

# BUSINESS COMBINATIONS

RELEVANT TO ACCA QUALIFICATION PAPER P2

THIS IS THE SECOND ARTICLE OF A TWO PART SERIES. PART ONE DEALT WITH SIMPLE GROUP COMBINATIONS, PIECEMEAL ACQUISITIONS, AND DISPOSALS. THIS ARTICLE FOCUSES ON THE IMPLICATIONS OF IFRS 3 (REVISED) FOR COMPLEX GROUP CALCULATIONS.

**The treatment of complex groups is very similar to the treatment under the old IFRS 3, in that effective shareholdings must be considered, and the indirect holding of the non-controlling interest (NCI) must still be calculated.**

One important issue is that, to ensure comparability between partial and full methods under IFRS 3 (Revised), the way in which the partial method deals with the indirect subsidiary differs from that under the old IFRS 3. The examples below explain and illustrate this revision in method.

**EXAMPLE 1**

J purchased its shareholding in B on 1 January 2007, and B purchased its shareholding in D on 31 December 2007. Control was achieved on these acquisition dates.

The following financial statements relate to the J Group as at 31 December 2008:

	J plc \$m	B plc \$m	D plc \$m
Cost of investment in B (80% holding)	32		
Cost of investment in D (60% holding)		22	
Other net assets	26	13.2	30
	<u>58</u>	<u>35.2</u>	<u>30</u>
Equity shares	40	24	20
Retained earnings	18	11.2	10
	<u>58</u>	<u>35.2</u>	<u>30</u>

The retained earnings were:

	B \$m	D \$m
1 January 2007	4	1
31 December 2007	13	3.2

The fair value of the NCI, based on effective shareholdings, was:

	B \$m	D \$m
1 January 2007	8	18.9
31 December 2007	9.8	20

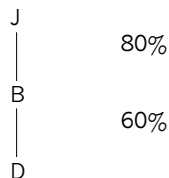
The goodwill of B is impaired, as at 31 December 2008, by \$4m following poor trading results for the year. There was no impairment prior to this date.

*Required*

For both full and partial methods, show the statement of financial position at 31 December 2008.

*Solution*

Under both full and partial scenarios, J Group's effective share of D will be 80% of 60%, or 48%.



J controls B from 1 January 2007, and controls D from 31 December 2007; therefore, the relevant acquisition date retained earnings are \$4m and \$3.2m respectively. By the same token, the fair values of the NCI at acquisition of B and D are \$8m and \$20m respectively.

# (REVISED) PT 2

THE TREATMENT OF COMPLEX GROUPS IS SIMILAR TO THE OLD IFRS 3 IN THAT EFFECTIVE SHAREHOLDINGS MUST BE CONSIDERED, AND THE INDIRECT HOLDING OF THE NON-CONTROLLING INTEREST (NCI) MUST STILL BE CALCULATED.

Full method

*Working (a) – Goodwill*

The goodwill relating to B is the same as it would be under a simple group scenario. The fair value of the consideration held in D represents the 60% shareholding purchased by B. The 20% element that belongs to the NCI of B needs to be deducted, thereby giving the net balance, which represents the effective 48% shareholding from the Group viewpoint.

In adding the fair value of the NCI in D (based on a 52% shareholding), we arrive at the total fair value of 100% of D, including the element attributable to goodwill. Finally, by deducting the fair value of the identifiable net assets, the balance represents goodwill attributable to both the J Group and the NCI:

	B \$m	D \$m
Fair value of consideration	32	22
Indirect holding in D belonging to NCI (20% x \$22m)		(4.4)
Fair value of NCI	<u>8</u>	<u>20</u>
	40	37.6
Fair value of identifiable net assets at acquisition (\$24m + \$4m) and (\$20m + \$3.2m)	<u>(28)</u>	<u>(23.2)</u>
Goodwill	<u>12</u>	<u>14.4</u>

As at 31 December 2008, the total goodwill is \$26.4m (\$12m + \$14.4m) less impairment of \$4m, ie \$22.4m.

*Working (b) – NCI*

As with simple groups, the NCI calculation:

- includes the share of post-acquisition retained earnings based on effective shareholdings
- includes any goodwill impairment/ credit attributable to the NCI, based on effective shareholding.

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- includes any goodwill impairment/ credit attributable to the NCI, based on effective shareholding.

