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IASBriefing

Issue 9 January 2003

This issue of IAS Briefing covers the IASB's December meeting. It also reports on the new Exposure Draft ED 3 Business Combinations issued in December. Once final, the new IFRS will replace IAS 22 Business Combinations.

Amendments to IAS 32 and IAS 39

As a result of the feedback received on the proposed amendments to IAS 32 and IAS 39 the Board decided to hold public meetings during the week of 10 March 2003 to give those parties who commented on the amendments an opportunity to discuss their views. If a party has not yet commented but wants to participate, this is still possible until **17 January 2003**.

ED 3 Business Combinations

The objective of the IASB in proposing a new standard is to achieve convergence in accounting practice in this area. The proposed standard is largely consistent with the US standards on business combinations, although some differences may remain, subject to FASB further reconsideration in a few cases. The proposed significant changes to current practice are as follows:

Goodwill and other intangible assets

- *Goodwill* - The ED proposes that goodwill may no longer be amortised, but instead will be subject to an annual impairment test. The principles of IAS 36 *Impairment of Assets* will be applied to test for impairment; however, there are new proposed rules to measure the impairment charge.

  If impairment is identified, it should be measured by comparing the carrying amount of goodwill for a cash-generating unit (CGU) with its implied value. The implied value is the difference between the recoverable amount of a CGU and the fair value of the net assets at the date of the impairment test. In this respect the proposed model is broadly consistent with the US GAAP model, except that it is applied to cash-generating units (i.e. potentially at a lower level of detail than US GAAP).

  The exposure draft also prohibits reversal of charges for impairment of goodwill.

- *Negative goodwill* - negative goodwill will be recognised as a gain in the income statement immediately upon acquisition.

- *Other intangibles* - there are new criteria for the recognition of intangible assets acquired in a business combination, which are based much more on legal form than the current recognition criteria in IAS 38 Intangible Assets. Intangible assets with finite lives will continue to be amortised over their useful lives; however, the new proposed standard will not limit them. Intangible assets with indefinite lives will be subject to annual impairment testing in accordance with IAS 36.

- *In-process research and development (IPR&D)* - ED 3 proposes that IPR&D will be recognised as a separate acquired intangible asset. FASB will address its treatment of IPR&D (currently immediate write-off) to see if convergence with IFRS can be achieved.

Uniting of interests

ED 3 proposes eliminating the uniting of interests method of accounting for business combinations that currently is allowed in limited circumstances under IAS 22.

Liabilities

- *Restructuring provisions* - The ED proposes prohibiting recording any provisions for future restructuring unless the acquiree had an obligation prior to the acquisition. This will result in a difference between IFRS and US GAAP.

- *Liabilities triggered by the combination* - Obligations that are triggered by the business combination (e.g. "golden parachutes") should be recognised on acquisition and therefore included in the determination of goodwill.

- *Contingent liabilities* - Under the proposed IFRS, contingent liabilities of the acquiree will be recognised at fair value, and subsequently remeasured at fair value. Currently, contingent liabilities are not valued on acquisition, but are adjusted against goodwill if the liability recognition criteria are satisfied within a limited time period subsequent to the acquisition.

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Subsequent changes
The ED proposes limiting the goodwill adjustment period to 12 months from the date of the acquisition. Currently, under IAS 22, subsequent changes are allocated to goodwill if they occur within the first full annual reporting period after the acquisition.

Transition
The proposal requires the IFRS to be applied prospectively to business combinations after the date of issue of the (final) IFRS. However, there are three exceptions to this general rule in respect of negative goodwill, intangibles, and existing goodwill.

- *Negative goodwill* - Any negative goodwill existing at the adoption date must be derecognised from the balance sheet.

- *Intangibles* - Existing intangibles that do not meet the recognition criteria are reclassified as goodwill.

- *Existing goodwill* - Any goodwill existing at the effective date will be frozen and will no longer be amortised.

The IASB has requested comments by 4 April 2003.

Business Combinations (Phase II)
Beyond the above proposal the IASB (together with the US FASB) currently is discussing in a separate project the application of the purchase method of accounting.

For step acquisitions (successive share purchases) resulting in control, the Board tentatively decided to require entities to increase the carrying amount of the previous investment to its fair value at the most recent acquisition date and show any gains or losses on remeasurement in the consolidated profit or loss of the period.

The Board also expressed its intention to prohibit adjustments to goodwill for subsequent recognition of deferred tax benefits acquired in a business combination but to require these benefits to be shown as income as required by IAS 12 *Income Taxes*.

First-time application of IFRS
In its discussion of the comment letters received on ED 1 *First-time application of IFRS* the Board decided to retain the definition of first-time adopter. It also agreed on the following changes to the proposals:

- The exemption for business combinations should not be mandatory. However, if one business combination is restated to IFRS, all subsequent business combinations have to be restated as well.

- ED 1 proposed that, if a first-time adopter did not restate a business combination, assets and liabilities that were not recognised under previous GAAP but would require recognition under IFRS, would have a deemed cost of zero. The Board concluded that its proposal should be changed to require the measurement of such assets and liabilities at amounts appropriately measured. They should be measured on the basis that the acquiree is a first time adopter at the same date as the acquirer.

- In cases where determining cumulative translation differences (CTD) for a foreign operation at the date of transition to IFRS would cause undue cost or effort entities should not be required to show the CTD as a separate component of equity.

- In order to leave the decision about the number of required comparative periods to national regulatory bodies, the Board will permit companies to present additional historical financial statements prepared under national/previous GAAP beyond the one year required by IFRS as "not prepared under IFRS" and to disclose the nature, but not the amount of major adjustments that would make the data comply with IFRS.

If you would like further information on any of the matters discussed in this *IAS Briefing*, please talk to your usual contact at KPMG or call any of our offices.

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