Draft Illustrative Examples

ED 3 BUSINESS COMBINATIONS

Comments to be received by 4 April 2003

These draft Illustrative Examples accompany the proposed International Financial Reporting Standard (IFRS) set out in ED 3 *Business Combinations* (see separate booklet). Comments on the draft IFRS and its accompanying documents should be submitted in writing so as to be received by **4 April 2003**.

All replies will be put on the public record unless confidentiality is requested by the commentator. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org.uk** or addressed to:

Annette Kimmitt
Senior Project Manager
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

Fax: +44 (0)20 7246 6411

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IASCF Publications Department,
1st Floor, 30 Cannon Street, London EC4M 6XH, United Kingdom.
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7332 2749
Email: publications@iasb.org.uk Web: www.iasb.org.uk

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INTERNATIONAL FINANCIAL REPORTING STANDARD
IFRS X Business Combinations

[Draft] Illustrative Examples

These [draft] examples are not part of the [draft] IFRS.

Examples of intangible assets satisfying the criteria for recognition separately from goodwill

The following guidance provides examples of intangible assets acquired in a business combination that are recognised under [draft] IFRS X *Business Combinations* separately from goodwill. To meet the definition of an intangible asset and thus be recognised by the acquirer separately from goodwill, a non-monetary asset without physical substance must be identifiable, ie it must arise from contractual or other legal rights or be separable.

The examples provided below are not intended to be an exhaustive list of intangible assets that would be recognised separately from goodwill. A non-monetary asset without physical substance acquired in a business combination might meet the identifiability criterion for identification as an intangible asset but not be included in this guidance.

Assets designated with the symbol # are those that would be recognised separately from goodwill because they arise from contractual or other legal rights. Assets designated with the symbol ∗ do not arise from contractual or other legal rights, but would be recognised separately from goodwill because they are separable. Assets designated with the symbol # might also be separable; however, separability is not a necessary condition for an asset to meet the contractual-legal criterion.

A Marketing-related intangible assets

1 Trademarks, trade names, service marks, collective marks and certification marks #

Trademarks are words, names, symbols or other devices used in trade to indicate the source of a product and to distinguish it from the products of others. A service mark identifies and distinguishes the source of a service rather than a product. Collective marks are used to identify the goods or services of members of a group. Certification marks are used to certify the

geographical origin or other characteristics of a good or service.

Trademarks, trade names, service marks, collective marks and certification marks may be protected legally through registration with governmental agencies, continuous use in commerce, or by other means. Provided it is protected legally through registration or other means, a trademark or other mark acquired in a business combination is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill. Otherwise, a trademark or other mark acquired in a business combination can still be recognised separately from goodwill provided the separability criterion is met, which would normally be the case.

The terms 'brand' and 'brand name' are often used as synonyms for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise. An entity is not precluded from recognising a group of complementary intangible assets commonly referred to as a brand as a single asset, provided the assets that make up that group have similar useful lives.

2 Internet domain names #

An Internet domain name is a unique alphanumeric name that is used to identify a particular numeric Internet address. Registration of a domain name creates an association between that name and a designated computer on the Internet for the period of the registration. Those registrations are renewable. A registered domain name acquired in a business combination is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill.

3 Trade dress (unique colour, shape or package design) #

4 Newspaper mastheads #

5 Non-competition agreements #

B Customer-related intangible assets

1 Customer lists ∗

A customer list consists of information about customers, such as their name and contact information. A customer list may also be in the form of a database that includes other information about the customers such as their order history and demographic information. A customer list does not generally arise from contractual or other legal rights. However, customer lists are valuable and are frequently leased or exchanged. Therefore, a

customer list acquired in a business combination would normally meet the separability criterion for recognition separately from goodwill. However, a customer list acquired in a business combination would not meet that criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its customers.

2 Order or production backlog #

An order or production backlog arises from contracts such as purchase or sales orders. An order or production backlog acquired in a business combination meets the contractual-legal criterion for recognition separately from goodwill, even if the purchase or sales orders are cancellable.

