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IFRS News

Shedding light on the IASB's activities*

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Reducing complexity in reporting financial instruments

The IASB issued a discussion paper 'Reducing Complexity in Reporting Financial Instruments' in March 2008. This is the first step towards a new standard for reporting financial instruments that is principle-based and less complex than current requirements under IAS 39. Part 1 of this article looks at reducing complexity and the Board's interim proposals. Jessica Taurae of the Global ACS Central team explains the implications.

The discussion paper, part of the Memorandum of Understanding[1] between the IASB and FASB seeks to identify the main causes of complexity in reporting financial instruments. It suggests intermediate and long term solutions to improve financial reporting for financial instruments.

The many ways of measuring financial instruments are described as one of the main reasons for today's complexity. A potential long term solution is to measure all financial instruments using a single measurement attribute, probably fair value. It is proposed that identical measurement of financial instruments would make reporting information easier to understand and increase comparability. The discussion paper supports the view that fair value is the only measure that is appropriate for *all* types of financial instruments and its use could reduce today's measurement-related complexity in the following ways:

Current Accounting	Discussion paper		
	Eliminated	Reduced	Retained
Criteria to distinguish between types of financial instruments (classification).	✓		
Identification and quantification of impairment.	✓		
Transfers between measurement categories of financial instruments.	✓		
Fair value hedging accounting for financial instruments [there would be no measurement mismatches]. Note: there may be other recognition and measurement mismatches relating to non-financial instruments where some form of fair value hedgeaccounting will be required.		✓	

(continued)

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Fair value impact	Eliminated	Reduced	Retained
Cash flow hedge accounting for exposures to changes in expected future cash flows.			✓
Identification and separation of embedded derivatives. Note: this may be required for non-financial instruments (eg leases).		✓	

The discussion paper acknowledges that it may not be feasible to require fair value for all types of financial instruments. It therefore proposes ways in which existing measurement requirements for financial instruments might be improved and simplified in the interim. The following may be considered in isolation or in some combination:

- amending the existing measurement requirements;
- replacing the existing measurement requirements with a fair value measurement principle with some optional exceptions; and/or
- simplifying hedge accounting requirements.

Amending the existing measurement requirements

IAS 39 includes four measurement categories – fair value through profit or loss (FVTPL); held-to-maturity (HTM); available for sale (AFS); and loans and receivables (LAR). This proposal envisages eliminating HTM or AFS, or both. It might also simplify or eliminate some of the requirements or restrictions of the existing measurement categories. Removal of the HTM category would be a move towards fair value for more financial instruments and eliminate the need for 'tainting' rules against transfers out of this category. Eliminating the AFS category would eliminate the need to reclassify gains and losses from equity to profit or loss when an instrument is sold or impaired. The implications of any of these suggestions would require presentation and disclosure issues to be addressed and may increase volatility in profit or loss.

Replacing the existing measurement requirements with a fair value measurement principle with some optional exceptions

The discussion paper sets out another possible intermediate approach of adopting a fair value measurement principle with some optional exceptions. A financial instrument could be measured using a cost-based method if it meets exception criteria. The discussion paper suggests that those exception criteria might depend on the variability of an instrument's cash flows. For example, instruments with highly variable future cash flows (eg derivative instruments and equity investments) might be required to be measured at fair value whereas instruments with fixed or slightly variable cash flows (eg market interest-bearing debt instruments) might be eligible for cost-based measurement. However, other exception criteria are also possible. The implications of this proposal clearly depend on what the optional exceptions are. However, any such change would increase volatility in profit or loss.

Simplifying hedge accounting

Two general approaches are proposed for hedge accounting. To eliminate (or possibly replace) existing hedge accounting requirements, or to maintain and simplify them.

The discussion paper sees the possibility of elimination of all hedge accounting. The consequence of this would be increased volatility in profit or loss.

