recorded in income. This will require detailed tracking on an investment-by-investment basis, including details of carrying amount and subsequent re-measurements.

- As before, many assets and liabilities will be measured at fair value, including intangible assets and contingent liabilities. The revised standard continues the requirement for identification of intangible assets, with very few intangibles being excluded from identification and valuation. The timely identification of the nature and possible value of intangible assets remains important, as this affects post-deal earnings. Indeed, where possible, the potential impact on earnings should be modelled pre-acquisition. This may affect the scope and timing of an acquirer’s due-diligence exercise.

- The standard clarifies the circumstances in which share-based payments affect goodwill or post-acquisition earnings. Entities will need to have systems to enable timely calculations of the value of replacement awards and those that they are replacing to ensure that the opening balance sheet and post-acquisition charges are appropriately modelled.

- Entities are required to redesignate all the acquiree’s hedge relationships and to test them for effectiveness.

- The new requirement that contingent consideration is fair valued at acquisition and, unless it is equity, is subsequently re-measured through earnings rather than the historic practice of re-measuring through goodwill, is likely to increase the focus and attention on the opening fair value calculation and subsequent re-measurements.

- Post-acquisition disclosures include annualised revenue and profit as if deals had been completed at the start of the financial year, analysis of acquired receivables’ gross contractual amounts and fair values and estimates of the range of outcomes on contingent consideration. None of these is likely to be easy to collect at short notice.

- If any part of the fair value exercise is not complete, disclosure is required of the items affected, the reasons why and any adjustments made to previously reported fair values.
Business implications (continued)

Much of the work outlined above requires valuations expertise. Most companies will not have depth of expertise in this area and may consider whether the expertise can be developed or expanded in-house or whether it will need to be sourced externally. Potential business combinations will require additional planning and resource.

Disclosures are required for material business combinations. Individually immaterial acquisitions may be aggregated for disclosure purposes. Even for business combinations completed after the end of the reporting period but before the financial statements are issued, many disclosures are required unless disclosure is impracticable and the reasons why it is impracticable are disclosed.
## IFRS surveys

**Presentation of income measures**  
Trends in use and presentation of non-GAAP income measures in IFRS financial statements.

**IFRS: The European investors’ view**  
Impact of IFRS reporting on fund managers’ perceptions of value and their investment decisions.

**Business review – has it made a difference?**  
Survey of the FTSE 350 companies’ narrative reporting practices. Relevant globally to companies seeking to benchmark against large UK companies.

**IFRS for SMEs – Is it relevant for your business?**  
It outlines why some unlisted SMEs have already made the change to IFRS and illustrates what might be involved in a conversion process.

## IFRS market issues

**IFRS 7: Ready or not**  
Key issues and disclosure requirements.

**IFRS 7: Potential impact of market risks**  
Examples of how market risks can be calculated.

**IFRS transition case studies**  
Companies in several industries share their experiences in making the change to IFRS. Orders for these flyers should be placed at global.ifrs.publications@uk.pwc.com.

**Making the change to IFRS**  
This 12-page brochure provides a high-level overview of the key issues that companies need to consider in making the change to IFRS.

## Corporate governance publications

**Audit Committees – Good Practices for Meeting Market Expectations**  
Provides PwC views on good practice and summarises audit committee requirements in over 40 countries.

**World Watch magazine**  
Global magazine with news and opinion articles on the latest developments and trends in governance, financial reporting, broader reporting and assurance.

**Building the European Capital Market – A review of developments – January 2007**  
This fourth edition includes the key EU developments on IFRS, the Prospectus and Transparency Directives, and corporate governance. It also summarises the Commission’s single market priorities for the next five years.

## To order copies of any of these publications, contact your local PricewaterhouseCoopers office or visit www.cch.co.uk/ifrsbooks

## IFRS tools

**Comperio**  
Your path to knowledge  
Online library of financial reporting and assurance literature. Provides the full text of IASB literature as well as ISAs, IAPS and IPSAS. Also contains PwC’s IFRS and corporate governance publications, and Applying IFRS. For more information, visit www.pwc.com/comperio

**P2P IFRS – from principle to practice**  
Interactive IFRS training  
PwC’s interactive electronic learning tool to bring people up to speed on IFRS. Contains 20 hours of learning in 37 interactive modules. Up to date as of October 2006. For more information, visit www.pwc.com/ifrs

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