Assurance and Advisory Business Services

International financial Reporting Standards

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Business Combinations

Summary of the IASB's proposals for a new approach to business combinations and non-controlling interests

Introduction

On 30 June 2005, the International Accounting Standards Board (IASB or Board) issued three Exposure Drafts proposing revisions to IFRS 3 *Business Combinations*, IAS 27 *Consolidated and Separate Financial Statements*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 19 *Employee Benefits*. If converted to standards in their present form, the Exposure Drafts (which run to a total of almost 500 pages) will change significantly the accounting for business combinations and the accounting for non-controlling interest transactions. The proposed amendments to IAS 37—which will also undergo a name change to *Non-financial liabilities*—will have an equally significant impact on the way companies account for contingencies.[1]

The most significant of the proposed changes would result in:

- a fundamental change in approach from a cost basis to a fair value basis, whereby goodwill is measured by reference to the fair value of the acquiree, as a whole, including goodwill attributable to any non-controlling interest. This could result in substantial grossing-up of goodwill and related minority interests in acquisitions involving less than 100%.
- recognising contingent consideration obligations at their acquisition date fair values, with subsequent changes in fair value generally reflected in profit and loss. This represents a significant change from the current practice of recognising contingent consideration obligations only when the contingency is probable and can be measured reliably.
- the elimination of the terms ‘contingent liability’ and ‘contingent asset’ from the draft revised IAS 37, and the introduction of the requirement for the value of ‘contingencies’ to be included in the measurement of related unconditional rights (an intangible asset) or unconditional obligations (a liability). This means that all assets

[1] This paper summarises only those aspects of the proposed changes to IAS 37 that impact the accounting for business combinations. The full impact of the IAS 37 (and IAS 19) amendments will be summarised in a separate document that Ernst & Young will issue shortly.

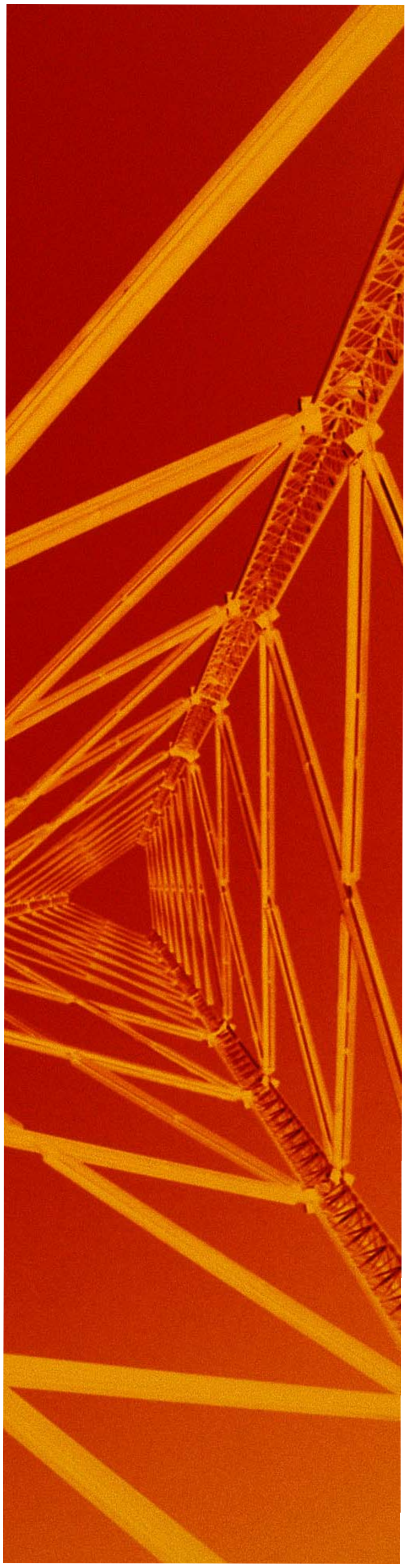
acquired and liabilities assumed that arise from contingencies will be recognised and measured at their acquisition date fair values. However, since conditional rights and obligations do not meet the definition of assets and liabilities, the acquirer will not recognise contingent assets and contingent liabilities of the acquiree when no unconditional rights or obligations exist.

- removal of the reliable measurement criterion for intangible assets acquired in a business combination. Instead, the IASB has introduced additional guidance—in the form of a 'fair value hierarchy'—for the purpose of estimating the fair values of assets acquired and liabilities assumed.
- expensing acquisition-related transaction costs.
- recognising gains and losses in initial equity holdings for step acquisition and partial disposal transactions.
- accounting for changes in the ownership of a subsidiary (that do not result in a loss of control) as equity transactions.
- recognising gains or losses on a loss of control in a subsidiary and requiring a re-measurement to fair value of any retained interest on the date control is lost.

The current practice of accounting for business combinations under IFRS is a cost based approach, whereby the cost of the acquired entity is allocated to the assets acquired and liabilities (and contingent liabilities) assumed. In contrast, the Exposure Draft adopts the approach that the acquirer should recognise the fair value of the business acquired, regardless of the acquirer's percentage ownership. It adopts the working principle that a business combination is an exchange of equal values and that the exchange should be measured based on the fair value of the consideration transferred or the fair value of the business (net assets) acquired, whichever is more reliably measurable. Under this approach, the acquirer would measure and recognise the assets and liabilities of an acquired business similarly, regardless of whether some or all of the equity interests are acquired or how the acquisition was achieved (eg, a step acquisition, a single purchase resulting in control, or a change in control without a purchase of equity interests).

The IASB expects to issue final standards in mid-2006 that would be effective for the first annual period beginning on or after 1 January 2007. We encourage you to review carefully the Exposure Drafts — which are available on the IASB's website (www.iasb.org)—and to submit your comments in writing to the IASB by the 28 October 2005, deadline. Ernst & Young will submit comment letters on the Exposure Drafts, and we will make these available to clients and others upon submission to the IASB.

The remainder of this document summarises the significant changes introduced by the three Exposure Drafts, as they relate to business combinations and changes in non-controlling interests. In addition, **Appendix A** contains a summary comparison of the proposed changes from current IFRS and current US GAAP.



Business combinations exposure draft

Background to the new proposals

The IASB added the business combinations project to its agenda in July 2001. The objective of the project is to achieve convergence between IFRS and US GAAP on the accounting for, and reporting of, business combinations, including the accounting for goodwill and other intangible assets. The first phase of the project was completed in March 2004 with the issuance of IFRS 3 *Business Combinations* and revised versions of IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*. The key provisions of those standards included the elimination of the pooling-of-interests method of accounting for business combinations, replacing the amortisation of goodwill and indefinite-lived intangibles with annual impairment tests, expanded guidance on recognising intangible assets apart from goodwill in a business combination, and increased disclosures about business combinations, goodwill and other intangible assets.

In April 2002 the IASB agreed to begin the second phase of its business combinations project. The objective of the second phase of the project is to seek convergence between IFRS and US GAAP on applying the purchase method of accounting.[2] During its deliberations, the IASB also decided to address issues relating to the accounting for any non-controlling interest and the treatment of the acquiree's contingencies. This has led to the issue of the IAS 27 and IAS 37 Exposure Drafts concurrently with the business combinations Exposure Draft.

In order to promote the international convergence of accounting and reporting standards for business combinations, the IASB collaborated with the Financial Accounting Standards Board (FASB) on the second phase of the project. The FASB and IASB (Boards) have developed common Exposure Drafts that incorporate the decisions reached in their joint phase two project, as well as the decisions reached in their separate phase one projects (which resulted in the FASB's issuance of Statement 141 *Business Combinations* in June 2001 and the IASB's issuance of IFRS 3 in March 2004). The Boards concurrently deliberated and reached the same conclusions on all of the fundamental issues that were considered in the second phase of the project.