The only additional element required is to reflect the fact that the NCI obtained its share of B's investment in D. This needs to be deducted in the NCI calculation as follows:

	B \$m	D \$m
At acquisition: 1 January 2007	8	
31 December 2007		20
Indirect holding in D belonging to NCI (20% x \$22m)		(4.4)
Post-acquisition profit: 20% x (\$11.2m - \$4m) and 52% x (\$10m - \$3.2m)	1.4	3.5
Goodwill impairment (20% x \$4m)	<u>(0.8)</u>	
Total NCI	<u>8.6</u>	<u>19.1</u>

This makes a total NCI of \$27.7m.

*Working (c) – Retained earnings*

The retained earnings calculation does not differ significantly when compared to the previous version of IFRS 3. It is important to realise that effective shareholdings are always used within this calculation.

	D \$m
J retained earnings	18
Share of post-acquisition B, 80% x (\$11.2m - \$4m)	5.8
Share of post-acquisition D, 48% x (\$10m - \$3.2m)	3.3
Less goodwill impaired, (80% x \$4m)	<u>(3.2)</u>
	<u>23.9</u>

*J Group: statement of financial position as at December 2008*

	<b>\$m</b>
Net assets (\$26m + \$13.2m + \$30m)	69.2
Goodwill (working (a))	22.4
Total net assets	<u>91.6</u>
Equity shares	40
Retained earnings (working (c))	23.9
NCI (working (b))	<u>27.7</u>
	<u>91.6</u>

### Partial method

The approach under the partial method is different to the approach used in the previous version of IFRS 3, in order to maintain comparability between the full and partial methods according to IFRS 3 (Revised). This revised approach is, in many respects, simpler than that according to the previous version of IFRS 3. This revised method follows exactly the same approach as the full method with the exception that the measurement of NCI is not at fair value and therefore, within the goodwill calculation, only a proportion of the identifiable net assets are included.

### Working (a) – Goodwill

The goodwill relating to B is the same as it would be under a simple group scenario. The fair value of the consideration held in D represents the 60% shareholding purchased by B; therefore the 20% element that belongs to the NCI of B still needs to be deducted, thus giving the net balance representing the effective 48% shareholding.

Fair value of identifiable net assets at acquisition will be based on the proportion acquired based on effective shareholdings. The balance resulting is the goodwill attributable to the Group's effective shareholdings:

	<b>B</b>	<b>D</b>
	<b>\$m</b>	<b>\$m</b>
Fair value of consideration	32	22
Indirect holding in D belonging to NCI (20% of \$22m)		(4.4)
Fair value of identifiable net assets at acquisition		
80% x \$28m and 48% x \$23.2m	<u>(22.4)</u>	<u>(11.1)</u>
Goodwill	<u>9.6</u>	<u>6.5</u>

Assuming that the impairment of goodwill relates only to the effective shareholding, then total goodwill as at 31 December 2008 is \$16.1m (\$9.6m + \$6.5m) less impairment of \$4m, ie \$12.1m. The difference in the goodwill under the partial method,

as compared to full method, is that the goodwill attributable to the NCI is valued at fair value.

### Working (b) – NCI

As with the full method, the NCI calculation needs to include the cost of the investment that B has in D. As NCI is not at fair value, the goodwill calculated previously only relates to the effective shareholding owned by the Group, and is therefore not part of this calculation.

	<b>B</b>	<b>D</b>
	<b>\$m</b>	<b>\$m</b>
At acquisition		
20% x \$28m and 52% x \$23.2m	5.6	12.1
Indirect holding		(4.4)
Post-acquisition profit		
20% x (\$11.2m - \$4m) and		
52% x (\$10m - \$3.2m)	<u>1.4</u>	<u>3.5</u>
Total NCI	<u>7.0</u>	<u>11.2</u>

This makes a total NCI of \$18.2m. Note that the NCI is not charged with its share of the goodwill impairment. Under the two methods, the difference of \$10.3m in the goodwill amounts (\$22.4m - \$12.1m) can be seen to be the difference of \$9.5m between the NCI figures (\$27.7m - \$18.2m) plus the impairment of goodwill charged against the NCI of \$0.8m.

### Working (c) – Retained earnings

The rule within the retained earnings calculation is to always use the effective shareholding. Remember, the assumption was that the goodwill impairment related to the proportion of B held by J.

