STATUTORY BOARD FINANCIAL REPORTING STANDARD

SB-FRS 103

Illustrative Examples

Business Combinations

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Illustrative Examples

These examples accompany, but are not part of, SB-FRS 103.

Examples of items acquired in a business combination that meet the definition of an intangible asset

The following guidance provides examples of items acquired in a business combination that meet the definition of an intangible asset and are therefore recognised under SB-FRS 103 *Business Combinations* separately from goodwill, provided that their fair values can be measured reliably. To meet the definition of an intangible asset a non-monetary asset without physical substance must be identifiable, i.e. 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 items acquired in a business combination that meet the definition of an intangible asset. 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 meet the definition of an intangible asset because they arise from contractual or other legal rights. Assets designated with the symbol * do not arise from contractual or other legal rights, but meet the definition of an intangible asset 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. Otherwise, a trademark or other mark acquired in a business combination can meet the definition of an intangible asset 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.

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.

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 normally meets the separability criterion for identification as an intangible asset. 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 identification as an intangible asset, 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 meet the contractual-legal criterion for identification as intangible assets. 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 business.

Customer relationships also meet the contractual-legal criterion for identification as intangible assets when an entity has a practice of establishing contracts with its customers, regardless of whether a contract exists at the date of acquisition.

As noted in B2, an order or a production backlog arises from contracts such as purchase or sales orders, and is therefore also considered a contractual right. Consequently, if an entity has customer relationships with its customers through these types of contracts, the customer relationships also arise from contractual rights, and therefore meet the contractual-legal criterion for identification as intangible assets.

4 Non-contractual customer relationships *

If a customer relationship acquired in a business combination does not arise from a contract, the relationship is an intangible asset 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 assets acquired in a business combination meet the criteria for identification as intangible assets 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 a separate 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 identification as intangible assets.

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 identification as intangible assets.

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 identification as an intangible asset. 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 identification as an intangible asset.

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 identification as an intangible asset. Otherwise, trade secrets acquired in a business combination meet the definition of an intangible asset only if the separability criterion is met, which is often likely to be the case.

Customer relationship intangible assets acquired in a business combination

The following examples illustrate the recognition in accordance with SB-FRS 103 *Business Combinations* of customer relationship intangible assets acquired in a business combination.

Example 1

Background

Parent obtained control of Supplier in a business combination on 31 December 20X4. Supplier has a five-year agreement to supply goods to Buyer. Both Supplier and Parent believe that Buyer will renew the supply agreement at the end of the current contract. The supply agreement is not separable.

Analysis

The supply agreement (whether cancellable or not) meets the contractual-legal criterion for identification as an intangible asset, and therefore is recognised separately from goodwill, provided its fair value can be measured reliably. Additionally, because Supplier establishes its relationship with Buyer through a contract, the customer relationship with Buyer meets the contractual-legal criterion for identification as an intangible asset. Therefore, the customer relationship intangible asset is also recognised separately from goodwill provided its fair value can be measured reliably. In determining the fair value of the customer relationship, Parent considers assumptions such as the expected renewal of the supply agreement.

Example 2

Background

Parent obtained control of Subsidiary in a business combination on 31 December 20X4. Subsidiary manufactures goods in two distinct lines of business—sporting goods and electronics. Customer purchases from Subsidiary both sporting goods and electronics. Subsidiary has a contract with Customer to be its exclusive provider of sporting goods. However, there is no contract for the supply

of electronics to Customer. Both Subsidiary and Parent believe that there is only one overall customer relationship between Subsidiary and Customer.

Analysis

The contract to be Customer's exclusive supplier of sporting goods (whether cancellable or not) meets the contractual-legal criterion for identification as an intangible asset, and is therefore recognised separately from goodwill, provided its fair value can be measured reliably. Additionally, because Subsidiary establishes its relationship with Customer through a contract, the customer relationship with Customer meets the contractual-legal criterion for identification as an intangible asset. Therefore, the customer relationship intangible asset is also recognised separately from goodwill, provided its fair value can be measured reliably. Because there is only one customer relationship with Customer, the fair value of that relationship incorporates assumptions regarding Subsidiary's relationship with Customer related to both sporting goods and electronics.