The discussion paper also suggests introducing less complex fair value hedges when discussing the potential replacement of existing hedge accounting requirements, but provides no alternative for cash flow hedge accounting. Fair value hedge accounting might be replaced by a fair value option for instruments that would otherwise be hedged items. It also suggests permitting recognition of gains and losses on financial instruments designated as hedging instruments outside profit or loss, or permitting recognition of gains and losses outside profit or loss on all financial instruments. These potential changes are considered under the current presentation requirements. However, they could be affected by decisions made by the IASB in the project on financial statement presentation.

The other approach suggested in the discussion paper is to maintain, but simplify existing hedge accounting requirements. The following table sets out the IASB's suggestions for reducing complexity and related implications.

Suggestion	Implication
Designation of hedge accounting is irrevocable.	Reduces management's flexibility and is a key advantage over an irrevocable fair value option.
Hedge accounting for partial hedges is prohibited.	Reduces the frequency in which hedge accounting is applied as the most common hedging strategies are partial hedges.
Eliminating the quantitative retrospective effectiveness test but requiring a prospective qualitative test.	Increases the number of hedging relationships and provides greater flexibility.
'Similar items' test for portfolio hedge accounting is relaxed or removed.	Increases the number of hedging relationships as hedge accounting would reflect the way that entities manage economic risk on a portfolio basis.
The reclassification of gains and losses to profit or loss for cash flow hedges is stated at inception of the hedge and will be recognised in profit or loss regardless of whether the forecast transaction occurs as planned.	Less complex and reduces the need to track individual gains and losses. However, mistakes in forecasting would cause volatility in profit or loss.

The IASB has decided that the following criteria must be met irrespective of which intermediate change is proposed:

- provide more relevant and easily understandable information for users;
- consistent with the long term measurement objective of fair value;
- not increase complexity; and
- any improvement and simplification must justify the cost of change.

The last section of the discussion paper sets out the IASB's arguments as to why fair value is the only measure appropriate for all types of financial instruments. Next month, in part 2, *IFRS News* takes a closer look at these proposals and considers whether fair value accounting provides the right answer.

[1] Memorandum of Understanding *A Roadmap for Convergence between IFRSs and US GAAP 2006-2008* published in February 2006.

IFRIC D-24 Customer contributions

The IFRIC issued a draft interpretation dealing with customer contributions in January 2008. Global ACS director Menachem Steinberger explains the proposals.

The proposals in IFRIC D24 Customer Contributions would apply when an entity receives property, plant and equipment (PP&E) from a customer to facilitate the supply of goods or services. It also applies when the entity receives cash to be used specifically to acquire PP&E, and the entity uses the PP&E to supply goods or services to the customer. These arrangements occur in the utilities, telecommunications and construction industries when, for example, a customer constructs, or finances the construction of, an extension to the electricity network to supply a specific site.

D24 would also apply when an asset is contributed by a party other than the customer, for example when a housebuilder constructs an asset that will be used by a utility to supply water to all the houses on the development. The IFRIC concluded that an arrangement in which one entity receives an asset (for example, an extension to a network) and another delivers the service (for example telephone services) is no different to an arrangement in which the service provider receives the asset directly.

The draft interpretation requires that the entity receiving the asset first assesses whether it qualifies for recognition as an asset. Assets that qualify for recognition are recorded initially at fair value and then depreciated over their useful life.

The entity receiving the asset has incurred an obligation to deliver services or provide access to the asset in the future. A liability equal to the fair value of the asset is therefore recognised as deferred revenue. The obligation is reduced and revenue recognised over the period in which the entity has obligation to deliver services. The length of the period will depend on the contractual arrangements but will not exceed the useful life of the asset.

The entity receiving the assets is also required to determine whether the arrangement with its customer contains a lease, in which case IAS 17 Leases is applied. When the arrangements result in the asset being leased back to the customer in a finance lease arrangement neither the asset nor the obligation is recognised.