3 Customer contracts and the related customer relationships #

If an entity establishes relationships with its customers through contracts, those customer relationships arise from contractual rights. Therefore, customer contracts and the related customer relationships acquired in a business combination are intangible assets that meet the contractual-legal criterion for recognition separately from goodwill. This will be the case even if confidentiality or other contractual terms prohibit the sale or transfer of a contract separately from the acquired entity or operation.

4. Non-contractual customer relationships ∗

If a customer relationship acquired in a business combination does not arise from a contract, the relationship is recognised as an intangible asset separately from goodwill if it meets the separability criterion. Exchange transactions for the same asset or a similar asset provide evidence of separability of a non-contractual customer relationship and might also provide information about exchange prices that should be considered when estimating fair value.

C Artistic-related intangible assets

Artistic-related intangible assets acquired in a business combination meet the criteria for recognition separately from goodwill if they arise from contractual or legal rights such as those provided by copyright. Copyrights can be transferred either in whole through assignments or in part through licensing agreements. An entity is not precluded from recognising a copyright intangible asset and any related assignments or licence agreements as a single asset, provided they have similar useful lives.

1 Plays, operas and ballets #

2 Books, magazines, newspapers and other literary works #

3 Musical works such as compositions, song lyrics and advertising jingles #

4 Pictures and photographs #

5 Video and audiovisual material, including films, music videos and television programmes #

D Contract-based intangible assets

1 Licensing, royalty and standstill agreements #

2 Advertising, construction, management, service or supply contracts #

3 Lease agreements #

4 Construction permits #

5 Franchise agreements #

6 Operating and broadcasting rights #

7 Use rights such as drilling, water, air, mineral, timber-cutting and route authorities #

8 Servicing contracts such as mortgage servicing contracts #

Contracts to service financial assets are one particular type of contract-based intangible asset. While servicing is inherent in all financial assets, it becomes a distinct asset (or liability):

(a) when contractually separated from the underlying financial asset by sale or securitisation of the assets with servicing retained; or

(b) through the separate purchase and assumption of the servicing.

If mortgage loans, credit card receivables or other financial assets are acquired in a business combination with servicing retained, the inherent servicing rights are not separately recognised as an intangible asset because the fair value of those servicing rights is included in the measurement of the fair value of the acquired financial asset.

9 Employment contracts that are beneficial contracts from the perspective of the employer because the pricing of those contracts is below their current market value #

E Technology-based intangible assets

1 Patented technology #

2 Computer software and mask works #

If computer software and program formats acquired in a business combination are protected legally, such as by patent or copyright, they meet the contractual-legal criterion for recognition separately from goodwill.

Mask works are software permanently stored on a read-only memory chip as a series of stencils or integrated circuitry. Mask works may have legal protection. Mask works with legal protection that are acquired in a business combination also meet the contractual-legal criterion for recognition separately from goodwill.

3 Unpatented technology *

4 Databases *

Databases are collections of information, often stored in electronic form (such as on computer disks or files). A database that includes original works of authorship may be entitled to copyright protection. If a database acquired in a business combination is protected by copyright, it meets the contractual-legal criterion for recognition separately from goodwill. However, a database typically includes information created as a consequence of an entity's normal operations, such as customer lists, or specialised information such as scientific data or credit information. Databases that are not protected by copyright can be, and often are, exchanged, licensed or leased to others in their entirety or in part. Therefore, even if the future economic benefits from a database do not arise from legal rights, a database acquired in a business combination meets the separability criterion for recognition separately from goodwill.

5 Trade secrets such as secret formulas, processes or recipes #

If the future economic benefits from a trade secret acquired in a business combination are legally protected, that asset meets the contractual-legal criterion for recognition separately from goodwill. Otherwise, trade secrets acquired in a business combination would be recognised separately from goodwill only if the separability criterion is met, which is often likely to be the case.

Reverse acquisitions

The following example illustrates the application of the guidance on reverse acquisition accounting provided as an application supplement in paragraphs B1-B14 of Appendix B of [draft] IFRS X *Business Combinations*.