2 The Exposure Draft proposes to rename the purchase method as the 'acquisition method'.

Scope

The IASB has added into the scope of the proposed revised standard the acquisition method of accounting for combinations involving only mutual enterprises (eg, credit unions, cooperatives, etc.) and combinations in which separate entities are brought together by contract alone (eg, dual listed corporations and stapled entity structures). The Board noted that one of the difficulties previously cited in applying the acquisition method to these combinations was that often there was an absence of reliably measurable consideration. Since, at first sight, the principle of recognising the combination at the fair value of the business acquired removes that problem, the Board concluded that the acquisition method of accounting should also be applied to those transactions.

The formation of a joint venture and combinations involving entities under common control (as in the current IFRS 3 and its predecessor IAS 22) would be excluded from the scope of the proposed revised standard. The proposed FASB statement also excludes these transactions. However, paragraphs 25 to 31 of Appendix C accompanying the proposed FASB statement provide guidance on the transfers of net assets or exchanges of shares between entities under common control. This guidance refers to Opinion 16 which requires an accounting treatment similar to pooling for these types of transactions.

Definition of a business combination

Under the current IFRS 3, a business combination is defined as 'the bringing together of separate entities or businesses into one reporting entity.' During the second phase of the business combinations project, the Board concluded that the definition of a business combination in the current IFRS 3 is too broad and that a business combination should be described in terms of an economic event, rather than in terms of consolidation accounting. The Board decided that the FASB's proposed definition of a business combination, which focuses on the obtaining of control, meets this condition. Therefore, the Exposure Draft proposes that a business combination is a 'transaction or other event in which an acquirer obtains control of one or more businesses' and the acquisition date for accounting purposes is the 'date the acquirer obtains control of the acquiree.'[3]

Thus, by emphasising the obtaining of control, the Exposure Draft narrows the current IFRS 3 definition of a business combination, which used the term 'bringing together' rather than 'obtaining control'. Notwith-standing this, the IASB states in the Basis for Conclusions accompanying the Exposure Draft that even though the new definition focuses on control, all business combinations included in the scope of the current IFRS 3 would be within the scope of the draft revised IFRS 3.

Definition of a business

The existing IFRS 3 definition states that a business generally consists of three different elements – (1) inputs, (2) processes that are applied to those inputs, and (3) resulting outputs that are, or will be, used to generate revenues. The Exposure Draft provides definitions of each of these elements and clarifies that a business would only be required to have the first two of these three elements (ie, inputs and processes), which together are or will be used to create outputs. Outputs would not need to be present for an integrated set of assets and activities to be a business.

The Exposure Draft also clarifies that a transferred set of activities and assets need not be self-sustaining (ie, contain all of the inputs and processes necessary for it to conduct normal operations after it is separated from the transferor) in order to be considered a business. The determination of whether a particular set of activities and assets is a business would be based on whether a willing acquirer[4] is *capable of* acquiring the business and continuing to produce outputs (eg, by integrating the acquired business with its own inputs and processes). The acquisition of a non-producing oil field (or perhaps a single piece of real estate) would currently not be treated as a business combination, whether it is acquired directly

3 Both the FASB and IASB versions of the Exposure Draft require the existing IFRS definition of acquisition date.

4 The term 'willing acquirer' is used with the same meaning as 'willing parties' in IAS 39 *Financial Instruments: Recognition and Measurement*.

or via a corporate entity. However, based on a literal reading of the proposed standard, we consider that many single asset acquisitions may be treated as business combinations. We are not certain that this is what the IASB intended when proposing the revised wording.

Additionally, the Exposure Draft contains guidance on assessing whether development stage entities are businesses. In these situations, various factors would need to be assessed to determine whether the transferred set of assets and activities is a business, including whether the set has begun its planned principal activities, has employees and other inputs and processes that can be applied to those inputs, is pursuing a plan to produce outputs, and has the ability to obtain access to customers that will purchase those outputs.

Finally, the Exposure Draft retains the presumption in the current IFRS 3 that if goodwill is present in a transferred set of activities and assets, the transferred set is presumed to be a business.

Measuring the fair value of the acquiree

Consistent with the IASB's overall working principle, the acquirer in a business combination would recognise the fair value of the business acquired, as a whole, as of the acquisition date. That fair value measurement principle would apply whether control is obtained by purchasing the acquiree's net assets, purchasing some (or all) of the acquiree's equity interests, by contract alone, or by other means. Under this approach, all of the goodwill of the acquired business, not just the acquirer's share, would be recognised.

The Board observed that business combinations are usually arm's length exchange transactions in which knowledgeable, unrelated willing parties exchange equal values. Thus, in the absence of evidence to the contrary, the fair value of the acquirer's interest in the acquiree and the exchange price paid by the acquirer for that interest (referred to in the Exposure Draft as the 'consideration transferred') would be the same. Since the fair value of the consideration transferred generally is more clearly evident and reliably measurable than the fair value of the acquiree, the Board concluded that the fair value of the consideration transferred is presumed to be the best evidence of the acquisition date fair value of the acquirer's interest in the acquiree.

If the acquirer obtains control of an acquiree through a purchase of less than 100% of the acquiree's equity interests, the fair value of the consideration transferred would provide presumptive evidence of the fair value of the partial interest acquired but would not, by itself, be representative of the fair value of the acquired business as a whole. In those situations, the fair value of the consideration transferred would be used together with other available information as a basis for determining the fair value of the acquiree.

If control were obtained through the purchase of a relatively small ownership interest, if control were achieved without the transfer of any consideration, or if there is evidence that indicates that the consideration transferred is not the best basis for measuring the fair value of the acquirer's interest in the acquiree as of the acquisition date (eg, a business combination in which the seller is acting under duress), the acquirer would be required to use other valuation techniques to directly measure the fair value of the acquiree. Active markets and observable prices generally do not exist for an entity that is similar to the acquired business. Thus, multiple valuation techniques (eg, market approach and income approach) that are appropriate in the circumstances, and for which reliable data is available, would be utilised and the results of those valuation techniques would be evaluated to estimate the fair value of the business acquired. The example on the next page is from the Exposure Draft and illustrates this point.

Consideration transferred

As noted above, the Board concluded that the fair value of the consideration transferred by the acquirer in a business combination is presumed to be the best evidence of the fair value of the acquirer's interest in the acquiree. The consideration transferred is comprised of (1) the acquisition date fair values of the assets transferred, liabilities incurred, and equity interests issued by the acquirer and (2) the acquisition date fair value of any non-controlling equity investment in the acquiree that the acquirer owned immediately

Example

Entity A owns 60% of Entity B's shares, and the remaining 40% of Entity B's 10 million shares are widely dispersed and have been publicly trading in the range of €9.85 – €10.15. Entity A desires to sell its controlling 60% interest in Entity B and has identified Entity C as the highest bidder. Following private negotiations Entity C buys all of Entity A's holdings in Entity B for €81 million (€13.50 per share), a premium of about €3.50 per share over the market price of the publicly traded non-controlling shares on the acquisition date. During the first week following the acquisition, the non-controlling shares of Entity B traded in the range of €8.50 – €13.00. Entity C willingly paid a premium over the market on the basis that:

- Entity B, as a whole, is worth between €110 million and €130 million to other market participants (based on market comparisons of companies similar to Entity B and its best estimate as to the likely synergies that those market participants might be able to achieve).
- Entity C can extract synergies similar to those of other market participants, as well as generate additional savings by making proprietary technology available to Entity B.

At issue is whether the price paid is representative of the fair value of Entity B as a whole. In this case, Entity C has information that suggests that €135 million (€81 million / 60%) is not necessarily representative of the amount that other knowledgeable, unrelated willing parties would pay for Entity B as a whole. Moreover, the trading of shares subsequent to acquisition also indicates that €13.50 is not representative of the fair value of Entity B as a whole.

