THE IMPACTS OF REVISIONS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS ON BUSINESS COMBINATIONS

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Abstract:
The pressures for intensified development in the global environment have been evident as the needs of the changing economy demand international harmonization. In this context, some amendments and revisions are continuously made to the International Accounting Standards and International Financial Reporting Standards by IASB, but accounting for business combinations under US GAAP uses the purchase method. This paper aims to examine the impacts of revisions to IFRS 3 and tries to determine the concerning effects on the treatment of goodwill for business combinations.

Key words: *IFRS, IAS, accounting revision*

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INTRODUCTION

The complexity of conducting international business operations across national borders, each with a different set of regulations and of different accounting methods, brings about the necessity for international harmonization, and one step further, for international convergence. The globalization of capital markets has also contributed to the need of address harmonization of financial reporting standards. The global market needs a common language and the communication of financial information and internationalized accounting and auditing standards.

Business combinations and the consolidated financial statements under the scope of International Financial Reporting Standards (IFRSs) which , as the successor of International Accounting Standards (IASS), constitutes the backbone of this paper. Thus, the subsequent section will mainly focus on IFRS 3, which is the concerning International Financial Reporting Standard on business combinations, its recent amendments and revisions which were issued in January 2008, and the new treatment of goodwill accounting.

LITERATURE REVIEW

In 2001, the International Accounting Standards Board (IASB) began a project to review IAS 22 Business Combinations (revised in 1998) as part of its initial agenda, with the objective of improving the quality of, and seeking the convergence on, the accounting for business combinations. The Board decided to address the accounting for business combinations in two phases.

The first phase was concluded in March 2004 by issuing simultaneously IFRS 3 Business Combinations to supersede IAS 22 and revised versions of IAS 36 and IAS 38. The Board's primary conclusion in the first phase was that virtually all business combinations are acquisitions. Accordingly, the Board decided to require the use of one method of accounting for business combinations-the acquisition method in IFRS 3, while the Board used to permit use of one of the two methods-the acquisition method, or the pooling of interests method of accounting in IAS 22. Another major amendment was related to the goodwill: while goodwill had been subject to amortization under the requirements of IAS 22, according to the successor standard IFRS 3, goodwill was supposed to be subject to impairment test within the scope of IAS 36 as it was expected to have art indefinite life and allocated to cash-generating units in order to asses its recoverability.

The second phase addresses the guidance for applying the acquisition method. In June 2005, the boards published an exposure draft of revisions to IFRS 3 and 141, together with exposure drafts of related amendments to IAS 27 Consolidated and Separate Financial Statements and Accounting Research Bulletin Consolidated Financial Statements.

While the IASB has recently made these necessary amendments and revisions to IFRS 3 Business Combinations and IAS 27 Consolidated and Separate Financial Statements on 10 January 2008, there are also consequential amendments to other standards, most notably IAS 28 Investments in Associates and IAS 31 Interests in Joint Ventures. The amendments result from proposals that were in an Exposure Draft published by the Board in June 2005. The amendments are effective for annual periods beginning on or after 1 July 2009. Earlier application is permitted but only back to an annual reporting period that begins on or after 30 June.

THE AMENDMENTS OF INTERNATIONAL FINANCIAL REPORTING STANDARDS ON BUSINESS COMBINATIONS

According with the recent amendments the objective of IFRS 3 is to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects. To accomplish that, principles and requirements are established for how the acquirer:

1. recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquire;
2. recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and
3. determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

Also the IASB has determined that Costs incurred in an acquisition are period costs. Costs of issuing debt or equity instruments are accounted for under IAS 39 Financial Instruments: Recognition and Measurement. All other costs associated with the acquisition must be expensed, including reimbursements to acquire for bearing some of the acquisition costs.

Some of the most significant changes are in relation to the purchase consideration. 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. Any previous stake is seen as being 'given up' to acquire the entity and 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 holding. If the value of the stake has increased, there will be a gain recognized in the statement of comprehensive income (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 expected to occur infrequently.

The standard clarifies also accounting for employee share-based payments by providing additional guidance on valuation, as well as how to decide whether share awards are part of the consideration for the business combination or compensation for future services.

The revised standard gives entities the option, on an individual transaction basis, to measure non-controlling interests (minority interest) at the fair value of their proportion of identifiable assets and liabilities or at full fair value. The first method will result in measurement of goodwill, which is basically the same as with the existing IFRS. However, the second method will record goodwill on the non-controlling interest as well as on the acquired controlling interest. Goodwill continues to be a residual but it will be a different residual under IFRS 3 (Revised) if the full fair value method is used as 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 but it is also because goodwill can be measured in two different ways.

1. 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 recognized at its share of identifiable net assets and does not include any goodwill.
2. Goodwill can also be measured on a 'full goodwill' basis, which means that goodwill is recognized for the non-controlling interest in a subsidiary as well as the controlling interest.

Under the previous version of IFRS 3, the non-controlling interest was recognized at their 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.

The revised IFRS 3 has introduced some changes to the assets and liabilities recognized in the acquisition balance sheet. The existing requirement to recognize all of the identifiable assets and liabilities of acquire is retained. Most assets are recognized at fair value, with exceptions for certain items such as deferred tax and pension obligations. The IASB has provided additional clarity that may well result in more intangible assets being recognized. Acquirers are required to recognize brands, licenses and customer relationships, and other intangible assets.

There is very little change to current guidance under IFRS as regards contingencies. Contingent assets are not recognized, 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.

In the same time the revised standard moves IFRS to the use of the economic entity model. Current practice is 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.

CONCLUSION

The amendments and revisions to IFRS 3 do not exercise completely new issues and not change the main framework but have more to do with the application of methods concerning business combinations.

Identifiable assets are the assets separable from the firm either physically or by contractual arrangement. Essentially all of the assets of a firm are identifiable except for goodwill. A company’s net identifiable assets are its total assets less goodwill and less the firm’s liabilities. Accountants and analysts often approach the calculation of net identifiable assets differently, usually because accountants have direct access to the company’s books, whereas analysts often are forced to estimate the balance of some accounts.

The revised standard also has increased disclosure requirements that will need to be considered in advance, including information about contingent liabilities, contingent consideration and the assumptions used in determining fair value of certain elements of the transaction.

The revisions to accounting for contingent consideration and express requirements to consider any amounts transferred to employees (including share-based payment arrangements) should be taken into account when negotiating the terms of the contract, to avoid reporting transactions differently to their intended outcome. Similarly, where non-controlling interests arise, management will need to consider its future intentions in order to select an appropriate method of valuation.

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