Example

This example illustrates the accounting for a reverse acquisition in which Entity A, the entity issuing equity instruments and therefore the legal parent, is acquired in a reverse acquisition by Entity B, the legal subsidiary, on 30 September 20X1. The accounting for any income tax effects is ignored in this example:

Balance sheets of A and B immediately before the business combination

	A	B
Current assets	500	700
Non-current assets	1,300	3,000
	1,800	3,700
Current liabilities	300	600
Non-current liabilities	400	1,100
	700	1,700
Owners' equity		
Accumulated profits	800	1,400
Issued equity		
100 ordinary shares	300	
60 ordinary shares		600
	1,100	2,000
	1,800	3,700

Other information

(a) On 30 September 20X1, A issues 2½ shares in exchange for each ordinary share of B. All of B's shareholders exchange their shares in B. Therefore, A issues 150 ordinary shares in exchange for all 60 ordinary shares of B.

(b) The fair value of each ordinary share of B at 30 September 20X1 is 40. The quoted market price of A's ordinary shares at that date is 12.

(c) The fair values of A's identifiable assets and liabilities at 30 September 20X1 are the same as their carrying amounts, with the exception of non-current

assets. The fair value of A's non-current assets at 30 September 20X1 is 1,500.

Calculating the cost of the business combination

As a result of the issue of 150 ordinary shares by A, B's shareholders own 60 per cent of the issued shares of the combined entity (ie 150 shares out of 250 issued shares). The remaining 40 per cent are owned by A's shareholders. If the business combination had taken place in the form of B issuing additional ordinary shares to A's shareholders in exchange for their ordinary shares in A, B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. B's shareholders would then own 60 out of the 100 issued shares of B and therefore 60 per cent of the combined entity.

As a result, the cost of the business combination is 1,600 (ie 40 shares each with a fair value of 40).

Measuring goodwill

Goodwill is measured as the excess of the cost of the business combination over the net fair value of A's identifiable assets and liabilities. Therefore, goodwill is measured as follows:

Cost of the business combination		1,600
Net fair value of A's identifiable assets and liabilities:		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	(400)	1,300
Goodwill		300

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Consolidated balance sheet at 30 September 20X1

Current assets [700 + 500]	1,200
Non-current assets [3,000 + 1,500]	4,500
Goodwill	300
	6,000
Current liabilities [600 + 300]	900
Non-current liabilities [1,100 + 400]	1,500
	2,400
Owners' equity	
Accumulated profits	1,400
Issued equity	
250 ordinary shares [600 + 1,600]	2,200
	3,600
	6,000

Earnings per share

Assume that B's profit for the annual reporting period ending 31 December 20X0 was 600, and that the consolidated profit for the annual reporting period ending 31 December 20X1 is 800. Assume also that there was no change in the number of ordinary shares issued by B during the annual reporting period ending 31 December 20X0 and during the period from 1 January 20X1 to the date of the reverse acquisition (30 September 20X1).

Earnings per share for the annual reporting period ending 31 December 20X1 is calculated as follows:

Number of shares deemed to be outstanding for the period from 1 January 20X1 to the acquisition date (ie the number of ordinary shares issued by A in the reverse acquisition)	150
Number of shares outstanding from the acquisition date to 31 December 20X1	250
Weighted average number of ordinary shares outstanding [(150 x 9/12) + (250 x 3/12)]	175
Earnings per share [800/175]	4.57

Restated earnings per share for the annual reporting period ending 31 December 20X0 is 4.00 (ie the profit of B of 600 divided by the number of ordinary shares issued by A in the reverse acquisition).

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Minority interest

In the above example, assume that only 56 of B's ordinary shares are tendered for exchange rather than all 60. Because A issues 2½ shares in exchange for each ordinary share of B, A issues only 140 (rather than 150) shares. As a result, B's shareholders own 58.3 per cent of the issued shares of the combined entity (ie 140 shares out of 240 issued shares).

