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Business Combinations and Goodwill

- Sections 19 FRS 102
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Definition

The bringing together of separate entities or businesses into one reporting entity usually by an acquiror gaining control of one or more businesses

Control

- The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities
  - Presumed to exist when the parent owns, directly or indirectly through subsidiaries more than half of the voting rights

Business

- An integrated set of activities and assets conducted and managed for the purpose of providing: (a) a return to investors; or (b) lower costs or other economic benefits directly and proportionately to policyholders or participants.
- A business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate revenues. If goodwill is present in a transferred set of activities and assets, the transferred set shall be presumed to be a business

Purchase method

- Identify the acquirer
- Determine the acquisition date
- Measure the cost of the business combination
- Allocate the cost of the business combination to the assets acquired, the liabilities and provisions for contingent liabilities assumed and recognise and measure any non controlling interest
- Recognise and measure any goodwill

Acquirer

- The acquirer is the entity that gains control of the other combining entities or businesses
- Indications
  - The larger entity
  - The entity giving up cash or other assets
  - The entity whose management is able to dominate the selection of the management team

Acquisition date

- Effectively the date that the acquirer gains control

Cost of a business combination

- Fair value of assets given, liabilities assumed and equity instruments issued, plus
- Any costs directly attributable to the business combination

Piecemeal acquisition

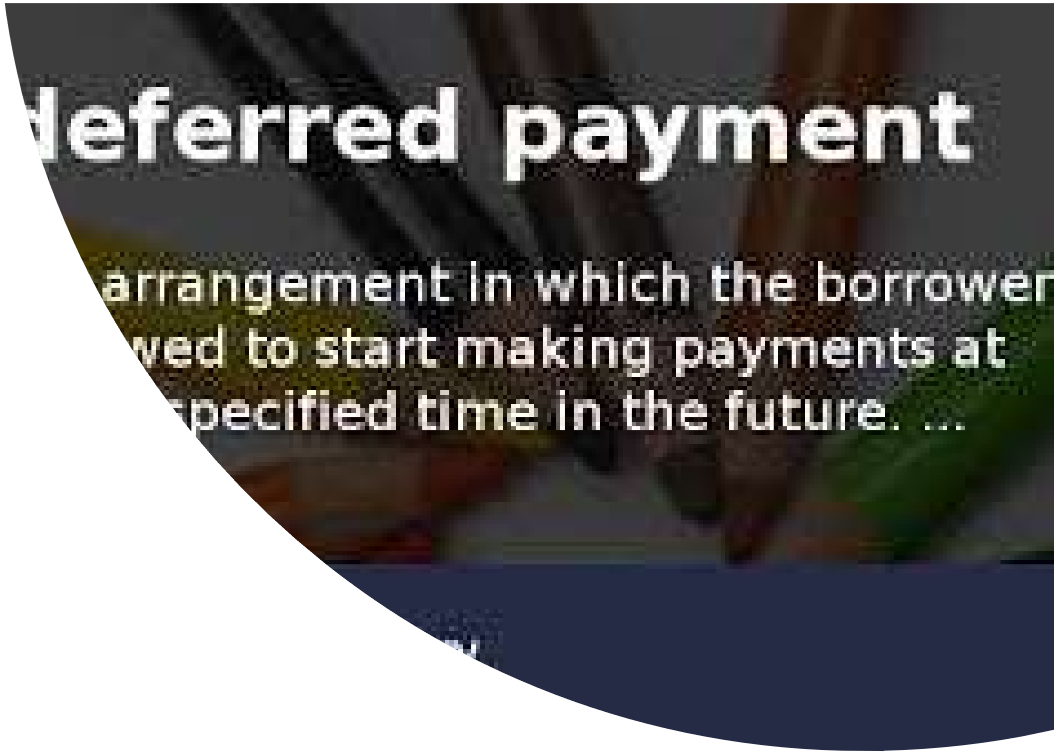
- Where control is achieved following a series of transactions
  - The fair values of the assets given, liabilities assumed and equity instruments issued on an aggregate basis, at the date of each transaction in the series

Contingent consideration

- An adjustment to the cost of the business combination contingent on future events
- Include the estimated amount of that adjustment – reflecting the time value of money, if material, if the adjustment is probable and can be measured reliably
- Adjust the cost of the business combination according to changes in the amounts that will probably be paid

Deferred consideration

- Discount future cashflows (and expected cashflows if contingent consideration exists) to present value
- The unwinding of the discount rate is recorded in profit or loss as a finance charge



