30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: www.iasb.org

International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **19 April 2007, London**

Project: **Business Combinations II**

Subject: **Effective Date (Agenda Paper 2D)**

PURPOSE OF THE MEMO

1. This memo addresses the effective date for the final standards on business combinations and noncontrolling interests that the staff expects the Boards will issue in mid-2007. This memo also asks the Boards whether early application of the standards should be permitted, as was proposed in the Exposure Drafts.

2. The staff notes that the current guidance contained in FASB Statement No. 141, *Business Combinations,* and IFRS 3, *Business Combinations,* is not converged. Because convergence will not be achieved until the new standards are issued and effective, the staff believes the Boards do not need to converge on the standards' effective dates and whether to permit early adoption. There would be no convergence opportunities lost if, for example,

the FASB was to adopt the guidance before the IASB. Likewise, if the IASB permits early adoption and the FASB does not, there would be no loss of comparability when comparing early IFRS adopters with entities that apply U.S. GAAP because they are currently not converged.

PROPOSAL IN THE EXPOSURE DRAFTS

3. The Exposure Drafts propose that the business combinations and noncontrolling interests standards:

    a. Be applied at the beginning of the first annual period beginning on or after December 15, 2006 (FASB) or January 1, 2007 (IASB)

    b. That the standards be applied only at the beginning of an annual period that begins on or after the standards are issued

    c. That early application be encouraged

    d. If applied early, that both standards be applied at the same time and that the entity disclose that fact.

4. The basis for the Boards' conclusions is as follows:

    a. The Boards preferred to make business combinations and noncontrolling interests effective at the same time and they preferred to make the noncontrolling interests standard effective at the beginning of an annual period. They believed that applying the standards at the beginning of an annual period, especially the noncontrolling interests standard, would minimize disruptions to practice and be easier for users to understand.

    b. The Boards also decided to encourage early application of both standards, as long as the provisions of both are applied at the same time. The Boards saw no reason to delay or preclude the application of the improvements for any significant length of time for entities that want to apply the provisions of both standards before their effective dates.

ISSUE 1: EFFECTIVE DATE

5. Respondents to the Exposure Drafts did not specifically address the proposed effective dates or whether early application should be allowed.

6. On January 11, 2007, members of the Investors Technical Advisory Committee (ITAC) told the FASB Board that "new standards should be effective as of the beginning of a year to achieve consistent application and implementation of new standards." At the February 28, 2007 FASB meeting and the February 23, 2007 IASB meeting, the Boards affirmed the guidance in the Exposure Drafts that would require that the entities apply both the business combinations and noncontrolling interests standards at the same time.

7. The staff continues to believe that the noncontrolling interests standard should be effective at the beginning of an entity's annual period as was proposed in the Exposure Draft. The proposed changes to the way noncontrolling interests are presented and disclosed is significant. Those changes would best be implemented at the beginning of an annual period. Therefore, the staff will ask the Boards to affirm that entities adopt both standards at the beginning of an annual period.

IASB Effective Date and Staff Recommendation

8. The IASB has stated that it "will not require the application of new IFRSs under development or major amendments to existing standards before 1 January 2009." If the standards are issued in mid-2007, that will allow approximately 18 months for translation, implementation, and for some jurisdictions to enact the standards into law. The staff believes that 18 months is sufficient time. The alternative would be to allow a longer period (say, 21 or 24 months) and the staff believes that is unnecessary. Therefore, the staff recommends that the IASB require that the business combinations and noncontrolling interests standards be effective for fiscal years beginning on or after January 1, 2009.

FASB Effective Date and Staff Recommendation

9. In contrast, the staff believes that the FASB has a choice. It can make the new standards effective either:

a. **December 15, 2008** (effectively the same time as the IASB);[1] or

b. At some date earlier than the IASB.

10. If the final standards will significantly improve the accounting for acquisitions and the presentation and reporting of noncontrolling interests, then one could argue that the proposed guidance should be effective as soon as reasonably possible. The basis for conclusions to the FASB's Exposure Drafts suggested that three to six months would give preparers adequate time to implement the proposed standards. Although respondents did not suggest otherwise, constituents generally asked the Board for more time to implement major standards. The staff plans to complete the balloting process by June 30, 2007, and to issue the final standards in July or August 2007. Therefore, the staff believes that the FASB could make the standards effective for fiscal years beginning on or after **December 15, 2007.**

11. Some Board members may believe that an effective date of December 15, **2007** does not provide preparers with adequate time whereas an effective date of December 15, **2008** would prevent users from benefiting from the improved guidance for approximately 18 months. While most entities have fiscal years that coincide with the calendar year, some do not. Board members may wish to consider an effective date between December 15, 2007 and December 15, 2008, such as (a) March 15, 2008, (b) June 15, 2008, or (c) September 15, 2008.

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[1] The staff notes that the FASB's version of the Exposure Drafts proposed that the standards be effective for annual periods beginning on or after **December 15th** while the IASB's version proposed that the standards be effective for annual periods beginning on or after **January 1st**. The IASB typically sets effective dates of January 1st for standards that are to be applied at the beginning of a calendar year. In contrast, the FASB typically sets effective dates of December 15th because some entities in the United States have calendar years that begin at the end of December for the purpose of achieving quarters with consistent lengths. (For example, many manufacturing companies operate on what is called a 5-4-4 system so that their quarters each consist of 13 weeks. Often, the 5-4-4 system results in an entity's calendar year beginning in the last week of December.) The staff is not aware of a similar practice internationally. Therefore, the staff believes that each Board could remain consistent with its current practice and still be considered converged with respect to effective dates (that is, the FASB selects a December 15th effective date and the IASB selects a January 1st effective date).