The proposals may mean that some entities that do not currently account for customer contributions will be required to gross up the balance sheet to recognise PP&E and deferred revenue. These entities would subsequently gross up the income statement with broadly equivalent revenue and depreciation over the service contract period. Some observers have questioned the need for an interpretation. Companies that receive customer contributions have had to develop accounting policies using the existing guidance in IAS 18, IAS 17, IFRIC 4 and SIC 27.

Stephen Cooper – Analyst and IASB Board member

Stephen Cooper was appointed as a part-time member of the IASB in July 2007. He is also Managing Director and Head of Valuation and Accounting Research at UBS Investment Bank in London. He talks to *IFRS News* about his experience as an analyst and IASB board member.

You've had 8 months at the Board now. What are your first impressions? Any surprises?

No major surprises. Having spent a number of years being involved with various IASB committees such as the Analyst Representative Group and the Advisory Groups for Share-based Payment and Financial Statement Presentation I knew reasonably well what I was letting myself in for. Perhaps the only surprise was the amount of due process and the resulting timescale the IASB operates to. I realised it would not be like writing a research report at UBS, but somehow I had not appreciated just how long producing a standard actually takes.

Who or what has impressed you at the IASB?

The level of the overall commitment to improve financial reporting and the quality of many of the individuals involved. I won't embarrass anybody by naming names.

You are a lone analyst (user of financial statements) amongst the preparers, academics, regulators and professional standard setters. Do you see differences in how you think and your priorities?

I think everyone is looking to set standards that provide useful information for investors. Having board members with a variety of backgrounds is probably the best way of achieving that. If there is a difference it is perhaps an appreciation of limitations of what investors can do with financial information, bearing in mind that the time available for analysis is generally constrained. Perhaps that is why I believe that presentation is a very important issue.

What can you, as an analyst, contribute to the Board?

I hope to contribute in all aspects of the Board's work, but particularly to be able to identify what information is important to users.

You are a 'part-time' Board member. What does that mean?

It effectively means full-time apart from perhaps doing less of the travelling and presenting at various conferences around the world. That occupies a significant amount of time for other board members. I certainly spend considerably more than 50% of my time at the IASB.

How much support do you get from UBS? Was it a struggle to persuade your organisation to allow you the time?

UBS has been very supportive in allowing me to switch to what is rather less than a part-time job there. They were also supportive in the past when I was a full-time employee, but would still spend time attending the IASB committees I mentioned earlier.

Were you 'headhunted' or did you queue up to join the Board?

A variety of people suggested I put my name forward for consideration by the IASCF Trustees, particularly considering the desire to see users represented on the board. It is something I had been considering for a while; I was not exactly headhunted.

Reflecting on the first seven years of the Board's work – what is the Board's most significant achievement so far?

I think perhaps the most significant achievement overall is the pace of global convergence that the IASB facilitated. A few years ago I would certainly not have predicted that so many major economies would either be in the process of adopting or converging with IFRS. Nor would I have predicted the current discussions taking place in the US. Global accounting convergence is something I had been advocating for many years at UBS, in the belief that this would bring significant benefits for investors. This view was supported by the predominantly positive experience of convergence in Europe in 2005. In terms of setting specific standards, I would say the most significant is IFRS 2 Share-based Payments. I remember when I first started in my role at UBS in 1997, how astonished I was that this expense was not recognised, and that so many people seemed to believe this was the right answer. I think the IASB deserves enormous credit for sticking to what is right in spite of the opposition from corporates, and it should be said, many accountants. It is interesting to note that few commentators today question that decision.

What is the most important project on the current agenda? What's the most important thing not on the current agenda?

It might be seen as a rather surprising choice, but I would suggest that insurance accounting is one of, if not the most important project. Clearly it is not the most important in terms of scope, as only a limited number of entities will

apply the eventual standard. However, the issues that are being dealt with in this project are amongst the most difficult the Board faces and have important implications for many other projects. These include identifying and measuring liabilities, and the problem of revenue recognition. I think the most important thing not on the agenda is intangible assets. While I agree with the decision taken last year not to add this project to the Board's agenda at the current time, I believe it is something that needs to be tackled at some point. For example, many investors are confused by the inconsistencies we currently have, such as recognising intangibles on a business combination but, generally, not otherwise.

