MALAYSIAN INSTITUTE OF ACCOUNTANTS

FRSIC

MALAYSIAN INSTITUTE OF ACCOUNTANTS
FINANCIAL REPORTING STANDARDS IMPLEMENTATION COMMITTEE
("FRSIC")

FRSIC Issue No. 21 [2008]

Accounting for Incremental Goodwill when Fair Value of Cost of Business Combination (based on Quoted Share Price) exceeds Agreement Price

The issue:

Both the old and revised FRS 3, Business Combinations ("FRS 3"), requires the cost of a business combination to be measured at fair value. While the old FRS 3 considered an independent valuation of equity shares to constitute fair value, even for marketable securities; the revised FRS 3 which took effect from 1 January 2006 strictly requires that the fair value of quoted equity instruments be measured as the published price of those equity instruments on the completion date of the business combination.

In other words, the new provision in the revised FRS 3 requires companies which undertake business combinations from 1 January 2006, where the whole or part of the consideration paid for businesses acquired comprise quoted equity shares, to record this portion of the cost of acquisition based on the shares' trading price as at the completion date of the business combination, irrespective of the share price previously determined in the sale and purchase agreement ("S&P").

This new requirement has a direct impact on the amount of goodwill/ negative goodwill to be recognized in an acquisition, depending on the fluctuations in the quoted shares' trading prices between the S&P date and the completion date. However, since any such "excess" goodwill created is purely due to market price movements which may not be substantiated by the underlying assets/ future economic benefits, it should be impaired.

The issue is that the new requirement causes unnecessary distortion to a company's financial results. In addition, when the amount of "excess" goodwill impaired is substantial, it could render a company with the PN17 status if the company's reserves cannot absorb the impairment amount.

Current accounting practice as observed by the Submitter:

Diverse. Some companies have impaired the "excess" goodwill and subsequently seek court approval to offset the impairment against the share premium account. Other companies have recognized the share price increase above the S&P agreed price in 'other reserves' instead of share premium account.

Reasons for the FRSIC to address the issue:

The new requirement has a possible material impact on a company's bottom line in the local

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environment, which would inadvertently deflate its profits.
Submitter's proposal or recommendation to address the issue: The provision in the revised FRS 3 requiring the cost of acquisition to be recorded at fair value resulting in an increase in share premium account but any subsequent impairment on "excess" goodwill cannot be offset against this share premium and instead should be written off to the income statement appears to contradict the general principles of accounting. As such, guidance is required from the FRSIC.
Submitted on: 8 January 2008
Corresponding FRSIC Consensus: PROJECT WAS DISCONTINUED. The FRSIC's deliberation: FRSIC has decided to discontinue the project as this is not an implementation issue but an issue resulted from the inherent attributes of the transaction process. The submitter had been notified of the FRSIC's decision. [*Last updated: 19 March 2014*]

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