Therefore, Entity C will be required to determine its best estimate of the fair value of Entity B, given that the price paid does not appear to indicate this, due to the control premium. An initial best estimate may be €121 million, comprising the €81 million (the fair value of the 60%) plus €40 million (four million non-controlling shares at €10.00). This value also falls within the range initially determined by Entity C to be the value of Entity B. Multiple valuation techniques, such as the market and income approaches, may be appropriate in this case in order to determine or refine any preliminary estimates made of the fair value of Entity B.

before the acquisition date. The consideration transferred may take many forms, including cash, tangible and intangible assets, a business or subsidiary of the acquiring entity, securities of the acquiring entity (eg, ordinary shares, preferred shares, options, warrants, and debt instruments), or other promised future payments of the acquiring entity, including contingent payments.

Contingent consideration

The acquirer may promise to deliver cash, additional equity interests, or other assets to the former owners of the acquired business after the acquisition date if certain specified events occur or conditions are met in the future. Such arrangements are commonly used by buyers and sellers when there are differences in view as to the fair value of the acquired business. Under the Exposure Draft, the acquiring entity would recognise contingent consideration obligations as of the acquisition date as part of the fair value of the consideration transferred in exchange for the acquired business. This represents a significant change from the current practice of recognising contingent consideration obligations only when the contingency is probable and can be measured reliably. Consistent with the IASB's overall working principle, the initial measurement of contingent consideration obligations would be fair value, based on circumstances that exist as of the acquisition date. Classification of contingent consideration obligations as either a liability or equity would be based on other applicable accounting standards, including IAS 32 *Financial Instruments: Disclosure and Presentation*.

The Board concluded that subsequent changes in the fair value of a contingent consideration obligation do not affect the acquisition date fair value of the consideration transferred to the acquiree. Instead, those subsequent changes in value are related to post-combination events and changes in circumstances of the combined entity. Thus, the Board believes that subsequent changes in value for post-combination events and circumstances should not affect the measurement of the consideration transferred or goodwill on the acquisition date. Therefore, after initial recognition, changes in the fair value of contingent consideration obligations would be accounted for by the acquirer as follows:

- Contingent consideration obligations that are classified as equity would not subsequently be re-measured, consistent with the accounting for equity instruments generally.
- Contingent consideration obligations classified as liabilities that:
  - are financial instruments and within the scope of IAS 39 would be accounted for in accordance with that standard. For example, liabilities for contingent consideration that are derivatives would subsequently be re-measured at fair value with changes in fair value recognised in profit and loss.
  - are non-financial liabilities that include a contingency would be accounted for in accordance with IAS 37 or other standards as appropriate.

Costs incurred in connection with a business combination

An acquirer generally incurs various acquisition-related costs in connection with a business combination, including:

- *direct costs* of the transaction, such as (i) costs for the services of lawyers, investment bankers, accountants, and other third parties and (ii) costs to issue debt or equity instruments used to effect the business combination (ie, issuance costs).
- *indirect costs* of the transaction, such as recurring internal costs (eg, the cost of maintaining an acquisition department).

Payments made to third parties for services that are directly related to a business combination are currently included as part of the cost of the acquisition. Debt issuance costs and the costs of registering and issuing equity securities are treated as a reduction of the proceeds of the debt or securities issued. The indirect costs of an acquisition are expensed in the period incurred.

The Board has concluded that acquisition-related costs, whether for services performed by external parties or internal staff of the acquirer, are not part of the fair value exchange between the buyer and seller for the acquired business. Rather, they are separate transactions in which the buyer makes payments in exchange for the services received. Thus, under the Exposure Draft, the acquirer would account for acquisition-related costs separately from the business combination, in accordance with applicable accounting standards. The Board noted that acquisition-related costs generally do not represent assets of the acquirer at the acquisition date since they are consumed as the services are rendered. Thus, with the exception of the costs of registering and issuing debt and securities,[5] acquisition-related costs generally would be expensed in the period that the related services are received.

Measuring and recognising the assets acquired and liabilities assumed

Consistent with the IASB's overall working principle, the assets acquired and liabilities assumed of the acquired business would be recognised as of the acquisition date and measured at fair value as of that date (with certain limited exceptions).

The Exposure Draft provides guidance for measuring and recognising particular assets acquired and liabilities assumed as of the acquisition date. In addition, although the objective of the second phase of the business combinations project was not focused on issues related to the 'day-two' accounting for assets acquired and liabilities assumed, the Exposure Draft provides guidance on the accounting for certain acquired assets and assumed liabilities subsequent to a business combination.

Many of the IASB's decisions would represent a significant change to current practice. These proposed changes are discussed further on the following page.

[5] These costs (sometimes called 'issuance costs') are accounted for as a reduction against the debt or equity raised in accordance with IAS 39 and IAS 32 respectively.

Fair value hierarchy

For the purpose of estimating the fair values of assets acquired and liabilities assumed, the Board decided to include additional guidance in the form of the hierarchy set out below (referred to as the *fair value hierarchy*). The fair value hierarchy reflects the general principle that fair value reflects the interaction of knowledgeable, unrelated, willing parties and it emphasises that quoted prices in active markets, when available, are the best evidence of fair value.

Level 1

Fair value is estimated using quoted prices for ***identical*** assets or liabilities in active reference markets. The reference market is the active market to which an entity has immediate access (the proposed revised standard explains the notion of immediate access and provides guidance in the situation when an entity has immediate access to multiple active markets with different prices). The proposed revised standard also provides guidance on the appropriate use of bid and asked prices in an active dealer market.

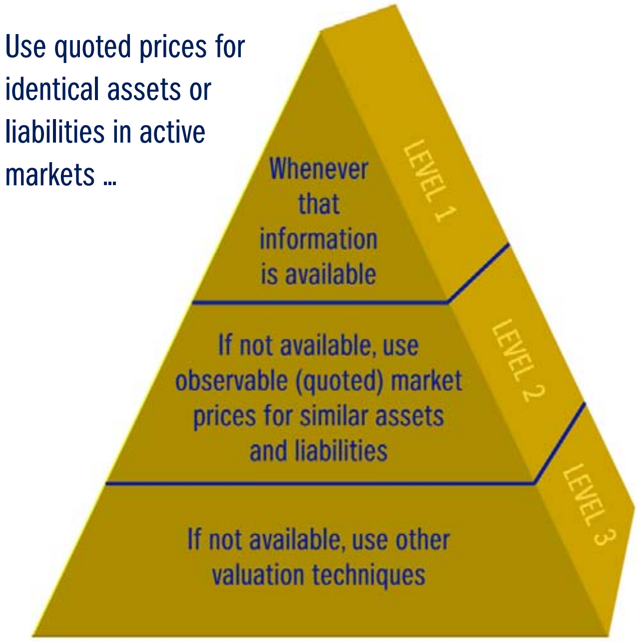
Level 2

If quoted prices for identical assets or liabilities in active markets are not available, fair value is estimated using quoted prices for ***similar*** assets or liabilities in active markets, adjusted as appropriate for differences (the price effect of the differences must be determined objectively).

Level 3

If quoted prices for identical or similar assets or liabilities in active markets are not available, or if differences between similar assets or liabilities are not determinable objectively, fair value is estimated using ***multiple valuation techniques*** consistent with the market approach, income approach, and cost approach. Fair value should be estimated by applying ***multiple valuation techniques***, unless this involves undue cost and effort and those techniques should ***maximise market inputs*** and minimise entity inputs.

The IASB acknowledges in the Exposure Draft the limited nature of this guidance, but decided that additional guidance should be developed as part of a broader consideration of fair value measurement issues. The IASB also acknowledge that the guidance



contained in the business combinations Exposure Draft may change when the FASB issues its final statement on *Fair Value Measurements* in the fourth quarter of 2005.