The cost of the business combination is calculated by assuming that the combination had taken place in the form of B issuing additional ordinary shares to the shareholders of A in exchange for their ordinary shares in A. In calculating the number of shares that would have to be issued by B, the minority interest is ignored. The majority shareholders own 56 shares of B. For this to represent a 58.3 per cent ownership interest, B would have had to issue an additional 40 shares. The majority shareholders would then own 56 out of the 96 issued shares of B and therefore 58.3 per cent of the combined entity.

As a result, the cost of the business combination is 1,600 (ie 40 shares each with a fair value of 40). This is the same amount as when all 60 of B's ordinary shares are tendered for exchange. The cost of the combination does not change simply because some of B's shareholders do not participate in the exchange.

The minority interest is represented by the 4 shares of the total 60 shares of B that are not exchanged for shares of A. Therefore, the minority interest is 6.7 per cent. The minority interest reflects the minority shareholders' proportionate interest in the pre-combination carrying amounts of the net assets of the legal subsidiary. Therefore, the consolidated balance sheet is adjusted to show a minority interest of 6.7 per cent of the pre-combination carrying amounts of B's net assets (ie 134 or 6.7 per cent of 2,000).

The consolidated balance sheet at 30 September 20X1 reflecting the minority interest is as follows:

Current assets [700 + 500]	1,200
Non-current assets [3,000 + 1,500]	4,500
Goodwill	300
	6,000
Current liabilities [600 + 300]	900
Non-current liabilities [1,100 + 400]	1,500
	2,400
Owners' equity	
Accumulated profits [1,400 x 93.3%]	1,306
Issued equity	
240 ordinary shares [560 + 1,600]	2,160
Minority interest	134
	3,600
	6,000

Business combination achieved in stages

The following example illustrates the application of the guidance on business combinations achieved in stages in paragraphs 57-59 of [draft] IFRS X *Business Combinations*. In particular, it deals with successive share purchases that result in an investee previously accounted for at fair value being included as a subsidiary in the consolidated financial statements.

Immediately following the example is a discussion of the outcome of applying the guidance in paragraphs 57-59 of [draft] IFRS X to the example assuming the investee had previously been accounted for at cost or by applying the equity method, rather than at fair value.

Example

Investor acquires a 20 per cent ownership interest in Investee (a service company) on 1 January 20X1 for 3,500,000 cash. At that date, the fair value of Investee's identifiable assets is 10,000,000, and the carrying amount of those assets is 8,000,000. Investee has no liabilities or contingent liabilities at that date. The following shows Investee's balance sheet at 1 January 20X1 together with the fair values of the identifiable assets:

	Carrying amounts	Fair values
Cash and receivables	2,000,000	2,000,000
Land	6,000,000	8,000,000
	8,000,000	10,000,000
Issued equity: 1,000,000 ordinary shares	5,000,000	
Accumulated profits	3,000,000	
	8,000,000	

During the year ended 31 December 20X1, Investee reports a profit of 6,000,000 but does not pay any dividends. In addition, the fair value of Investee's land increases by 3,000,000 to 11,000,000. However, the amount recognised by Investee in respect of the land remains unchanged at 6,000,000. The following shows Investee's balance sheet at 31 December 20X1 together with the fair values of the identifiable assets:

	Carrying amounts	Fair values
Cash and receivables	8,000,000	8,000,000
Land	6,000,000	11,000,000
	14,000,000	19,000,000
Issued equity: 1,000,000 ordinary shares	5,000,000	
Accumulated profits	9,000,000	
	14,000,000	

On 1 January 20X2, Investor acquires a further 60 per cent ownership interest in Investee for 22,000,000, thereby obtaining control. Before obtaining control, Investor does *not* have significant influence over Investee, and accounts for its initial 20 per cent investment at fair value with changes in value included in profit or loss. Investee's ordinary shares have a quoted market price at 31 December 20X1 of 30 per share.*

Throughout the period 1 January 20X1 to 1 January 20X2, Investor's issued equity was 30,000,000. Investor's only asset other than its investment in Investee is cash.