Imagine you have a magic wand. What would you fix or change in the current standards?

I would eliminate all of the options in standards so that investors know what they are getting, simplify measurement, and provide a more meaningful cash flow statement.

Life after the withdrawal of the reconciliation; what will happen with convergence?

I see no reason why convergence will change in any way.

Will the US move to IFRS? Is this a good idea for the rest of the world?

I don't know whether the US will or not, and could not even guess at a probability it would happen – definitely a level 3 measurement! However, I certainly think investors would be best served if all companies followed a global set of high quality accounting standards.

BC2 – endorsement or not?

Although BC2 was dealt with before I joined the board, I support the standard. Yes, I believe it will be endorsed; I certainly hope so.

Is there enough enforcement of IFRS? Can a global set of standards work without a global regulator?

Clearly the answer to this would vary by jurisdiction. Generally I believe that enforcement could be improved, both at the auditor level and by regulators. Yes, a global regulator would help, although better coordination and a common approach amongst the current group of regulators would be a very good start.

What is a principles based standard? Can we (preparers, auditors, users, regulators and the lawyers) live with judgements?

I think it is where one does not need a new standard for every new transaction that a preparer comes up with; which I think is a good thing. The problem is that some of the parties you mention want the comfort of a detailed rule book. For these, living with judgements will require something of a change in mindset.

Changing landscape of global standard-setting

Recent announcements from the two pre-eminent standard-setting organisations show that the tectonic plates are shifting in the world of accounting. The IASCF Trustees have announced a likely increase in size of the IASB as it gears up to be the global standard setter. The US FASB, meanwhile, is being slimmed down. Graham Gilmour examines the latest developments.

At their meetings in January and March this year, the Trustees of the International Accounting Standards Committee Foundation (IASCF) – the body that oversees the IASB – refined their plans for the forthcoming constitutional review. The Trustees are committed to review the constitution every five years. The normal periodic review, this time, coincides with a review of strategy, as the Trustees consider how to give the IASB the accountability and operational capability it needs to be a truly global standard setter.

The fact that many larger market economies (for example Canada, India, Japan and Korea) have recently declared that they expect to converge with IFRS, between now and 2012, represents a step-change in the use of the standards. It also has far-reaching implications for the dynamics of the relationship between the IASB/IASCF organisation and national regulators. National government authorities are effectively putting their faith in the IASB to set accounting standards on their behalf. The authorities will need to have confidence in the accountability of the Board to the Trustees, and of the Trustees to this wider political constituency. Adoption of IFRS in the US would further emphasise these issues of political accountability. If the IASB becomes the world's standard setter, it will also have to consider operational aspects – such as the size of the Board and the staff, and how it communicates with an increased constituency of stakeholders around the world.

The Trustees have therefore announced a two-stage process for the review of the Constitution. They will consult first on a proposal to form a 'Monitoring Group' (MG) that will provide a further tier of political-level oversight above the Trustees. The MG would likely comprise senior representatives of international regulatory and other bodies such as IOSCO, the European Commission and

World Bank. It is proposed that the MG would be responsible for the appointment of Trustees and for reviewing how the Trustees appoint members of the IASB. It would also review the Board's strategy and its compliance with due process.

This first stage of the consultation process – likely to begin later this month – will also include a proposal to increase the size of the IASB to 16 members (from 14), and to introduce for the first time on the Board minimum geographical composition thresholds. It is argued that the Board's increasingly global constituency calls for greater geographical diversity in the membership. One formula being considered is to have four members from each of North America, Europe and Asia/Oceania, with the remaining four members appointed from any area subject to maintaining overall balance.

It is thought that obtaining early support for the MG and an enlarged IASB is crucial to obtaining wider buy-in for the changes to the constitution as a whole. Further detailed changes to the constitution will be consulted on in a second phase, perhaps beginning in the second half of 2008.