Exceptions to the fair value principle

The Board made certain limited exceptions to the principle that all assets acquired and liabilities assumed should be measured at fair value. In the following cases, the relevant assets and liabilities are recognised and measured in accordance with another standard.

- Assets classified as held for sale at the acquisition date in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* are measured at fair value less costs to sell.
- Deferred tax assets and liabilities are measured in accordance with IAS 12 *Income Taxes*.
- If the acquiree is the lessee to an operating lease, the acquirer does not recognise the acquiree's rights under the operating lease separately from its obligations as part of the purchase price allocation (ie, the asset and liability arising from the operating lease is not recognised on a gross basis). Also, although existing leases of the acquiree are new leases from the perspective of the acquirer, the classification of the leases between operating

and finance is not revisited. However, the acquirer is required to recognise separately an intangible asset or a liability for the favourable or unfavourable portion of an operating lease that is not at market terms as of the acquisition date.

- Assets or liabilities relating to an acquiree's employee benefit plans are measured in accordance with IAS 19.[6] However, the effect of any plan amendments made contemporaneously with, or subsequent to, the business combination would be considered a post-combination expense.

Removal of the reliable measurement criterion for intangible asset

The current IFRS 3 states that any asset acquired or liability assumed in a business combination must be able to be measured reliably to be recognised. The inclusion in IFRS 3 of the reliability of measurement criterion was the result of extensive field tests conducted by the IASB on the proposals in the Exposure Draft preceding IFRS 3 (ie, ED 3 *Business Combinations*). Those field visits, which included discussions with accountants and valuation professionals, highlighted that there were certain circumstances in which an intangible asset acquired in a business combination might not be able to be reliably measured.

Despite this, and in the interest of convergence with US GAAP, the Board has decided not to include an equivalent statement in the draft revised IFRS 3. The Board believes that sufficient information should always exist to measure reliably the fair value[7] of an intangible asset acquired in a business combination.

Contingencies

Under the current IFRS 3, contingent liabilities assumed are included in the purchase price allocation at their fair value, whilst contingent assets of the acquired business are not referred to at all. In developing the Exposure Drafts, the Board concluded that in order to represent fairly the economic circumstances at the acquisition date, in principle, all assets acquired and liabilities assumed should be measured and recognised at their acquisition date fair values, including assets and liabilities arising from contingencies.

The Board's approach to this issue has been to eliminate the terms 'contingent liability' and 'contingent asset' from the draft revised IAS 37, and to require the value of 'contingencies' to be included in the measurement of related unconditional rights (an intangible asset) or unconditional obligations (a liability).

For example, the proposed revised IAS 37 and the proposed consequential amendments to IAS 38 refer to the notion of 'conditional' rights and obligations arising from past events from which future economic benefits may flow, based on the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. Since conditional rights and obligations do not meet the definition of assets and liabilities, the acquirer will not recognise contingent assets and contingent liabilities of the acquiree.

However, the Board notes that conditional rights and obligations are often accompanied by *unconditional* rights and obligations which will usually meet the asset and liability definitions. For example, if the acquiree is involved in litigation there is a conditional obligation to pay damages depending upon the decision of the court. But, in addition, since legal proceedings have commenced the acquiree has an unconditional obligation to participate in the court proceedings and perform as the court decides. In such cases, the fair value of the unconditional right or obligation is affected by, and reflects, the likelihood of the contingency occurring and the amount of the contingency. By contrast, if it is merely possible that a matter could become the subject of legal proceedings, no unconditional obligation, and therefore, no liability, exists.

[6] Under paragraph 108 of IAS 19, acquired post-employment assets and liabilities are recognised at the present value of the obligation, less the fair value of any plan assets.

[7] The issue of reliability of measurement in the determination of fair values is discussed in Ernst & Young's paper entitled *How fair is fair value,* obtainable at www.ey.com.

Whilst contingent assets and liabilities will not be recognised in their own right, their value will be recognised when they are accompanied by an unconditional right or obligation. Notwithstanding this, the IASB states in the Basis for Conclusions accompanying the IAS 37 Exposure Draft that even though the proposed approach is different from that in the current IFRS 3, it should be viewed only as a 'refinement' of the requirements in IFRS 3. They observe that in most cases there would be no change in obligations recognised in accordance with the existing and proposed revisions of IFRS 3. It is not clear to us that this is the case.

Provisions or valuation allowances

Under the Exposure Draft, the acquirer would not recognise a separate provision or valuation allowance as of the acquisition date for assets acquired in a business combination that are initially recognised at fair value. For example, since receivables (including loans) that are acquired in a business combination would be recognised and measured at fair value at the acquisition date, any uncertainty about collections and future cash flows would be included in the fair value measure. Accordingly, the acquiring entity would not recognise a separate provision or valuation allowance for uncollectible amounts at the acquisition date.

Subsequent recognition of tax benefits not recognised at the acquisition date

The Exposure Draft would change the accounting for deferred tax benefits that did not meet the criteria for separate recognition as part of the business combination, but which are subsequently realised. Under the current IFRS 3, the carrying amount of goodwill is reduced for the subsequent recognition of such deferred tax benefits. Further, the current IFRS 3 does not impose a time limit in terms of adjusting goodwill for the subsequent realisation of deferred tax benefits acquired in a business combination.

Under the Exposure Draft, those tax benefits that did not meet the criteria for separate recognition as part of the business combination, but which are subsequently realised, would be recognised directly as a reduction of income tax expense.[8] The Board considers that such changes in the value of deferred tax benefits are likely to be a consequence of events occurring after the business combination, and therefore should not impact the initial accounting for a business combination.

This proposed change would be applied prospectively (ie, an acquirer would not adjust the accounting for *prior* business combinations if the deferred tax benefits failed to satisfy the criteria for separate recognition as of the acquisition date and are subsequently recognised, unless the rebuttable presumption referred to in the footnote applies).

Step acquisitions

An acquirer may obtain control of an acquiree through a series of acquisitions of two or more different investments (commonly referred to as a 'step acquisition'). Under the current IFRS 3, an acquirer is required to treat each exchange transaction separately for the purpose of measuring goodwill (this results in a step-by-step comparison of the cost of the individual investments with the acquirer's interest in the net fair value of the acquiree's identifiable assets and liabilities at each step).

The Exposure Draft proposes that if the acquirer holds a non-controlling equity investment in the acquiree immediately before obtaining control, then the acquirer would re-measure that investment at fair value as of the acquisition date and recognise any unrealised gains or losses in profit and loss.[9] The Board believes that a change from holding a non-controlling equity investment in an entity to obtaining control of that entity is a significant change in the nature of and economic circumstances

[8] However, there would be a rebuttable presumption that tax benefits for those items that are recognised within one year following the acquisition date would first be applied to reduce goodwill related to the acquisition to zero, with any excess tax benefit reported as a reduction of income tax expense. The rebuttable presumption would be overcome if the recognition of the tax benefits results from a discrete event or circumstance that occurred during the one-year period subsequent to the acquisition date and, thus, could not have been foreseen at the acquisition date.

[9] If the acquirer recognised changes in the value of its non-controlling equity investment directly in equity (eg, the investment was classified as available-for-sale securities in accordance with IAS 39), the amount that was recognised directly in equity would be reclassified and included in the calculation of any gain or loss as of the acquisition date (ie, recycled through profit and loss).

