Project **Amendments to IFRS3 and IAS27**

Topic **Earlier Application of IFRS 3**

Introduction

1. The transition requirement in paragraph 64 of IFRS 3 *Business Combinations* (as issued in 2008) (IFRS 3R) permits an entity to apply the revised standard before 1 July 2009. However, it restricts early application as follows: 'this IFRS shall be applied only at the beginning of an annual reporting period that begins on or after 30 June 2007'. Some constituents ask the IFRIC to clarify:
   (a) whether IFRS 3R can be applied early only from the beginning of an annual period or from any time during the annual period; and
   (b) if the revised standard can be adopted early at any time during the annual period, whether an entity must restate prior business combinations that occurred in the same annual period.

Background

2. Some constituents believe that the Board intended to permit earlier application of IFRS 3R at any time during the reporting period as IFRS 3R is a transaction based standard. Those constituents question therefore whether the wording in the standard truly reflects the Board's intentions.

3. Other constituents assume that the requirement is clear that IFRS 3R can be adopted early only for full annual periods. However, they believe that the wording is unclear in the following respects:

(a) It is not clear whether to meet the requirements in IFRS 3R.64 the revised standard has to be applied from the first business combination in the annual period or whether an entity may decide subsequently to apply IFRS 3R.

(b) If an entity may decide subsequently to apply IFRS 3R, a question arises whether an entity must restate prior business combinations that occurred during the same annual period. Constituents question also whether in this case an entity has to restate its quarterly and interim financial statements if those statements have already been issued.

4. To illustrate those issues consider the following example: entity A's reporting period is the calendar year. In January 2008, entity A enters into a business combination that it recognises according to the requirements in IFRS 3 (as issued in 2004). In October 2008, entity A enters into a second business combination. Constituents question whether entity A:

   (a) may apply IFRS 3R to account for the business combination in October 2008; and

   (b) must restate the business combination in January 2008 to comply with the requirements in IFRS 3R.

Staff Analysis

5. The staff notes that in its February 2007 meeting the Board specifically discussed whether an entity could apply IFRS 3R for a business combination that occurred during an annual period before its effective date of 1 July 2009 and then apply the IFRS 3R and amended IAS 27 from that point forward.

6. The Board affirmed in the meeting that if an entity applied the two revised standards early, it should apply them from the beginning of the annual period. The Board noted that IFRS 3 applies to transactions. In contrast, IAS 27 applies to annual periods. However, the Board decided that an entity must apply both standards at the same time. As a consequence, an entity must apply both

standards from the beginning of an annual period whether or not it applies them early.

7. Therefore, we believe that the wording in IFRS 3R.64 accurately reflects the Board's conclusion when it limits the early application of the revised standard to the beginning of an annual reporting period.

8. However, we believe that this does not mean for the example above that entity A could not decide in October 2008 to apply the revised standard. We note that IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states in IAS 8.15 that the same accounting policies are applied within each period and from one period to the next unless there is a change in accounting policy.

9. We believe that consistent with this requirement an entity can decide at any time during the period to apply IFRS 3R early. But, if an entity chooses earlier application of the revised standard, we believe that it must apply the same accounting policy to the whole period. This means that the entity must restate all prior business combinations that occurred in the same period and that it has previously recorded according to the requirements in IFRS 3 (as issued in 2004). We note that this interpretation would imply the restatement of any previously reported interim financial statements.

10. IFRS 3R.64 requires prospective application. Therefore, an entity that adopts the revised standard early does not need to restate the accounting for business combinations that occurred before the beginning of the annual period in which IFRS 3R is adopted.

11. For the example above, this means that entity A can decide in October 2008 to apply IFRS 3R early. As a consequence, entity A must restate the business combination in January 2008 and might have to restate interim financial statements that it has reported before October 2008. Entity A does not need to restate the accounting for business combinations that took place before 1 January 2008.

Staff recommendation and question to the IFRIC

12. We recommend that the IFRIC not add this issue to its agenda. We believe that the wording in IFRS 3R.64 clearly requires application of the revised standard for the whole annual period if it is applied early. Therefore, we do not expect divergence in practice.

13. We note that the question of whether an entity must decide at the beginning of a reporting period to apply a revised IFRS early or whether it can make that decision during the reporting period is not a question that is special to IFRS 3R. We believe that this question occurs for all IFRSs that permit early application and can be answered in accordance with the general principles in IAS 8. Therefore, we do not think that the wording in IFRS 3R needs to be clarified to state when an entity needs to decide to apply the revised standard early.

14. Wording for tentative agenda decision in Appendix A

Question to the IFRIC
Does the IFRIC agree that it should not add a project to its agenda to clarify the requirements for earlier application of the revised IFRS 3? If not, why? Does the IFRIC have any comments on the proposed wording for the tentative agenda decision?

[Appendix A has been omitted from this Observer note]