While the IASCF Trustees are contemplating an increase in the size of the IASB, the equivalent body in the US – the Financial Accounting Foundation (FAF) – has moved to reduce the size of the FASB from seven to five members. This was among a number of changes approved by the FAF in February to the oversight, structure and operations of the FAF and the FASB.

The FAF also approved a change in the FASB's technical agenda-setting process, to give the chairman Bob Herz greater authority to set the FASB's project plans, agenda and priority of projects.

In its comment letter on the proposed changes, PwC's US firm indicated that it was willing to support the reduction in board size from seven to five, as long as the FAF determines that the reduction will increase the FASB's efficiency sufficiently to outweigh the potential detriment of there being less expertise on the Board.

The FASB's role as a standard-setter is likely to change significantly with the anticipated move to IFRS as the financial accounting and reporting framework used in the US capital markets. These changes are the first steps as the FASB begins transitioning to its new role.

Graham Gilmour is a senior manager in the UK firm's Public Affairs group and works closely with the Global ACS Central team.

The IASCF's announcements can be found on www.iasb.org

The FAF's annoucement can be found on www.fasb.org

Update on Korea's move to IFRS

Korea has come a long way towards transition to IFRS since the government and the Korean Accounting Standards Board (KASB) officially announced the 'roadmap to IFRS' in March 2007. Kevin Lee, partner and SeungKyoung Yoo, senior-manager in PwC Korea's IFRS Centre of Excellence provide an update on Korea's progress.

The launch of Korea's roadmap marked the country's formal commitment to adopt IFRS into national GAAP from 2009. The Korean government is revising the relevant laws and regulations to endorse IFRS, and plans to release these in the second half of 2008. A significant milestone was reached on 21 December 2007 when the Korean International Financial Reporting Standards as issued by the IASB (K-IFRS) were released.

The K-IFRS is a word-for-word translation of the full IFRS issued by the International Accounting Standards Board. The translation was undertaken in accordance with the due process set out in the IASCF's copyright agreement. It was also reviewed by the 'Big 4' accounting firms in Korea. The K-IFRS includes the 'Framework for Preparation and Presentation of Financial Statements', all current International Accounting Standards (IASs), International Financial Reporting Standards (IFRSs) and current interpretations issued by the Standards Interpretations Committee (SIC) and the International Financial Reporting Interpretations Committee (IFRIC). The list of IFRSs and its corresponding K-IFRS is presented in the Appendix.

The IFRS Basis for Conclusions and Application Guidance are also being translated into Korean and are due for release later this year.

KASB and large Korean corporations are now familiarising themselves with the standard setting process and are contributing towards the financial funding of the IASCF. Korean listed companies will be required to apply K-IFRS from 2011, and many corporations have started IFRS conversion projects in readiness for adoption.

IFRS Roadmap

Adoption date	Company	Basis of implementation
1 January 2009	All companies except financial institutions	Voluntary
1 January 2011	All listed companies and financial institutions*	Mandatory

** Financial institutions include non-listed companies in certain financial sectors*

The Korean securities regulator (Financial Supervisory Service) established the IFRS International Advisory Committee in January 2008. The committee comprises eight members from regulatory, academic and professional backgrounds including foreign experts with experience in the US and EU. It will support and advise the Financial Supervisory Service throughout the IFRS adoption process. Kevin Lee, Leader of the IFRS Group in PwC Korea is one of the committee members appointed as a representative of the Big 4 in Korea.

The KASB began offering K-IFRS courses to public and private accountants and corporate personnel to promote IFRS education in December 2007.

Many conferences, surveys, seminars, training events and other meetings with companies still indicate a concern over required changes to the regulatory environment for the adoption of IFRS as the national GAAP to become a reality. Further concerns include the availability of information and resources to deal with the transition, and costs associated with implementing this change. Consistent interpretation of IFRS is also a major concern for the Korean regulatory body and KASB. This will require close interaction and cooperation with the IASB.