Example

The fair value of Entity B is determined to be €1,000, and the fair value of Entity B's identifiable net assets is €700. Entity A acquires a 60% controlling interest in Entity B for €630. Entity A accounts for the above transaction as follows:

Fair value of nets assets acquired	€ 700	
Goodwill[(A)]	300	
Cash		€ 630
Non-controlling interest in Entity B[(B)]		370

(A) Goodwill would be allocated between the controlling and non-controlling interests. The amount of goodwill allocated to the controlling interest would be €210, which is the fair value of the controlling interest (ie, consideration transferred of €630) less the controlling interest's share in the fair value of the identifiable net assets acquired of €420 ($700 x 60%). The remainder of the goodwill of €90 (€300 total less €210 allocated to the controlling interest) would be allocated to the non-controlling interests. Under the current IFRS 3, only €210 would be recognised as goodwill, being the goodwill allocated to the controlling interest only

(B) The non-controlling interest in Entity B is measured and recognised as the sum of (i) the non-controlling interest's proportional interest in the acquisition date fair values of Entity B's identifiable net assets of €280 (€700 x 40%) plus (ii) the non-controlling interest's share of goodwill of €90. Under the current IFRS 3, only €280 would be recognised as minority interests since the goodwill associated with the minority interest is not recognised.

surrounding that investment. That change warrants a change in the investment's classification and measurement (ie, a re-measurement event).

The acquirer's non-controlling equity investment in the acquiree prior to obtaining control, after re-measurement to fair value, is a component of the fair value of the consideration transferred by the acquirer in the business combination (see 'Consideration transferred' on page 4).

Partial acquisitions

The current IFRS 3 prescribes a 'purchased-goodwill' approach. That is, only goodwill attributable to the acquirer is recognised as part of the accounting for the business combination. Goodwill attributable to any non-controlling interests must not be recognised.

Under the Exposure Draft, in a business combination in which the acquirer holds less than 100% of the equity interests in the acquiree at the acquisition date, the acquirer would recognise the acquiree, as a whole, and the assets acquired and liabilities assumed at the full amount of their fair values as of that date (regardless of the percentage ownership in the acquiree).

The excess of the fair value of the business acquired over the net amount of the recognised identifiable assets acquired and liabilities assumed would be measured and recognised as goodwill. Thus, all of the goodwill of the acquired business, not just the acquirer's share, would be recognised under this 'full-goodwill' approach. The amount of goodwill would then be allocated to the controlling and non-controlling interests. An example of this is shown above.

The amount of goodwill that is allocated to the acquirer would be measured as the difference between the fair value of the acquirer's equity interest in the acquiree (ie, the consideration transferred) and the acquirer's share in the fair value of the separately-recognised net assets acquired. The remainder of the goodwill would be allocated to the non-controlling interests. Therefore, the portion of goodwill initially allocated to the controlling and non-controlling interests may not be equal to the total recognised goodwill multiplied by the respective ownership percentages in the acquiree (eg, when the acquirer pays a premium to acquire the controlling interest in the subsidiary).

Bargain purchase transactions

If the fair value of the acquirer's interest in the business acquired exceeds the fair value of the consideration transferred for that interest (ie, a bargain purchase transaction), then the excess would first reduce goodwill related to the transaction to zero[10] with any remaining excess recognised as a gain on the acquisition date.

IFRS 3 is currently based on a cost allocation model and presumes that, with one exception, the fair value of the acquirer's interest in the business acquired is equivalent to the fair value of the consideration transferred for that interest. In other words, with one exception, IFRS 3 presumes that there are no bargain purchases. The exception arises only when the consideration transferred is less than the fair value of the acquirer's interest in the identifiable net assets. When this is the case, IFRS 3 currently requires a gain to be recognised for the excess of the fair value of the acquirer's interest in the identifiable net assets acquired over the consideration transferred.

Assessing what is part of the exchange for the acquiree

Under the Exposure Draft, the acquirer would be required to assess whether any portion of the transaction price (ie, payments or other arrangements) or any assets acquired or liabilities assumed are not part of the exchange for the acquiree. The objective of this assessment is to distinguish the elements of the business combination from other payments made (or received) in connection with the business combination that are for other purposes. In order to complete this assessment, the acquirer needs to evaluate the substance of transactions or events that are entered into by the parties to the business combination to determine whether those transactions or events were arranged primarily for the economic benefit of the acquirer or the combined entity, rather than for the economic benefit of the acquiree or its former owners. The reason for some of these changes is to bring IFRS in line with existing US guidance. The assistance of experts may be required to evaluate the substance of the transaction.

Examples of payments or other arrangements that would not be considered part of the exchange for the acquiree include the following:

- payments that effectively settle pre-existing relationships between the acquirer and acquiree
- payments to compensate employees or former owners of the acquiree for future services (see example below)
- payments to reimburse the acquiree or its former owners for paying the acquirer's costs incurred in connection with the business combination.

Example

At acquisition date, Entity A (the acquirer) exchanges replacement awards that require three years of future service for share-based payment awards of Entity B (the acquiree), for which the vesting period (four years) was completed before the business combination. At the date of acquisition, the fair value of the replacement awards and the fair value of the replaced awards are the same (€1,000). Accordingly, there is no excess value to be recognised as an expense by the acquirer at the acquisition date.

In this case, the total vesting period is seven years – the vesting period of the original award plus the vesting period of the replacement award. The portion attributable to past services equals the fair value of the replacement award (€1,000) multiplied by the ratio of the past vesting period (4 years) to the total vesting period (7 years). Thus, €571 would be attributable to past services (and included as part of the consideration transferred by Entity A) and €429 would be attributable to the future services (and recognised as compensation cost in the post-combination financial statements).

[10] When less than 100% of the acquiree is owned, there would be a proportionate reduction in the goodwill attributable to the non-controlling interest. No gain is attributable to the non-controlling interest.

Example

Entity P (parent) sells a 20% interest in Entity S (subsidiary) for €1,000, reducing its interest to 80%. Entity P continues to control Entity S after the transaction.

IAS 27 currently is silent on how a parent should account for a sale of a portion of its shares. However, some companies have previously recognised a gain or loss on the parent's profit and loss, measured as the difference between the proceeds received from the sale of the shares and the carrying amount of the shares sold.

However, under the proposed requirements, any gain or loss recognised by Entity P would not be included in its consolidated profit and loss. Instead, the sale of the 20% interest would be an equity transaction in the consolidated financial statements. If the book value of the 20% interest sold was €800, the journal entry would be as follows:

Cash	€1,000	
Equity		€200
Non-controlling interest		800

Non-controlling interests Exposure Draft

The Board's intention in developing this Exposure Draft was to reflect only those changes related to its decisions in the second phase of the business combinations project, and not to reconsider all the requirements in IAS 27. The changes proposed to IAS 27 primarily relate to the accounting for increases and decreases of ownership interests in a subsidiary after control is obtained, and accounting for the loss of control of subsidiaries.

Allocation of losses to non-controlling interests[11]

Under the proposed revised IAS 27, when allocating losses to the controlling and non-controlling interests, losses would continue to be allocated to the non-controlling interests even if those losses exceed the non-controlling interest in the equity of the subsidiary. Under the current IAS 27, losses that are otherwise attributable to the non-controlling interest are allocated to the controlling (majority) interest once the non-controlling interest in the equity of the subsidiary has been reduced to zero, except to the extent that the minority interest has a binding obligation and is able to make an additional investment to cover the losses.

Changes in parent's ownership interest in a subsidiary (without loss of control)

Consistent with the Board's view that non-controlling interests are part of the equity of the consolidated group, changes in a parent's controlling ownership interest that *do not result in a loss of control of the subsidiary* would be accounted for in the consolidated financial statements as transactions with equity holders in their capacity as equity holders with no gain or loss recognised.

A parent may ***decrease*** its ownership interest in a subsidiary by selling a portion of the subsidiary's shares it holds, or by causing the subsidiary to issue shares to non-controlling interests. In such cases, the carrying amount of the non-controlling interest would be adjusted (ie, increased) to reflect the change in its ownership interest in the subsidiary's net assets, as shown in the example. Any difference between the consideration received and the adjustment made to the carrying amount of the non-controlling interest would be recognised directly in equity attributable to the controlling interest.

