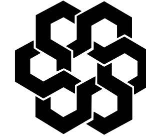

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This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.
These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: **23 January 2007, London**

Project: **Business Combinations II**

Subject: **Non-controlling Interests and Goodwill: Follow-up (Agenda paper 2A)**

This agenda paper has been prepared for the IASB.
It has been given to the FASB for information purposes only.

Introduction

1. At the December 2006 IASB meeting (see Agenda Paper 2A/FASB Memorandum #32) the Board tentatively decided (9-5) that, in principle, non-controlling interests (NCI) should be measured at fair value at the acquisition date. However, the Board also tentatively decided (9-5) to make an exception to that principle. The Board did not decide what the other measurement attribute should be but, given the discussions the Boards have had in this project, the staff assumes that it would be to measure NCI as a proportion of the acquiree's identifiable net assets as of the acquisition date.

2. The Board asked the staff to consider the effects of these tentative decisions on other parts of the business combinations project and on convergence. The Board also asked the staff to consider the nature of the exception and whether entities should always be prohibited from measuring NCI at fair value.

Basis for a measurement exception

3. Based on comments made at the December meeting and in small group sessions, it seems that most Board members who voted for an exception for NCI did so on the basis that they were not convinced that the marginal informational benefits of measuring NCI at fair value exceed the marginal costs of doing so.

4. Measuring NCI at fair value is likely to be more costly than measuring it at its acquisition date proportion of the acquiree's identifiable net assets. The Board members supporting an exception are concerned that the benefits of measuring NCI at fair value could be small—and the comment letters provided mixed signals. These Board members concluded that currently they do not have sufficient evidence to support a requirement that NCI be measured at fair value—marginal costs are easier to assess than marginal benefits, which are difficult to assess. It is therefore unclear whether there are net benefits in applying the principle of fair value to NCI.

5. The basis for a measurement exception is not, in the staff's view, a question of reliability. The staff's analysis of reliability makes it clear that there is unlikely to be a sound basis for concluding that NCI cannot be measured reliably (within the *Framework's* definition of reliable). The decisions the Board has made so far in this project support that assessment (eg intangible assets, remeasuring previously-held NCI in a step acquisition and applying the acquisition method in the absence of reliably measurable consideration such as in a share for share exchange between two privately-held or mutual entities).

The control model

6. The business combinations exposure draft (BC ED) proposed that an acquirer recognise all of every asset—including goodwill—at the acquisition date even if there is a non-controlling interest in the acquiree. The acquisition date is the date at which goodwill is initially measured and recognised in a business combination. The BC ED proposed that no additional goodwill be recognised after the acquisition date (ie once control is obtained) even if additional non-controlling ownership interests are acquired. It is also not derecognised if some ownership interests are sold but control is not lost.

7. The basis for this approach is that achieving control over a business gives the acquirer control over, and responsibility for, all of the assets and liabilities of

the acquiree. The Boards have agreed that achieving control of a business should therefore be the basis for recognising all of, and only, the assets acquired and liabilities assumed by the acquirer. This means that only one 'initial measurement' of the components of a business combination (including all of the assets, liabilities, equity and consideration) is required and this is at the date control is achieved. That proposal is a fundamental change from IFRS 3 *Business Combinations* and FASB Statement No. 141, *Business Combinations*, which have, to varying degrees, requirements to measure layers of assets and NCI every time the ownership interest changes.

8. Economically and legally the responsibilities of the acquirer and the rights of the NCI holders are not affected by the measurement attribute for NCI. NCI and goodwill exist regardless of how they are measured. The acquirer's responsibility to the NCI holders is the same whether the acquirer measures NCI at fair value, as a proportion of the acquiree's identifiable net assets or using some other measure.

9. The BC ED proposed that any changes in the ownership interests after the acquisition date that do not cause the acquirer to lose control would be accounted for as transactions between owners. The staff thinks that measuring NCI at a basis other than fair value does not change that basic model, for NCI or goodwill. The decisions in December affect **how** NCI and goodwill are measured. They do not, in the opinion of the staff, change **what** is being recognised.