However, if both Parent and Subsidiary believed there were separate customer relationships with Customer—one for sporting goods and another for electronics—the customer relationship with respect to electronics would be assessed by Parent to determine whether it meets the separability criterion for identification as an intangible asset.

Example 3

Background

Entity A obtained control of Entity B in a business combination on 31 December 20X4. Entity B does business with its customers solely through purchase and sales orders. At 31 December 20X4, Entity B has a backlog of customer purchase orders from 60 per cent of its customers, all of whom are recurring customers. The other 40 per cent of Entity B's customers are also recurring customers. However, as of 31 December 20X4, Entity B does not have any open purchase orders or other contracts with those customers.

Analysis

The purchase orders from 60 per cent of Entity B's customers (whether cancellable or not) meet the contractual-legal criterion for identification as intangible assets, and are therefore recognised separately from goodwill, provided their fair values can be measured reliably. Additionally, because Entity B has established its relationship with 60 per cent of its customers through contracts, those customer relationships meet the contractual-legal criterion for identification as an intangible asset. Therefore, the customer relationship intangible asset is also recognised separately from goodwill provided its fair value can be measured reliably.

Because Entity B has a practice of establishing contracts with the remaining 40 per cent of its customers, its relationship with those customers also arises through contractual rights, and therefore meets the contractual-legal criterion for identification as an intangible asset. Entity A recognises this customer relationship separately from goodwill, provided its fair value can be measured reliably, even though Entity B does not have contracts with those customers at 31 December 20X4.

Example 4

Background

Parent obtained control of Insurer in a business combination on 31 December 20X4. Insurer has a portfolio of one-year motor insurance contracts that are cancellable by policyholders. A reasonably predictable number of policyholders renew their insurance contracts each year.

Analysis

Because Insurer establishes its relationships with policyholders through insurance contracts, the customer relationship with policyholders meets the contractual-legal criterion for identification as an

intangible asset. Therefore, the customer relationship intangible asset is recognised separately from goodwill, provided its fair value can be measured reliably. In determining the fair value of the customer relationship intangible asset, Parent considers estimates of renewals and cross-selling. SB-FRS 36 *Impairment of Assets* and SB-FRS 38 *Intangible Assets* apply to the customer relationship intangible asset.

In determining the fair value of the liability relating to the portfolio of insurance contracts, Parent considers estimates of cancellations by policyholders. SB-FRS 104 *Insurance Contracts* permits, but does not require, an expanded presentation that splits the fair value of acquired insurance contracts into two components:

(a) a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and

(b) an intangible asset, representing the fair value of the contractual rights and obligations acquired, to the extent that the liability does not reflect that fair value. This intangible asset is excluded from the scope of SB-FRS 36 and SB-FRS 38. After the business combination, Parent is required to measure that intangible asset on a basis consistent with the measurement of the related insurance liability.

Reverse acquisitions

The following example illustrates the application of the guidance on reverse acquisition accounting provided as an application supplement in paragraphs B1-B15 of Appendix B of SB-FRS 103 *Business Combinations*.

Example 5

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
	CU	CU
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		
Retained earnings	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 CU40. The quoted market price of A's ordinary shares at that date is CU12.

(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 CU1,500.

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 (i.e. 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 CU1,600 (i.e. 40 shares each with a fair value of CU40).