Example

- Acquisition costs include
  - Cash payment CU 500,000
  - Land transferred in part payment that has a carrying value of CU 100,000 and a fair value of CU 150,000
  - Shares issued by the acquirer to the shareholders of the acquired business – 10,000 shares in total. No fair value observable for the shares but the PE in the industry is 10 and the EPS of the acquirer per the most recent financial statements is CU 0.15. A discount of 30% is appropriate to reflect the non marketability of the acquirers shares.
  - A deferred payment of CU 200,000 payable in 3 years. An appropriate discount rate is 6%
  - A contingent payment based on future profits of CU 125,000. It’s not expected that the profit targets will be achieved
  - Direct costs associated with the acquisition, incurred by the acquirer of CU 15,000

Fair value of net assets

- Record at fair value all assets and liabilities that exist and not just those assets and liabilities that are recorded on the balance sheet of the acquiree
- Intangible assets – brands, trade names, customer lists etc…
    a. Recognise separate to goodwill if the recognition criteria from Section 18.8 are satisfied (probable inflow of economic benefit and value can be reliably measured) and
    b. The intangible asset arises from contractual or other legal rights and
    c. The intangible asset is separable (capable of being separated or divided from the entity and sold, transferred, licensed etc…)

Intangible assets

- An entity *may choose* to recognise intangible assets separately from goodwill for which condition a and either b or c are satisfied
    - *This policy will then be applied to all intangible assets in the same class*
    - *This policy will be applied consistently to all business combinations*

Contingent liabilities

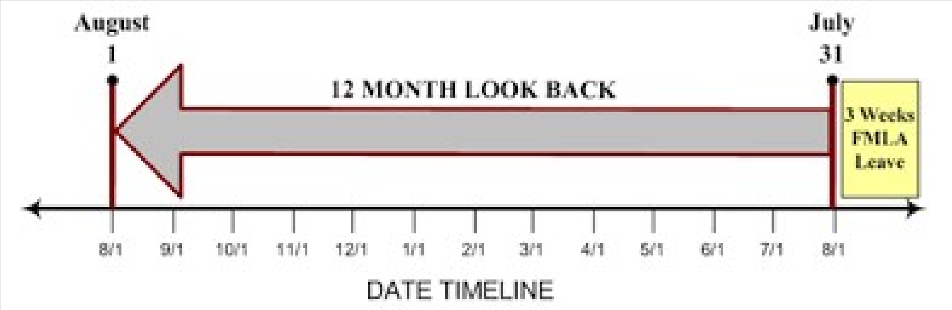
- Record at fair value any contingent liabilities that exist at the date of acquisition

Restructuring

- Unless an obligation exists for the acquiree to reorganise at the acquisition date, no liability will be recorded for reorganisations in the fair value exercise at the acquisition date
- Similarly, no liability will be recorded at the acquisition date for future costs associated with the business combination or indeed for future expected losses

Provisional values

- 12 month rule – from the date of the business combination
- Retrospective adjustment – adjust as if the new information was available at the acquisition date
- If adjustments are required after 12 months – *Section 10 Accounting policies, estimates and errors*