10. If the Board decides that the proposed exception relates to **what** is being measured (rather than **how** to measure it), in the case of subsequent acquisitions each asset and liability of the acquiree would need to be measured at fair value at each subsequent acquisition date in order to calculate goodwill. Imposing such a significant compliance cost is inconsistent with the concerns many Board members had about the decision usefulness (informational benefits) of goodwill and NCI (see paragraphs 3-4).

Permitting fair value

11. As noted above, the staff assumes that the alternative to measuring NCI at fair value would be to measure it as a proportion of the acquiree's identifiable net assets. In the December meeting the question emerged as to whether an entity

should be prohibited from measuring NCI at fair value because of cost-benefit concerns.

12. The staff therefore asks the Board to consider whether the exception to fair value should be required in all circumstances or whether it might be appropriate to allow entities to measure NCI at fair value. The staff believes that one possibility is to require preparers to measure NCI at fair value unless the cost of doing so exceeds the benefits. This would allow preparers to decide for themselves whether or not the benefits exceed the costs based on their particular circumstances. This could alleviate some Board members' concerns related to the uncertainties about the costs and benefits of measuring NCI at fair value. The staff believes that the method selected by the preparer should be applied consistently for every acquisition and not on a case by case basis.

13. The advantages and disadvantages of allowing an acquirer to measure NCI either at fair value or at its acquisition date proportion of the acquiree's identifiable net assets are discussed in the following paragraphs.

Consistency and comparability

14. In the Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information* the Boards expressed the view that permitting alternative accounting methods for the same transaction or other events is undesirable. Alternatives diminish comparability and may diminish other desirable qualities as well, for example, faithful representation and understandability. Furthermore, permitting alternative accounting methods for the same transaction bears the risk of creating incentives for accounting arbitrage.[1]

15. The staff believes there is, conceptually, a trade-off between comparability and allowing preparers to apply the principle agreed to by the Board. Certainly, allowing two measurement attributes for NCI has the potential to reduce comparability between financial statements. However, the staff questions

[1] Requiring that all IFRS financial statements show NCI as its proportionate interest in the net identifiable assets reduces comparability between financial statements prepared in accordance with IFRSs and financial statements prepared in accordance with US GAAP. There is, therefore, a trade-off between improved comparability between the financial statements of IFRS and US GAAP constituents and a loss of comparability between financial statements of IFRS constituents.

whether a concern about the lack of comparability might overstate the consequences of allowing some preparers to measure NCI at fair value.

16. Many of the Board members who supported making an exception to the fair value measurement principle for NCI questioned the decision usefulness of NCI and goodwill in the balance sheet after initial recognition, notwithstanding how they are measured.

17. The accounting for impairments is likely to be the primary area of concern in terms of comparability. Having different bases for measuring NCI initially affects goodwill. Two otherwise identical businesses might report different impairment losses if one had measured the NCI at fair value and the other as its proportionate interest in the net identifiable assets.

18. The staff notes, however, that the circumstances that cause an impairment are often specific to an entity and impairments are, generally, not made in every reporting period for every entity. This means that concerns about comparability relate to an item that occurs infrequently and which often will be the focus of detailed analysis by users. This contrasts with items that are reported every period, such as accounting for joint venture activities.

Ongoing assessment of decision usefulness

19. Allowing two measurement attributes might actually improve consistency in practice in the longer term. Empirical analysis of the actions preparers take and the information demanded by users will help the Board reassess the decision usefulness (and the marginal costs) of each approach in the future. The staff thinks that any measurement alternative should be reviewed in the medium term. Analysing how often the exception is applied will help the IASB decide whether to eliminate the exception and should provide a basis for both Boards to converge on the measurement attribute.

Consequences for other aspects of the project

20. This section summarises other parts of the business combinations project that are affected by whether NCI is measured at fair value or as a proportion of the acquiree's identifiable net assets. The staff believes that the decision not to measure NCI at fair value does not harm other aspects of the project, but the consequences of doing so might be material.