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:

	CU	CU
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

Consolidated balance sheet at 30 September 20X1

	CU
Current assets [CU700 + CU500]	1,200
Non-current assets [CU3,000 + CU1,500]	4,500
Goodwill	300
	6,000
Current liabilities [CU600 + CU300]	900
Non-current liabilities [CU1,100 + CU400]	1,500
	2,400
Owners' equity	
Retained earnings	1,400
Issued equity	
250 ordinary shares [CU600 + CU1,600]*	2,200
	3,600
	6,000

Earnings per share

Assume that B's profit for the annual period ending 31 December 20X0 was CU600, and that the consolidated profit for the annual period ending 31 December 20X1 is CU800. Assume also that there was no change in the number of ordinary shares issued by B during the annual 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 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 (i.e. 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 × 9/12) + (250 × 3/12)]	175
Earnings per share [800/175]	CU4.57

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

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 (i.e. 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

* In accordance with paragraph B7(c) of SB-FRS 103, the amount recognised as issued equity instruments in the consolidated financial statements is determined by adding to the issued equity of the legal subsidiary immediately before the business combination [CU600] the cost of the combination [CU1,600]. However, the equity structure appearing in the consolidated financial statements (i.e. the number and type of equity instruments issued) must reflect the equity structure of the legal parent, including the equity instruments issued by the legal parent to effect the combination.

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 CU1,600 (i.e. 40 shares each with a fair value of CU40). 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 (i.e. CU134 or 6.7 per cent of CU2,000).

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

	CU
Current assets [CU700 + CU500]	1,200
Non-current assets [CU3,000 + CU1,500]	4,500
Goodwill	300
	600
Current liabilities [CU600 + CU300]	900
Non-current liabilities [CU1,100 + CU400]	1,500
	2,400
Owners' equity	
Retained earnings [CU1,400 x 93.3%]	1,306
Issued equity	2,160
240 ordinary shares [CU560 + CU1,600]	
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 58-60 of SB-FRS 103 *Business Combination*s. 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 58-60 of SB-FRS 103 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 6

Investor acquires a 20 per cent ownership interest in Investee (a service company) on 1 January 20X1 for CU3,500,000 cash. At that date, the fair value of Investee's identifiable assets is CU10,000,000, and the carrying amount of those assets is CU8,000,000. 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
	CU	CU
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	
Retained earnings	3,000,000	
	8,000,000	

During the year ended 31 December 20X1, Investee reports a profit of CU6,000,000 but does not pay any dividends. In addition, the fair value of Investee's land increases by CU3,000,000 to CU11,000,000. However, the amount recognised by Investee in respect of the land remains unchanged at CU6,000,000. The following shows Investee's balance sheet at 31 December 20X1 together with the fair values of the identifiable assets:

	Carrying amounts	Fair values
	CU	CU
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	
Retained earnings	9,000,000	
	14,000,000	

On 1 January 20X2, Investor acquires a further 60 per cent ownership interest in Investee for CU22,000,000 cash, 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 CU30 per share.[♣]

Throughout the period 1 January 20X1 to 1 January 20X2, Investor's issued equity was CU30,000,000. Investor's only asset apart from 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 CU3,500,000. However, Investee's 1,000,000 ordinary shares have a quoted market price at 31 December 20X1 of CU30 per share. Therefore, the carrying amount of Investor's initial 20 per cent investment is remeasured in Investor's financial statements to CU6,000,000 at 31 December 20X1, with the CU2,500,000 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 CU30,000,000. However, Investor paid CU22,000,000 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.

	CU
Cash	26,500,000
Investment in Investee	6,000,000
	32,500,000
Issued equity	30,000,000
Retained earnings	2,500,000
	32,500,000

Accounting for the business combination

Paragraph 25 of SB-FRS 103 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 (i.e. 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 (CU3,500,000) plus the cost of the subsequent 60 per cent ownership interest (CU22,000,000), irrespective of the fact that the carrying amount of the initial 20 per cent interest has changed.