12. Another argument in favor of selecting an effective date earlier than the IASB is that the final business combinations and noncontrolling interests standards will be closer converged to IFRS 3 and IAS 27 than Statement 141 and ARB 51 currently are (for example, recognizing the identifiable net assets at full fair value in a partial or step acquisition, classification of noncontrolling interests, and so on). As a result, requiring the new business combinations and noncontrolling interests standards to be effective earlier would result in greater convergence during 2008 than delaying the effective dates until December 15, 2008.

13. The other view is that since this is a joint project, both Boards should select the same effective date. Although the staff does not believe the earlier effective date would pose a significant challenge to preparers, there are some significant issues that need to be addressed by the FASB, the IASB, and the SEC ideally before the new standards are effective. These open items may not be resolved prior to December 15, 2007. These issues include:

    a. **Amending FASB Statement No. 2, *Accounting for Research and Development Costs.*** At the October 18, 2006 meeting, the FASB affirmed the guidance in the Exposure Draft requiring that all identifiable research and development (R&D) assets (including tangible and intangible R&D assets to be used in R&D activities that have no alternative future use) acquired as part of a business combination should be recognized as assets and measured at fair value. The FASB also decided to extend that decision to R&D assets acquired in an asset acquisition other than a business combination. The FASB will need to expose that decision for comment. *[sentence omitted from observer note]*

    b. **Amending FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* and IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations.*** At the FASB's May 31, 2006 meeting and the IASB's May 2006 meeting, the Boards decided to amend Statement 144 and IFRS 5 and require that assets held for sale to be measured at *fair value* rather than *fair value less costs to sell.* Additionally, the FASB decided to amend Statement 144 to eliminate the guidance in paragraph 32 of Statement 144 that allows the acquirer to classify a long-lived asset as held for sale if it is *probable* that the acquirer could meet the recognition criteria within three months of the acquisition date. The Boards will need to expose those decisions for comment. *[sentence omitted from observer note]*

c. **SEC Regulations**: The decision to classify noncontrolling interests as equity will require that the SEC amend its regulations (S–X) to change the classification of minority interests. Such amendments involve setting rules and it is expected that doing so will require a significant amount of time. The SEC has other amendments to make, such as amendments to Staff Accounting Bulletins. However, those amendments should take less time than the amendments to its regulations.

14. A **December 15, 2008** effective date gives the Board and the SEC additional time to address the guidance outlined in the preceding paragraph.

15. The staff recommends that the FASB set an effective date of **December 15, 2008,** which is effectively the same as the IASB. This recommendation is made on the basis that it will take time for the FASB and SEC to amend the guidance described above. Also, because this is a joint project, the staff believes that the Boards should agree on the same effective date.

Question 1: What should the effective date be for the final business combinations and noncontrolling interests standards?

ISSUE 2: EARLY ADOPTION

16. The next issue is whether an entity should be allowed to apply the standards before their effective date. The Exposure Drafts proposed to *encourage early application* provided that the business combinations and noncontrolling interests standards are applied at the same time. The staff questions whether the Boards should continue to encourage early application.

a. **Alternative A**: Permit / encourage early application provided that both standards are applied simultaneously and that they are applied at the beginning of a fiscal year.

b. **Alternative B**: Do not permit early application.

Alternative A: Permit Early Application

17. Some could argue that since the Boards have developed guidance that improves the accounting for acquisitions and the accounting and reporting of noncontrolling interests, constituents should be allowed to implement the improved guidance before the effective date if they choose to do so. The IASB often encourages early application of its standards.

Alternative B: Do Not Permit Early Adoption

18. Others believe that early application impairs comparability. On January 11, 2007, members of ITAC told the FASB Board that "entities should not be given the option of transition methods as that discretion decreases the comparability of information presented." Additionally, "to address the concerns of credit analysts, public and nonpublic entities should be subject to the same effective date of a new standard."

19. The staff notes that the weight given to comparability might be different for the IASB than it is for the FASB. The proposed standard will result in less pervasive changes to current practice under IFRS 3 than the changes to U.S. GAAP. Additionally, users of IFRS provided mixed feedback on the need for comparability.

20. As stated above, the FASB, the IASB, and the SEC will need to amend some guidance after issuance of the final standards. Proponents of Alternative B do not believe that entities should be given an option to adopt the proposed standards before that guidance is amended.

Staff Recommendation

21. The FASB staff recommends the FASB **prohibit** early application based on the need to amend guidance and the feedback received from ITAC.

22. The IASB staff recommends that the IASB **permit** early application. The IASB staff places less weight on problems of comparability for IFRS users. The changes to the initial measurement of assets and liabilities from IFRS 3 are not as pervasive as the changes from Statement 141. Many of the changes will make business combination transactions more transparent (such as separating acquisition related costs and the proposed accounting for contingent consideration). Other changes provide guidance for transactions for which there is currently no guidance (such as additional acquisitions of some, or all, of the noncontrolling interests after the business combination). The IASB staff thinks that it is not appropriate to prevent those improvements from being applied earlier than the effective date. The IASB staff believes that the improved transparency will enhance comparability even if only some users early adopt. Additionally, in many cases, the proposals will reduce the costs of compliance because of the simpler model for measuring goodwill. As a result, the IASB staff believes that entities should be permitted to apply the standards before the effective date.

Question 2: Do the Boards want to prohibit or permit early application of the business combinations and noncontrolling interests standards?