Bargain purchases and overpayments

21. The BC ED proposes that in a bargain purchase situation the acquirer shall account for a bargain purchase by reducing the amount of goodwill recognised in the transaction. If goodwill is reduced to zero any remaining excess shall be recognised as a gain. As a consequence, the recognition of only a portion of goodwill could result in a higher gain in a bargain purchase situation.

Attribution of losses to controlling interest and NCI

22. According to the IAS 27 *Consolidated and Separate Financial Statements* exposure draft (IAS 27 ED) losses applicable to NCI should be attributed to them, even if doing so would result in NCI being reported as a deficit. As a consequence of measuring NCI at a measurement attribute other than fair value a deficit might occur sooner and more often.

Impairment testing

23. Measuring NCI as its proportionate interest in the identifiable net assets of the acquiree would result in the need for the acquirer to 'gross up' the goodwill for subsequent impairment testing (as if the full goodwill method had been applied on Day 1). A consequence of not remeasuring goodwill when subsequent acquisitions are made is that it would require goodwill to be 'grossed up' for impairment testing purposes even if subsequently the acquirer obtained control of 100 per cent of the acquiree.

Acquiring NCI

24. Measuring NCI as its proportionate interest in the identifiable net assets of the acquiree and treating subsequent acquisitions as equity transactions might result in a larger reduction in equity when subsequent acquisitions are made—because the value of NCI will not reflect its portion of the goodwill. This consequence could be alleviated if acquirers were permitted to measure NCI at fair value at the acquisition date. Acquirers would be able assess whether the benefits of a lower reduction in equity exceed the costs of measuring NCI at fair value.

Convergence

25. The FASB is strongly in favour of measuring NCI at fair value (6-1). It is the staff's understanding that the FASB is unlikely to move to a method that measures NCI as a proportion of the acquiree's identifiable net assets. The IASB's decision to exempt NCI from the fair value measurement principle is likely to cause the final business combinations standard not to be converged.

26. Until the reconciliation requirement is removed by the US SEC, registrants that file under both US GAAP and IFRSs would need to maintain two parallel records if the IASB's version of the final standard requires that NCI be measured as its proportionate interest in the acquiree's identifiable net assets. Allowing IFRS preparers to measure NCI at fair value would remove this burden. This would reduce compliance costs, such as the time and effort involved in the initial calculation of goodwill and the allocation of goodwill for impairment testing purposes, the costs of auditing two NCI values, the costs of reconciling between IFRSs and US GAAP and the costs related to communicating to users of financial statements.

Summary and staff recommendation

27. One of the major benefits of the BC ED proposals is that the accounting for subsequent acquisitions is easier because goodwill (and all of the acquiree's assets and liabilities) only have to be measured once (at the acquisition date). The staff believes that it is important to retain that benefit, even if NCI is not measured at fair value.

28. The staff therefore recommends that, once control has been achieved, any changes in ownership interests between the controlling and non-controlling interests are transfers between owners and that goodwill not be remeasured.

29. The staff thinks that an acquirer should be permitted to assess whether to measure NCI at fair value or as a proportion of the acquiree's identifiable net assets based on cost-benefit considerations. This would allow preparers to apply the Board's decision that recognising the fair value of NCI is the conceptually correct principle and to decide which method to use to account for NCI based on whether the benefits outweigh the costs. This approach:

    (a) allows SEC registrants to measure NCI using one measurement attribute rather than two (which would reduce their compliance costs);

    (b) could lead to comparability in practice over time; and

    (c) could provide the opportunity for empirical research and a reassessment in the future—based on market 'feedback'.

30. Furthermore, the staff believes that preparers must be able to make an assessment according to their particular circumstances. The method selected by

the preparer should be applied consistently for every acquisition and not on a case by case basis.

Questions for the Board

31. Does the Board agree that the basis for the exception is cost-benefit? If not, please explain the basis for the exception.

32. Does the Board agree that the exception is one of measurement and that once control has been achieved any changes in ownership interests (such as subsequent acquisitions or dispositions) between the controlling and non-controlling interests are transfers between owners and that goodwill not be remeasured?

33. Does the Board agree that the final IFRS version of the standard should allow NCI to be measured at fair value if the preparers believe that there is a net benefit in doing so?