A parent may ***increase*** its ownership interest in a subsidiary in many ways, including purchasing additional outstanding shares of the subsidiary, having the subsidiary reacquire a portion of its outstanding shares from

[11] The Exposure Draft proposes to re-name 'minority interests' to 'non-controlling interests'.

minority interests, or having the subsidiary issue new shares to the parent. The accounting for an increase in ownership interest in a subsidiary would be the same (although with opposite journal entries) as the accounting for a decrease in ownership interest discussed on previous page.

The amounts charged or credited directly to equity due to changes in the parent's ownership interest in a subsidiary would not be reflected as adjustments to the numerator of the parent's earnings-per-share calculation, in accordance with IAS 33 *Earnings per Share*. However, the effects of transactions with the non-controlling interest will, in accordance with IAS 1 *Presentation of Financial Statements*, be disclosed in the statement of changes in equity or in the notes to the financial statements. In addition, the Board decided that entities would not be precluded from presenting an additional EPS measure that includes the effects of equity transactions with non-controlling interests in the numerator of the EPS calculation.

Loss of control of a subsidiary

In most instances, control of a subsidiary is lost as the result of the parent's decision to sell its controlling interest in the subsidiary to another party. However, control may be lost with or without a change in absolute or relative ownership levels, as a result of a contractual arrangement, or if the subsidiary becomes subject to the control of a government, court, administrator, or regulator.

When a parent loses control of a subsidiary, a gain or loss would be recognised in the consolidated profit and loss and measured as follows:

	Proceeds (if any) from the transaction that resulted in the loss of control
+	Fair value of any retained non-controlling equity investment in the former subsidiary at the date control is lost
–	Parent's interest in the former subsidiary's net assets at the date control is lost (including goodwill)
=	Gain (loss) recognised

An example of this is shown at the right.

As previously noted, the Exposure Draft would require any retained non-controlling equity investment in a former subsidiary to be re-measured to fair value on the date that control of the subsidiary is lost with the gain or loss on re-measurement included in profit and loss of the period.

In situations when the parent loses control of a partially-owned subsidiary, the non-controlling interest's share of the carrying amount of the net assets of the former subsidiary at the date control is lost would be derecognised against the carrying amount of the non-controlling interest. Thus, no gain or loss related to the non-controlling interest would be recognised.

Example

Entity A previously acquired a 90% interest in, and control of, Subsidiary B. On 31 December 2006, the carrying amount of Subsidiary B as a whole is €100 million, and the carrying amount attributable to the non-controlling interests in Subsidiary B (including the non-controlling interests' share of other equity balances) is €10 million. On 1 January 2007, Entity A sells a portion of its interest in Subsidiary B to a third party for cash proceeds of €120 million. As a result of the sale, Entity A loses control of Subsidiary B but retains a 10% non-controlling ownership interest in Subsidiary B. The fair value of the retained interest on that date is €15 million.

The consolidated gain on disposal is calculated as follows (in millions):

	Cash proceeds	€ 120
+	Plus fair value of retained non-controlling equity investment	15
	Subtotal	135
–	Less Entity A's share of Subsidiary B's net assets	90
=	Gain on sale	€ 45

In addition, because Subsidiary B was less than wholly-owned when control was lost, the non-controlling interests' share of the carrying amount of Subsidiary B's net assets of €10 million would be derecognised against the carrying amount of the non-controlling interests. Thus, no gain or loss related to the non-controlling interest is recognised in consolidated profit and loss.

Further, the gain or loss arising on loss of control of a subsidiary must also include the parent's share of gains or losses that were recognised previously directly in equity (eg, the parents share of any gains or losses on cash flow hedges of a net investment or those related to available for sale financial assets).

Effective date and transition

The IASB is proposing that the revised standards will be effective for the first annual period beginning on or after 1 January 2007. Earlier adoption will be encouraged; however, if the proposed revised standards are applied before the effective date, the proposed revised IFRS 3, the proposed revised IAS 37, ***and*** the proposed revised IAS 27 will have to be applied at the ***same time***.

The proposed revised IFRS 3 would apply prospectively to business combinations for which the acquisition date is on or after the beginning of the annual period in which the proposed revised standard is adopted. Retrospective application to business combinations before the adoption of the proposed revised IFRS 3 would be prohibited. As a result, the current version of IFRS 3 would continue to apply to combinations effected *before* the effective date of the proposed revised IFRS 3, and, with two exceptions, assets and liabilities that arose from those past business combinations would not be adjusted.

The two exceptions to this general rule are as follows:

- The amended version of IAS 12 would be applied prospectively to deferred tax assets acquired as part of the combination and recognised *after* the effective date of the revised IFRS 3 (ie, unless the rebuttable presumption applies, goodwill shall not be adjusted for the subsequent recognition of deferred tax benefits that failed to satisfy the criteria for separate recognition as of the acquisition date).
- Any previously recognised contingent liabilities that are not accompanied by a related unconditional obligation would be derecognised with a corresponding credit to goodwill.[12]

By contrast, a number of the provisions in the proposed revised IAS 27 (dealing with non-controlling interests) would be applied retrospectively, as follows:

- Attribute consolidated profit and loss and other amounts recognised directly in equity to the controlling and non-controlling interests in accordance with the provisions of the proposed revised standard.
- If losses applicable to the non-controlling interest in a subsidiary were previously attributed to the controlling interest because they exceeded the non-controlling interest in the equity of the subsidiary, re-attribute those losses to the controlling and non-controlling interests.
- If gains or losses were recognised in profit and loss for decreases in a parent's controlling ownership interest in a subsidiary that did not result in a loss of control of that subsidiary, reclassify those gains or losses from retained earnings to contributed equity.

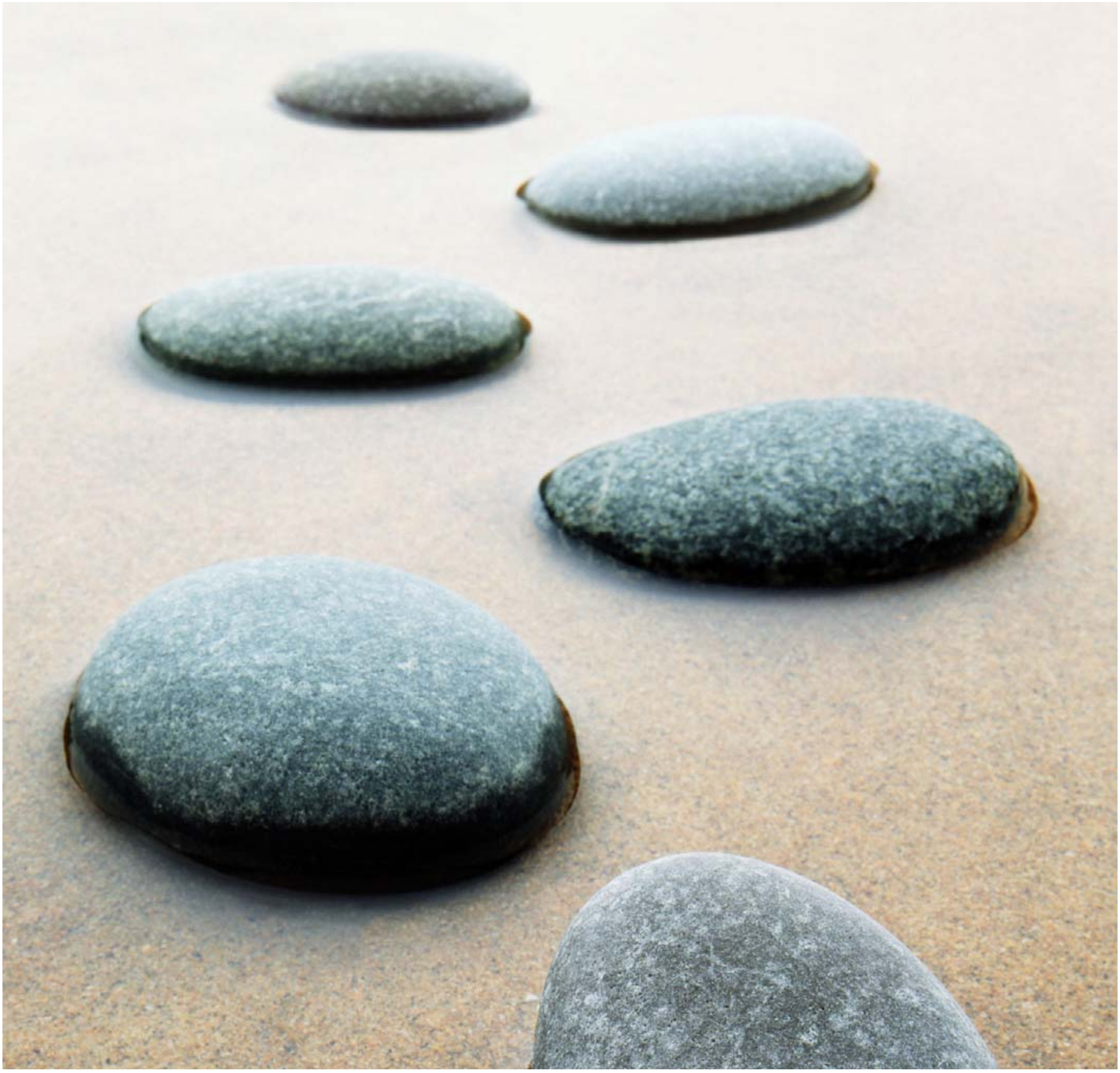
However, the following provisions of the proposed revised IAS 27 would be required to be applied prospectively:

- the requirement to account for increases in a parent's controlling ownership interest in a subsidiary (ie, acquisitions of non-controlling interests) as equity transactions, when these increases occurred before these amendments are applied
- the requirement to re-measure to fair value any retained investment in a former subsidiary when the control was lost before these amendments are applied.

12 This applies until goodwill is reduced to zero, but only to the extent of the amount initially recognised for the contingent liability. Any remaining balance would be derecognised against retained earnings.

Remaining differences with US GAAP

While the Exposure Draft issued by the IASB and that issued by the FASB reach the same conclusions on the fundamental issues, there still exist some differences (apart from the obvious terminology differences) because of the Boards' decision to produce guidance for accounting for business combinations that is consistent with other existing IFRS or FASB standards. There also still remain some disclosure differences. For a detailed analysis of the differences, refer to the Basis for Conclusions accompanying the Exposure Draft.



Appendix A

Summary of significant differences between current practice (IFRS and US GAAP) and the proposed standards

	IFRS Current Practice	US GAAP Current Practice	Proposed IASB Standard
Business combinations			
Scope			
Business combinations involving only mutual entities and business combinations achieved by contract alone	IFRS 3 does not apply to these business combinations.	Effective date of Statement 141 was deferred for combinations involving only mutual entities. Statement 141 does not address transactions in which control is obtained through means other than an acquisition of net assets or equity interests.	The requirements of the proposed revised IFRS 3 (ie, acquisition accounting) apply to these business combinations.
Definition of a business combination	A business combination is defined in IFRS 3 as 'the bringing together of separate entities or businesses into one reporting entity.'	For purposes of applying Statement 141, a business combination occurs when an entity acquires net assets that constitute a business or acquires equity interests of one or more other entities and obtains control over that entity or entities.	A business combination is defined as 'a transaction or other event in which an acquirer obtains control of one or more businesses.'
Definition of a business	The current definition of a business is provided in IFRS 3 and does *not* include a presumption that a transferred set of activities and assets in the development stage that has not commenced planned principal operation cannot be a business.	Current definition of a business and related application guidance is provided in EITF Issue No. 98-3.	Definition of a business would be broadened and clarified with additional application guidance.
Measuring the fair value of the acquiree - consideration transferred			
Contingent consideration	Contingent consideration is included in the cost of the business combination if it is probable and can be reliably measured. If the contingency does not occur or the estimate needs to be revised, the cost of the business combination is adjusted accordingly (thereby impacting the amount of goodwill recognised). If, subsequent to the acquisition date, any contingent adjustment becomes probable and can be measured reliably, it is recorded as an adjustment to the cost of the business combination.	Recognised as an additional element of the cost of the acquisition when the contingency is resolved and the additional consideration is issued or becomes issuable.	Recognised and measured at fair value at the acquisition date and classified as either a liability or equity, based on existing IFRS. Subsequent to initial recognition, contingent consideration obligations that are (1) classified as equity would not be subsequently re-measured, (2) classified as liabilities and are financial instruments within the scope of IAS 39 would be accounted for in accordance with that standard, and (3) classified as liabilities and are not within the scope of IAS 39 would be accounted for in accordance with the proposed revised IAS 37, or other IFRS as appropriate.

Appendix A (continued)

	IFRS Current Practice	US GAAP Current Practice	Proposed IASB Standard
Marketable equity securities of the acquirer	Equity instruments issued by the acquirer, in exchange for control over the acquiree, shall be measured by the acquirer at the date of the exchange (usually the acquisition date).	The fair value of the acquirer's marketable equity securities that are issued as consideration in a business combination are measured (for purposes of determining the cost of the acquisition) as of the date that the terms of the acquisition are agreed to and announced. The fair value of all other consideration transferred is measured as of the acquisition date.	The fair value of *all* consideration transferred would be measured as of the acquisition date.
Measuring the fair value of the acquiree - costs incurred in connection with a business combination			
Acquisition-related costs	Direct costs incurred in connection with a business combination (eg, finder's fees, advisory, accounting, legal valuation, and other professional fees) are included as part of the cost of the acquired business.	US GAAP is the same or similar to IFRS current practice.	These costs are not part of the fair value exchange between the buyer and seller for the acquired business and, therefore, would be expensed as incurred.
Measuring the fair value of the acquiree - measuring and recognising the assets acquired and liabilities assumed			
Contingencies	Contingent liabilities of the acquiree are required to be recognised provided their fair values at the acquisition date can be reliably measured.	Recognised during allocation period and measured either at fair value or, if fair value is not determinable, then consistent with the guidance in FASB Statement No. 5.	Measured and recognised at their acquisition date fair values. The fair value reflects the likelihood of the contingency (the unconditional right or obligation) occurring and the amount of the contingency. The proposed revised IAS 37 (and the proposed amended IAS 38) will remove the concepts of contingent assets/liabilities. They will refer to the notion of 'conditional' rights and obligations that relate to unconditional rights (an intangible asset) and unconditional obligations (a liability) respectively.
Intangible assets	Recognise separately from goodwill if the item meets the definition of an intangible asset in IAS 38 and the fair value can be reliably measured. The fair value of intangible assets acquired in a business combination can *normally* be measured with sufficient reliability to be recognised separately from goodwill.	US GAAP is the same or similar to the proposed standard.	Recognise separately from goodwill if the item meets the definition of an intangible asset in IAS 38. With the exception of an assembled workforce (which is prohibited from being recognised as an intangible asset separate from goodwill), sufficient information *always* exists to measure reliably the fair value of intangible assets acquired in a business combination.