In addition, and in accordance with paragraph 58 of SB-FRS 103, 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 CU3,500,000
goodwill = 3,500,000 – [20% x 10,000,000] = CU1,500,000

For the 60% ownership interest costing CU22,000,000:
goodwill = 22,000,000 – [60% x 19,000,000] = CU10,600,000

The following shows Investor's consolidation worksheet (all amounts in CU) 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)
Retained earnings	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 recognise Investee's identifiable assets at fair values at the acquisition date		
(2)	Retained earnings	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	
	Retained earnings [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		
(4)	Issued equity [60% x 5,000]	3,000	
	Asset revaluation surplus [60% x 5,000]	3,000	
	Retained earnings [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	
	Retained earnings [20% x 9,000]	1,800	
	Minority interest (in issued equity)	1,000	
	Minority interest (in asset revaluation surplus)	1,000	
	Minority interest (in retained earnings)	1,800	
	To recognise the minority interest in the Investee		

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.

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* The CU2,000,000 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 CU6,000,000, but its fair value was CU8,000,000. In accordance with paragraph 58 of SB-FRS 103, 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.

(c) issued equity of CU30,000,000 comprising the issued equity of Investor of CU30,000,000.

(d) an asset revaluation surplus of CU600,000. 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% × CU3,000,000].

(e) a retained earnings balance of CU1,200,000. This amount reflects the changes in Investee's retained earnings after Investor acquired its initial 20 per cent interest that is attributable to that 20 per cent interest [20% × CU6,000,000].

Therefore, the effect of applying the requirements in SB-FRS 103 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 retained earnings 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 SB-FRS 103 if the investee had previously been accounted for at cost or using the equity method

As discussed above, paragraph 25 of SB-FRS 103 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 (i.e. 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 (CU3,500,000) plus the cost of the subsequent 60 per cent ownership interest (CU22,000,000).

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 SB-FRS 103 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 retained earnings 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.

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

Completing the initial accounting for a business combination

The following example illustrates the application of the guidance in paragraph 62 of SB-FRS 103 *Business Combinations* on completing the initial accounting for a business combination when the acquirer has, at the end of the first period after the combination, accounted for the combination using

provisional values. This example does not address the accounting for any income tax effects arising from the adjustments.

SB-FRS 103 requires the acquirer to account for a business combination using provisional values if the initial accounting for a business combination can be determined only provisionally by the end of the reporting period in which the combination is effected. The acquirer is required to recognise any adjustments to those provisional values as a result of completing the initial accounting:

(a) within twelve months of the acquisition date; and

(b) from the acquisition date. Therefore:

  (i) the carrying amount of an identifiable asset, liability or contingent liability that is recognised or adjusted as a result of completing the initial accounting is calculated as if its fair value at the acquisition date had been recognised from that date.

  (ii) goodwill or any gain recognised in accordance with paragraph 56 is adjusted from the acquisition date by an amount equal to the adjustment to the fair value at the acquisition date of the identifiable asset, liability or contingent liability being recognised or adjusted.

  (iii) comparative information presented for the periods before the initial accounting for the combination is complete is presented as if the initial accounting had been completed from the acquisition date. This includes any additional depreciation, amortisation or other profit or loss effects recognised as a result of completing the initial accounting.

Example 7

An entity prepares financial statements for annual periods ending on 31 December and does not prepare interim financial statements. The entity was the acquirer in a business combination on 30 September 20X4. The entity sought an independent appraisal for an item of property, plant and equipment acquired in the combination. However, the appraisal was not finalised by the time the entity completed its 20X4 annual financial statements. The entity recognised in its 20X4 annual financial statements a provisional fair value for the asset of CU30,000, and a provisional value for acquired goodwill of CU100,000. The item of property, plant and equipment had a remaining useful life at the acquisition date of five years.

Four months after the acquisition date, the entity received the independent appraisal, which estimated the asset's fair value at the acquisition date at CU40,000.

As outlined in paragraph 62 of SB-FRS 103, the acquirer is required to recognise any adjustments to provisional values as a result of completing the initial accounting from the acquisition date.