Accounting for the initial investment before obtaining control

Investor's initial 20 per cent investment in Investee is measured at 3,500,000. However, Investee's 1,000,000 ordinary shares have a quoted market price at 31 December 20X1 of 30 per share. Therefore, the carrying amount of Investor's initial 20 per cent investment is remeasured in Investor's financial statements to 6,000,000 at 31 December 20X1, with the 2,500,000 increase recognised in profit or loss for the period. Therefore, Investor's balance sheet at 31 December 20X1, before the acquisition of the additional 60 per cent ownership interest, is as follows:

* Therefore, Investee's market capitalisation at 31 December 20X1 is 30,000,000. However, Investor paid 22,000,000 for the additional 60 per cent of the issued shares and control of Investee on 1 January 20X2. This indicates that Investor paid a significant premium for control of Investee.

Cash	26,500,000
Investment in Investee	6,000,000
	32,500,000
Issued equity	30,000,000
Accumulated profits	2,500,000
	32,500,000

Accounting for the business combination

Paragraph 24 of [draft] IFRS X states that when a business combination involves more than one exchange transaction, the cost of the combination is the aggregate cost of the individual transactions, with the cost of each individual transaction determined at the date of each exchange transaction (ie the date that each individual investment is recognised in the acquirer's financial statements). This means that for this example, the cost to Investor of the business combination is the aggregate of the cost of the initial 20 per cent ownership interest (3,500,000) plus the cost of the subsequent 60 per cent ownership interest (22,000,000), irrespective of the fact that the carrying amount of the initial 20 per cent interest has changed.

In addition, and in accordance with paragraph 57 of [draft] IFRS X, each transaction must be treated separately to determine the goodwill on that transaction, using cost and fair value information at the date of each exchange transaction. Therefore, Investor recognises the following amounts for goodwill in its consolidated financial statements:

For the 20% ownership interest costing 3,500,000:
goodwill = 3,500,000 – [20% x 10,000,000] = 1,500,000

For the 60% ownership interest costing 22,000,000:
goodwill = 22,000,000 – [60% x 19,000,000] = 10,600,000

The following shows Investor's consolidation worksheet immediately after the acquisition of the additional 60 per cent ownership interest in Investee, together with consolidation adjustments and associated explanations:

	Investor	Investee	Consolidation Adjustments Dr	Consolidation Adjustments Cr	Consolidated	
Net Assets						
Cash and receivables	4,500	8,000			12,500	
Investment in Investee	28,000	-		2,500 (2) 3,500 (3) 22,000 (4)	-	
Land	-	6,000	5,000 (1)		11,000	See note (a)
Goodwill	-	-	1,500 (3) 10,600 (4)		12,100	See note (b)
	32,500	14,000			35,600	
Issued equity	30,000	5,000	1,000 (3) 3,000 (4) 1,000 (5)		30,000	See note (c)
Asset revaluation surplus	-	-	400 (3) 3,000 (4) 1,000 (5)	5,000 (1)	600	See note (d)
Accumulated profits	2,500	9,000	2,500 (2) 600 (3) 5,400 (4) 1,800 (5)		1,200	See note (e)
Minority interest	-	-		3,800 (5)	3,800	See note (a)
	32,500	14,000			35,600	

Consolidation Adjustments

		Dr	Cr
(1)	Land	5,000	
	Asset revaluation surplus		5,000
	To record Investee's identifiable assets at fair values at the acquisition date		
(2)	Accumulated profits	2,500	
	Investment in Investee		2,500
	To restate the initial 20 per cent investment in Investee to cost		
(3)	Issued equity [20% x 5,000]	1,000	
	Asset revaluation surplus [20% x 2,000*]	400	
	Accumulated profits [20% x 3,000]	600	
	Goodwill	1,500	
	Investment in Investee		3,500
	To recognise goodwill on the initial 20 per cent investment in Investee and record the elimination of that investment against associated equity balances		
(4)	Issued equity [60% x 5,000]	3,000	
	Asset revaluation surplus [60% x 5,000]	3,000	
	Accumulated profits [60% x 9,000]	5,400	
	Goodwill	10,600	
	Investment in Investee		22,000
	To recognise goodwill on the subsequent 60 per cent investment in Investee and record elimination of that investment against associated equity balances		
(5)	Issued equity [20% x 5,000]	1,000	
	Asset revaluation surplus [20% x 5,000]	1,000	
	Accumulated profits [20% x 9,000]	1,800	
	Minority interest (in issued equity)		1,000
	Minority interest (in asset revaluation surplus)		1,000
	Minority interest (in accumulated profits)		1,800
	To record the minority interest in the Investee		