Korea has made much progress towards full transition of IFRS since the announcement of the roadmap. PwC Korea is the largest accounting firm in Korea and continues to play a major role as commentator, contributor and advisor through this accounting change.

New trustees appointed to IASC Foundation

The International Accounting Standards Committee (IASC) Foundation has appointed three new Trustees.

- **Robert Glauber,** retired chairman and chief executive officer, NASD (the private sector regulator of the US securities market), and former Under Secretary of the Treasury for Finance, United States
- **Pedro Malan,** former Minister and former president of the Central Bank of Brazil, and currently chairman of the board of Unibanco
- **Luigi Spaventa,** former chairman of the Commissione nazionale per le società e lar borsa (Consob) and former Minister of the Budget, Italy.

The appointments are for a term of three years, renewable once.

The new trustees replace retirees William McDonough of the United States, Roberto Teixeria da Costa of Brazil and Kees Storm of the Netherlands.

The criteria for selecting Trustees mandate that Trustees "shall have an understanding of, and be sensitive to the challenges associated with the adoption and application of high quality global accounting standards developed for use in the world's capital markets and by other users" and "the mix of Trustees shall broadly reflect the world's capital markets and a diversity of geographical and professional backgrounds".

Commenting on the appointments, Paul Volcker, chairman of the Trustee Appointments Advisory Group said:

"The Advisory Group believes that the Trustees have identified three particularly well-qualified individuals with relevant experience at a critical time for the organisation. We congratulate the Trustees for having conducted an open and thorough process to replace those leaving the organisation".

IFRS 3 - Reflections on the new standard

The IASB issued IFRS 3 (Revised) Business Combinations in January 2008. Three months on, IASB Board member Philippe Danjou responds to questions on the difficulties of applying the new standard and explains the improvements it brings to international accounting regulatory governance, to competition between companies and to transaction management.

How does the new IFRS 3 improve international accounting regulatory governance?

PwC: The request for comments on the exposure draft of proposed amendments to IFRS 3 (referred to as 'BC2') triggered criticism on a range of issues. These included the increased use of fair value, the adoption of the 'economic entity' model for the preparation of consolidated financial statements, the counter-intuitive effects resulting from the proposed guidance and the absence of field tests concerning ground-breaking proposals. Few of these concerns are addressed in the final version of the new IFRS 3. Furthermore, despite the IASB's endeavours over more than 15 years to reduce the number of accounting options available, a new option with major implications, the 'full goodwill' method (ie, the measurement of Non Controlling Interests at Fair Value), has been added.

PD: The issuance of the new version of the standards (IFRS 3 and IAS 27 and FAS 141 and 160) shows that convergence is not a one-way process – towards US GAAP. The preparation of the new standard provided a breakthrough opportunity for the formulation of common positions by the world's two leading standard-setting bodies, the IASB and the FASB.

These common positions:
- are the result of three years' work by a joint IASB/FASB team;
- represent a true departure from current practice under US GAAP and to a lesser extent under IFRS;
- were decided separately, but in an almost identical manner, by the IASB and FASB.

As for the 'full goodwill' method, which is more accurately described as the measurement of non-controlling interests at fair value, it is optional under IFRS and mandatory under US GAAP. This compromise was adopted because the IASB Board was unable to reach a majority agreement on a single final solution. The Board was divided on the assessment of the costs and benefits of this change to the standard. It takes heed of the criticism voiced in Europe while allowing for the application of the same treatment under the two accounting frameworks.

How does the new IFRS 3 level the playing field for European and American companies?

PD: Some of the counter-intuitive accounting consequences, which were extensively covered in your preceding articles[1], could put companies off at first.

The new IFRS 3 is nevertheless the first international standard that permits a common assessment of a key component of financial reporting, namely accounting for acquisitions and disposals.

Thanks to the revised guidance:
- if two companies – say a US firm and a European based one – are competing to acquire the same target, neither of the bidders will gain an advantage from its accounting framework.
- even when there is no such competition, it will be possible to compare the impact on the respective financial statements if the two companies involved have a similar external growth record.