	<b>\$m</b>
J retained earnings	18
Share of post-acquisition B,	
80% x (\$11.2m - \$4m)	5.8
Share of post-acquisition D,	
48% x (\$10m - \$3.2m)	3.3
Less goodwill impaired	<u>(4)</u>
	<u>23.1</u>

*J Group statement of financial position as at December 2008*

	<b>\$m</b>
Net assets (\$26m + \$13.2m + \$30m)	69.2
Goodwill (working (a))	<u>12.1</u>
Total net assets	<u>81.3</u>
Equity shares	40
Retained earnings (working (c))	23.1
NCI (working (b))	<u>18.2</u>
	<u>81.3</u>

TO ENSURE COMPARABILITY BETWEEN PARTIAL AND FULL METHODS UNDER IFRS 3 (REVISED), THE WAY IN WHICH THE PARTIAL METHOD DEALS WITH THE INDIRECT SUBSIDIARY DIFFERS FROM THAT UNDER THE OLD IFRS 3.

It is important to consider how the exercise would differ if the shareholding in the indirect subsidiary D had been acquired by B before J purchased its shareholding in B.

#### EXAMPLE 2

Using the information in **Example 1**, assume that J purchased its shareholding in B on 31 December 2007, and B purchased its shareholding in D on 1 January 2007. All other facts within the scenario are unchanged.

#### Required

Using the full goodwill method, show the statement of financial position at 31 December 2008.

#### Solution

Whether using the full or partial method, it is important to consider the date of acquisition, as this will impact on the acquisition date retained earnings.

J controls B from 31 December 2007, and B controls D from 1 January 2007; therefore, the relevant acquisition date retained earnings are as at 31 December 2007, as this is when J is able to control both entities. Therefore, the retained earnings at this date – of \$13m and \$3.2m respectively – will be used. Similarly, the fair values of the NCI of B and D are \$9.8m and \$20m respectively at acquisition.

Effectively, the implications of B having purchased its shareholding in D prior to J purchasing its shareholding in B are the values attributed to the NCI and retained earnings at acquisition. All other calculations, workings, and processes involved in performing the consolidation are the same as **Example 1**.

#### Working (a) – Goodwill

	B	D
	\$m	\$m
Fair value of consideration	32	22
Indirect holding in D belonging to NCI (20% of \$22m)		(4.4)
Fair value of NCI	<u>9.8</u>	<u>20</u>
	41.8	37.6
Fair value of identifiable net assets at acquisition	<u>(37)</u>	<u>(23.2)</u>
Goodwill	4.8	14.4

As at 31 December 2008, the goodwill in the Group statement of financial position is \$19.2m, less impairment \$4m, ie \$15.2.

#### Working (b) - NCI

	B	D
	\$m	\$m
At acquisition	9.8	20
Indirect holding		(4.4)
Post-acquisition profit 20% x (\$11.2m - \$13m) and 52% x (\$10m - \$3.2m)	(0.4)	3.5
Goodwill (20% x \$4m)	<u>(0.8)</u>	
Total NCI	8.6	<u>19.1</u>

This makes a total NCI of \$27.7m.

#### Working (c) - Retained earnings

	D
	\$m
J	18
Share of post-acquisition B, 80% x (\$11.2m - \$13m)	(1.4)
Share of post-acquisition D, 48% x (\$10m - \$3.2m)	3.3
Less goodwill impaired (80% x \$4m)	<u>(3.2)</u>
	<u>16.7</u>

This would give the following group statement of financial position:

#### J Group statement of financial position as at December 2008

	\$m
Net assets (\$26m + \$13.2m + \$30m)	69.2
Goodwill (working (a))	<u>15.2</u>
Total net assets	84.4
Equity shares	40
Retained earnings (working (c))	16.7
NCI (working (b))	<u>27.7</u>
	<u>84.4</u>

#### CONCLUSION

It is important for students to understand these accounting procedures, as it can be seen that the accounting for complex groups is, in fact, quite complex in itself.

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IT IS IMPORTANT FOR STUDENTS TO UNDERSTAND THESE ACCOUNTING PROCEDURES AS IT CAN BE SEEN THAT THE ACCOUNTING FOR COMPLEX GROUPS IS, IN FACT, QUITE COMPLEX IN ITSELF.