Appendix A (continued)

	IFRS Current Practice	US GAAP Current Practice	Proposed IASB Standard
Research and development assets	IFRS 3 is the same or similar to the proposed standard.	Research and development assets acquired in a business combination that have no alternative future use (in-process research and development) are measured at fair value and charged to expense as of the acquisition date.	Research and development assets acquired in a business combination would be recognised and measured at their acquisition-date fair values. Subsequent to initial recognition, intangible R&D assets would be accounted for in accordance with IAS 38.
Restructuring activities	IFRS 3 is the same or similar to the proposed standard.	Costs of an acquirer's plan to exit an activity of the acquiree or involuntarily terminate or relocate employees of the acquiree are recognised as liabilities assumed and included in the purchase price allocation if the conditions in EITF Issue No. 95-3 are satisfied.	These costs would be recognised separately from the business combination accounting as post-combination expenses of the combined entity.
Valuation allowances or provisions	IFRS 3 is silent in this regard.	Separate valuation allowances are recognised in the purchase price allocation in certain cases (eg, allowances for uncollectible loans or accounts receivable).	No separate valuation allowances or provisions would be recognised for acquired assets that are recognised at fair value.
Pension and post-retirement benefit obligations	Net employee benefit assets or liabilities for defined benefit plans are valued at the present value of the defined benefit obligation less the fair value of any plan assets. An asset is only recognised to the extent that it is probable that it will be available to the acquirer in the form of refunds from the plan or a reduction in future contributions.	If it is expected that the acquiree's plan will be terminated or curtailed, the effects of those actions are considered in measuring the acquisition date projected benefit obligation and accumulated post-retirement benefit obligation that is assumed by the acquirer.	The effect of a planned termination or curtailment of an acquiree's plan would *not* be considered in measuring the acquisition date post-employment benefit obligation that is assumed by the acquirer.
Recognition of deferred tax assets after the initial accounting is complete	The carrying amount of goodwill is reduced for the subsequent recognition of deferred tax assets. Further, IFRS 3 does not impose a time limit in terms of adjusting goodwill for the subsequent realisation of deferred tax benefits acquired in a business combination.	Tax benefits recognised in subsequent periods resulting from the reduction of a valuation allowance that was recorded at the acquisition date are first applied to reduce goodwill to zero, then to reduce other non-current intangibles to zero, and lastly to reduce income tax expense.	Rebuttable presumption that acquired deferred tax benefits recognised within one year after the acquisition date are an adjustment to any deferred tax benefits recognised at that date, and will therefore result in a goodwill adjustment. The rebuttable presumption is overcome if the recognition results from a discrete event that occurred after acquisition date. If the rebuttable presumption is overcome, or the tax benefits are recognised more than one year after the acquisition date, they would be credited to profit and loss, or, if appropriate, equity (ie, no adjustment to goodwill).

Appendix A (continued)

	IFRS Current Practice	US GAAP Current Practice	Proposed IASB Standard
Tax deductible goodwill	IAS 12 is silent in this regard.	A deferred tax asset is not recognised at the acquisition date for tax benefits arising from tax deductible goodwill that is in excess of goodwill for financial reporting purposes. Instead, the tax benefit for that excess is recognised when realised on the tax return.	A deferred tax asset would be recognised at the acquisition date for tax benefits arising from tax deductible goodwill that is in excess of goodwill for financial reporting purposes.
Other changes			
Partial acquisitions and step acquisitions	The identifiable assets acquired and liabilities of the acquiree are recognised at their fair value at the acquisition date (provided the specified criteria are met). Only 'purchased goodwill' (the difference between the cost of the interest acquired and the acquirer's proportional interest in the fair value of the identifiable assets acquired and liabilities assumed) is recognised. The recognition of goodwill attributable to the non-controlling interest is prohibited. Where a business combination is achieved in stages by successive share purchases, each exchange transaction is treated separately by the acquirer to determine the amount of goodwill associated with that transaction. Further, any fair value adjustment to the acquiree's assets and liabilities at the acquisition date that relate to previously held interests of the acquirer is accounted for as a revaluation.	The assets and liabilities of the acquiree are recognised at a mixture of current exchange prices and historical book values.	The acquirer would recognise the acquiree, as a whole, and the assets acquired and liabilities assumed at the full amount of their fair values as of the acquisition date. This results in the 'full goodwill' of the business acquired being recognised. Any non-controlling equity investment in the acquiree that is held by the acquirer immediately before obtaining control of the acquiree would be re-measured at fair value with the unrealised holding gain or loss recognised in the consolidated profit and loss.
Bargain purchase transactions	IFRS 3 requires the excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets and liabilities over cost to be recognised immediately in the consolidated profit and loss.	Goodwill and certain other long-lived assets are reduced to zero before an extraordinary gain is recognised.	Where the fair value of the acquirer's interest in the acquiree exceeds the consideration transferred for that interest, the acquirer would account for that excess by reducing the amount of goodwill related to the transaction in proportion to that interest. If the goodwill is reduced to zero, any remaining excess is recognised as a gain in the consolidated profit and loss.

Appendix A (continued)

	IFRS Current Practice	US GAAP Current Practice	Proposed IASB Standard
Measurement period	IFRS 3 is the same or similar to the proposed standard.	Any adjustments that are made during the purchase price allocation period to the provisional values assigned at the acquisition date are generally accounted for on a prospective basis.	Any adjustments that are made during the measurement period to the provisional values assigned at the acquisition date would be 'pushed back' to the date of acquisition. Thus, comparative information for prior periods would be adjusted (eg, changes to depreciation or amortisation expense) as a result of completing the initial accounting for a business combination.
Non-controlling interests			
Presentation of non-controlling interests in subsidiaries	IAS 27 is the same or similar to the proposed standard.	Non-controlling (or minority) interests are generally reported as a 'mezzanine' item between liabilities and equity. The portion of a subsidiary's income (loss) attributed to the non-controlling interest is reported as expense (income) in the determination of consolidated net income.	Non-controlling interests would be reported as a separate component of consolidated shareholders' equity. Amounts that are attributed to the non-controlling interest would not be reported as income or expense in the determination of consolidated profit and loss.
Attribution of losses of the subsidiary	When losses applicable to the minority in a consolidated subsidiary exceed the minority interest in the subsidiary's equity, the excess, and any further losses applicable to the minority, are allocated against the majority interest, except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.	Losses that are otherwise attributable to the non-controlling interests are allocated to the controlling interest once the non-controlling interest in the equity capital of the subsidiary has been reduced to zero.	Losses would continue to be allocated to the non-controlling interests even if those losses exceed the non-controlling interest in the equity capital of the subsidiary.

Appendix A (continued)

	IFRS Current Practice	US GAAP Current Practice	Proposed IASB Standard
Increase in parent's ownership interest in a subsidiary	IAS 27 is silent on accounting for acquisitions of minority interest. Practice varies, depending on the circumstances, between adjustments against goodwill, equity, or a combination of goodwill and equity.	The parent applies the purchase method of accounting when its ownership interest in a subsidiary is increased.	Increases in a parent's ownership interest in a subsidiary would be accounted for as equity transactions of the consolidated entity.
Decrease in parent's ownership interest in a subsidiary (without loss of control)	IAS 27 is silent on accounting for the decrease in parent's ownership interest in a subsidiary. Practice varies, depending on the circumstances, between adjustments through the profit and loss or equity.	The parent recognises a gain or loss (or records an adjustment directly to equity in certain cases) when its ownership interest in a subsidiary is decreased.	Decreases in a parent's ownership interest in a subsidiary that do not result in a loss of control of the subsidiary would be accounted for as equity transactions of the consolidated entity.
Loss of control of a subsidiary	The carrying amount of the investment at the date that the entity ceases to be a subsidiary shall be regarded as the cost on initial measurement of a financial asset in accordance with IAS 39.	US GAAP is the same or similar to IFRS current practice.	Any retained non-controlling equity investment in a former subsidiary is re-measured to fair value on the date that control of the subsidiary is lost, with the gain or loss on re-measurement included in profit and loss.

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