We are proud of what has been achieved so far with convergence – and there is more to come.

PwC: Yes, but the provisions of the new standard may not be applied retrospectively to earlier transactions and there is an exemption upon first-time adoption of IFRS. This means that the full comparability of earnings is many years off. This situation favours American companies, which have long benefited from the 'pooling of interests' method, which has been a catalyst for business combinations.

How does the new IFRS 3 enhance transaction transparency?

PD: As explained in your previous articles[1], the new guidance may in some cases increase the volatility of earnings and equity because of the extended use of fair value.

However, by requiring the recognition in the income statement of transaction costs and the re-measurement of any previously-held interest upon gaining control and of the retained interest upon losing control, it enhances transparency and gives companies the opportunity to:
- better justify the residual goodwill;
- provide better disclosure of transaction costs and of existing unrealised gains related to acquisitions and disposals, thereby making the information more readily visible.

PwC: But given the particularly counter-intuitive accounting consequences of the new standard for market practitioners, there will be no simplification of financial communication in the initial years.

How does the new IFRS 3 live up to the simplification of guidance announced by the IASB?

PD: Some of the consequences of the new guidance may seem counter-intuitive relative to current practice. However, this is always the case when changes are introduced. People need time to get used to the new rules.

That aside, the approach underpinning the new IFRS 3 is a highly logical one and gives precedence to two key events – the obtaining and the loss of control. These events justify re-measurements to fair value and the recognition of the resulting

gain or loss in the income statement. Conversely, transactions not entailing a change in control do not alter the economic entity and are not perceived as significant. Accordingly, the related dilution/accretion is recorded in equity.

Admittedly, the logic has been taken to the extreme, but the treatment is rigorous and straightforward. Furthermore, no exemptions are allowed other than the option to apply the 'full goodwill' method under the compromise reached by the IASB.

And so, yes, the new version of the standard is an initial example of the revision of IFRS guidance in the direction of simplification. The simplification is even greater relative to US GAAP, as there will no longer be fair value re-measurements for step acquisitions.

PwC: Did simplification have to be taken so far? The logic pursued is the result of the balance sheet approach under IFRS taken to the extreme. If we continue along this road, fears will continue to arise concerning the introduction of full fair value over the long term and other innovations regarding framework concepts.

Wouldn't an arbitrary agreement be preferable in some cases to logic taken to the extreme?

How does the new IFRS 3 facilitate the management of acquisitions?

PD: The 'economic entity' approach is useful here for the financial analysis, for example, because of its treatment of non-controlling interests:

- for the purposes of the debt-to-equity ratio, non-controlling interests are included in consolidated equity, as the debt calculation includes 100% of subsidiaries' debt;
- for the purposes of the net profit margin ratios, non-controlling interests are included in the calculation of consolidated profit, which arises out of the consolidation of 100% of subsidiaries' turnover.

PwC: Change represents an opportunity to take a fresh look at how we do things and improve the effectiveness of procedural and management approaches. Our previous articles[1] have provided some essential advice in this vein:

Adapt acquisition/disposal strategies:
Acquisition and disposal decisions quite rightly are not and should not be dictated by accounting considerations. However, the consequences of the new IFRS 3 on earnings and equity are such that the impact of proposed transaction terms on the financial statements should be anticipated and simulated in order to avoid unwelcome surprises.

Contain costs:

- Transactions costs will no longer be included in goodwill, but instead will be clearly visible in the income statement.
- The newly-introduced possibility to recognise specific liability-related indemnities granted by the seller as assets will prompt companies to extend the protection provided under liability indemnification clauses and better monitor related compliance. The aim here is to achieve a neutral impact on the income statement.
- The desire to avoid the expensing of payments due to former owners retained in managerial positions after the acquisition date will prompt companies to word the clauses governing such payments carefully.

[1] Articles appeared in *Les Echos* (French daily newspaper)

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