* The 2,000,000 asset revaluation surplus represents the amount by which the fair value of Investee's land at the date of the first exchange transaction exceeds its carrying amount; the carrying amount of the land at the date Investor acquired the initial 20 per cent interest was 6,000,000, but its fair value was 8,000,000. In accordance with paragraph 57 of [draft] IFRS X, each transaction must be treated separately for the purpose of determining the amount of goodwill on that transaction, using cost and fair value information at the date of each exchange transaction.

Notes

The above consolidation adjustments result in:

(a) Investee's identifiable net assets being stated at their full fair values at the date Investor obtains control of Investee. This means that the 20 per cent minority interest in Investee also is stated at the minority's 20 per cent share of the fair values of Investee's identifiable net assets.

(b) goodwill being recognised from the acquisition date at an amount based on treating each exchange transaction separately and using cost and fair value information at the date of each exchange transaction.

(c) issued equity of 30,000,000 comprising the issued equity of Investor of 30,000,000.

(d) an asset revaluation surplus of 600,000. This amount reflects that part of the increase in the fair value of Investee's identifiable net assets after the acquisition of the initial 20 per cent interest that is attributable to that initial 20 per cent interest [20% x 3,000,000].

(e) an accumulated profits balance of 1,200,000. This amount reflects the changes in Investee's accumulated profits after Investor acquired its initial 20 per cent interest that is attributable to that 20 per cent interest [20% x 6,000,000].

Therefore, the effect of applying the requirements in [draft] IFRS X to business combinations involving successive share purchases for which the investment was previously accounted for at fair value with changes in value included in profit or loss is to cause:

- changes in the fair value of previously held ownership interests to be reversed (so that the carrying amounts of those ownership interests are restated to cost).
- changes in the investee's accumulated profits and other equity balances after each exchange transaction to be included in the post-combination consolidated financial statements to the extent that they relate to the previously held ownership interests.

Applying [draft] IFRS X if the investee had previously been accounted for at cost or using the equity method

As discussed above, paragraph 24 of [draft] IFRS X requires the cost of a business combination involving more than one exchange transaction to be measured as the aggregate cost of the individual transactions, with the cost of each individual transaction determined at the date of each exchange transaction (ie the date that each individual investment is recognised in the acquirer's financial statements). Therefore, irrespective of whether the initial 20 per cent investment in Investee is accounted for at cost, by applying the equity method or at fair value, the cost to Investor of the combination is the aggregate of the cost of the initial 20 per cent ownership interest (3,500,000) plus the cost of the subsequent 60 per cent ownership interest (22,000,000).

In addition, and again irrespective of whether the initial 20 per cent investment in Investee is accounted for at cost, by applying the equity method or at fair value, each transaction must be treated separately for the purpose of determining the amount of goodwill on that transaction, using cost and fair value information at the date of each exchange transaction.

Therefore, the effect of applying the [draft] IFRS X to any business combination involving successive share purchases is to cause:

- any changes in the carrying amount of previously held ownership interests to be reversed (so that the carrying amounts of those ownership interests are restated to cost).
- changes in the investee's accumulated profits and other equity balances after each exchange transaction to be included in the post-combination consolidated financial statements to the extent that they relate to the previously held ownership interests.

Consequently, the consolidated financial statements immediately after Investor acquires the additional 60 per cent ownership interest and obtains control of Investee would be the same irrespective of the method used to account for the initial 20 per cent investment in Investee before obtaining control.

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Changes in the values assigned to the acquiree's identifiable assets

The following examples illustrate the application of the guidance in paragraphs 62 and 63 of [draft] IFRS X *Business Combinations* on the accounting for error corrections related to the initial accounting for a business combination. These examples do not address the accounting for any income tax effects arising from the adjustments.