Therefore, in the 20X5 financial statements, an adjustment is made to the opening carrying amount of the item of property, plant and equipment. That adjustment is measured as the fair value adjustment at the acquisition date of CU10,000, less the additional depreciation that would have been recognised had the asset's fair value at the acquisition date been recognised from that date (CU500 for three months' depreciation to 31 December 20X4). The carrying amount of goodwill is also adjusted for the reduction in value at the acquisition date of CU10,000, and the 20X4 comparative information is restated to reflect this adjustment and to include additional depreciation of CU500 relating to the year ended 31 December 20X4.

In accordance with paragraph 69 of SB-FRS 103, the entity discloses in its 20X4 financial statements that the initial accounting for the business combination has been determined only provisionally, and explains why this is the case. In accordance with paragraph 73(b) of SB-FRS 103, the entity discloses in its 20X5 financial statements the amounts and explanations of the adjustments to the provisional values recognised during the current reporting period. Therefore, the entity discloses that:

- the fair value of the item of property, plant and equipment at the acquisition date has been increased by CU10,000 with a corresponding decrease in goodwill; and

o the 20X4 comparative information is restated to reflect this adjustment and to include additional depreciation of CU500 relating to the year ended 31 December 20X4.

Error corrections

The following examples illustrate the application of the guidance in paragraphs 63 and 64 of SB-FRS 103 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,[*] SB-FRS 103 requires adjustments to be made to the initial accounting for a business combination after that initial accounting is complete only to correct an error in accordance with SB-FRS 8 *Accounting Policies, Changes in Accounting Estimates and Error*s. After that accounting is completed, adjustments cannot be recognised for the effect of changes in accounting estimates. In accordance with SB-FRS 8, the effect of a change in an accounting estimate is recognised prospectively. SB-FRS 8 provides guidance on distinguishing corrections of errors from changes in accounting estimates.

Example 8

An entity prepares financial statements for annual 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 CU100,000. The carrying amount of goodwill at 31 December 20X1 was CU100,000.

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, CU20,000 of the CU100,000 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 64 of SB-FRS 103, SB-FRS 8 requires the correction of an error to be accounted for retrospectively, and for the financial statements 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 CU20,000 less the amount that would have been recognised as depreciation of the fair value adjustment (CU1,000 for three months' depreciation to 31 December 20X1). The carrying amount of goodwill is also adjusted for the reduction in value at the acquisition date of CU20,000, and the 20X1 comparative information is restated to reflect this adjustment and to include additional depreciation of CU1,000 relating to the year ended 31 December 20X1.

In accordance with SB-FRS 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 CU20,000 with a corresponding decrease in goodwill; and
- the 20X1 comparative information is restated to reflect this adjustment and to include additional depreciation of CU1,000 relating to the year ended 31 December 20X1.

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[*] 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.

Example 9

This example assumes the same facts as in Example 8, except that the amount initially allocated to property, plant and equipment assets is decreased by CU20,000 to correct the error, rather than increased by CU20,000. This example also assumes that the entity determines that the recoverable amount of the additional goodwill is only CU17,000 at 31 December 20X1.

In the 20X2 financial statements, the opening carrying amount of property, plant and equipment assets is reduced by CU19,000, being the fair value adjustment at the acquisition date of CU20,000 less CU1,000 in depreciation expense recognised for the three-month period to 31 December 20X1. The carrying amount of goodwill is increased by CU17,000, being the increase in value at the acquisition date of CU20,000 less a CU3,000 impairment loss to reflect that the carrying amount of the adjustment exceeds its recoverable amount. The 20X1 comparative information is restated to reflect this adjustment and to exclude the CU1,000 depreciation and include the CU3,000 impairment loss.

In accordance with SB-FRS 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 CU20,000 with a corresponding increase in goodwill; and

- the 20X1 comparative information is restated to reflect this adjustment and to exclude CU1,000 depreciation recognised during the year ended 31 December 20X1 and include a CU3,000 impairment loss for goodwill relating to the year ended 31 December 20X1.