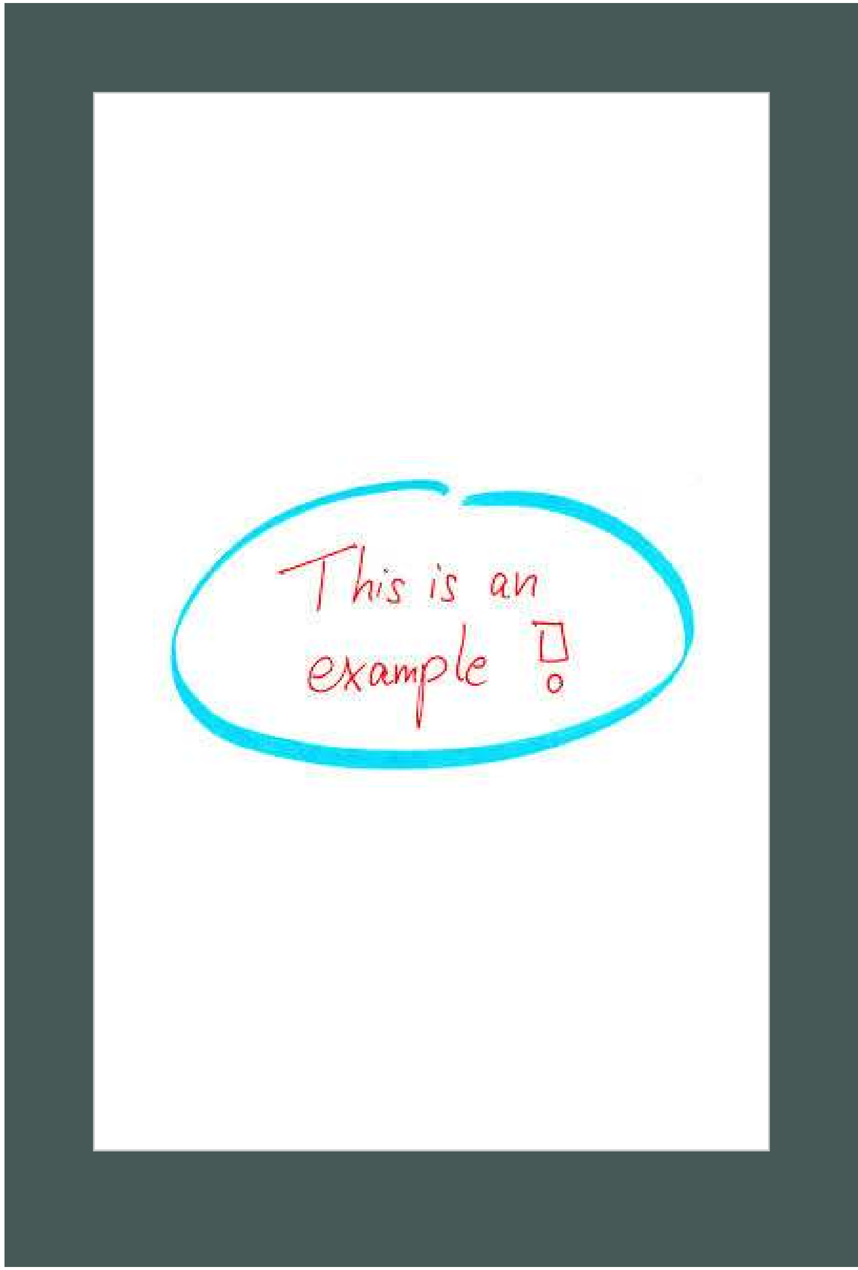


Goodwill

- Record as an asset at cost – cost of the business combination versus the acquiror’s interest in the net amount of the identifiable assets, liabilities and contingent liabilities
- Amortise over the assets useful life – maximum 10 years
- Carry out a test for impairment when deemed appropriate in accordance with *Section 27 Impairment of assets*

Example

- H acquired 75% of S on March 31, 2018.
- They paid cash of CU 275,000 and incurred costs of CU 12,000
- The carrying value of equity at the date of acquisition of S equals CU 291,400
- The land assets of S have a fair value that is CU 19,000 above the NBV and they also have a customer list that has been assessed to have a value of CU 12,000
- Calculate the goodwill



Negative goodwill

- Check your calculations
- Show separately on the SOFP below positive goodwill
- Release to the profit or loss as the related non monetary assets are recovered with any amount exceeding the fair value of the non monetary assets recorded in profit or loss in the period expected to be benefitted

Example

- Cost of business combination is CU 140,000
- Fair value of the net assets acquired is CU 170,000
- Fair value of the non monetary assets is CU 135,000 and they all have a remaining useful life of 10 years
- Calculate the negative goodwill and show how it's treated in future years

Consolidation procedures

- Same year ends – 3 month rule
- Same accounting policies – adjust the subsidiary individual statements
- Cancel intercompany transactions
- Cancel intercompany unrealised profits and losses

EXAMPLE 7

Parentis, a public listed company, acquired 600 million equity shares in Offspring on 1 April 2016. The purchase consideration was €405 million

The SOFPs of the two companies at 31 March 2017 are shown below:

	Parentis		Offspring	
	€ million	€ million	€ million	€ million
ASSETS				
Non Current Assets (note (i)		640		340
Investments		405		Nil
		1045		340
Current Assets				
Inventory (note iii)	76		22	
Accounts Receivables (note iv)	84		44	
Bank	Nil	160	4	70
		1205		410
EQUITY AND LIABILITIES				
Equity attributable to Equity holders of the Parent				
Equity Shares 25 cent each		375		200
Share Premium		150		Nil
Retained Earnings – 1 April 2016	210		120	
- year ended 31 March 2017	84	294	20	140
		819		340
Current Liabilities:				
Accounts Payable (note iv)	130		27	
Taxation	45		23	
Overdraft	25	200	nil	50
Non Current Liabilities:				
10% Loan Note		186		20
		1205		410

The following information is relevant:

(i) At the date of acquisition the fair values of Offspring's net assets were approximately equal to their carrying amounts with the exception of its properties. These properties had a fair value of €40 million in excess of their carrying amounts which would create additional depreciation of €2 million in the post acquisition period to 31 March 2017. The fair values have not been reflected in Offspring's SOFP.

(ii) Offspring sold Parentis goods for €15 million in the post acquisition period. €5 million of these goods are included in the Inventory of Parentis at 31 March 2017. The profit made by Offspring on these sales was €6 million.

(iii) Offspring's accounts payable account (in the records of Parentis) of €7 million does not agree with Parentis's accounts receivable account (in the records of Offspring) due to cash in transit of €4 million paid by Parentis.

(iv) No impairment of Goodwill .