With three exceptions,* [draft] IFRS X requires adjustments to the initial accounting for a business combination after that initial accounting is complete only to correct an error in accordance with [draft] IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Adjustments to the initial accounting after that accounting has been completed cannot be recognised for the effect of changes in accounting estimates. In accordance with IAS 8, the effect of a change in an accounting estimate shall be recognised prospectively. Guidance on distinguishing corrections of errors from changes in accounting estimates is provided in [draft] IAS 8.

Example 1

An entity prepares financial statements for annual reporting periods ending on 31 December and does not prepare interim financial statements. The entity was the acquirer in a business combination on 30 September 20X1. As part of the initial accounting for that combination, the entity recognised goodwill of 100,000. The carrying amount of goodwill at 31 December 20X1 was 100,000.

During 20X2, the entity becomes aware of an error relating to the amount initially allocated to property, plant and equipment assets acquired in the business combination. In particular, 20,000 of the 100,000 initially allocated to goodwill should be allocated to property, plant and equipment assets that had a remaining useful life at the acquisition date of five years.

As outlined in paragraph 63 of [draft] IFRS X, [draft] IAS 8 requires the correction of an error to be accounted for retrospectively, and for the financial statements

* Two of the three exceptions relate to adjustments to the cost of a business combination after the initial accounting for the combination is complete. The third relates to the subsequent recognition by the acquirer of the acquiree's deferred tax assets that did not satisfy the criteria for separate recognition when initially accounting for the business combination.

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to be presented as if the error had never occurred by correcting the error in the comparative information for the prior period(s) in which it occurred.

Therefore, in the 20X2 financial statements, an adjustment is made to the opening carrying amount of property, plant and equipment assets. That adjustment is measured as the fair value adjustment at the acquisition date of 20,000 less the amount that would have been recognised as depreciation of the fair value adjustment (1,000 for 3 months' depreciation to 31 December 20X1). The carrying amount of goodwill is also adjusted for the reduction in value at the acquisition date of 20,000, and the 20X1 comparative information is restated to include 1,000 depreciation relating to the year ended 31 December 20X1.

In accordance with [draft] IAS 8, the entity discloses in its 20X2 financial statements the nature of the error and that, as a result of correcting that error, an adjustment was made to the carrying amount of property, plant and equipment. The entity also discloses that:

- the fair value of property, plant and equipment assets at the acquisition date has been increased by 20,000 with a corresponding decrease in goodwill; and

- the 20X1 comparative information is restated to include 1,000 depreciation relating to the year ended 31 December 20X1.

Example 2

This example assumes the same facts as in Example 1, except that the amount initially allocated to property, plant and equipment assets is decreased by 20,000 in order to correct the error, rather than increased by 20,000. This example also assumes that the entity determines that the recoverable amount of the additional goodwill is only 17,000 at 31 December 20X1.

In the 20X2 financial statements, the opening carrying amount of property, plant and equipment assets is reduced by 19,000, being the fair value adjustment at the acquisition date of 20,000 less 1,000 in depreciation expense recognised for the three-month period to 31 December 20X1. The carrying amount of goodwill is increased by 17,000, being the increase in value at the acquisition date of 20,000 less a 3,000 impairment loss to reflect that the carrying amount of the adjustment exceeds its recoverable amount. The 20X1 comparative information is restated to exclude the 1,000 depreciation and to include the 3,000 impairment loss.

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In accordance with [draft] IAS 8, the entity discloses in its 20X2 financial statements the nature of the error and that, as a result of correcting that error, an adjustment was made to the carrying amount of property, plant and equipment. The entity also discloses that:

- the fair value of property, plant and equipment assets at the acquisition date has been decreased by 20,000 with a corresponding increase in goodwill; and

- the 20X1 comparative information is restated to exclude 1,000 depreciation recognised during the year ended 31 December 20X1 and to include a 3,000 impairment loss for goodwill relating to the year ended 31 December 20X1.

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