cutting through complexity

Business combination accounting for interests in a joint operation

Amendments answer long-standing question

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IN THE HEADLINES

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> “The amendments bring clarity to an area in which there has been long-running debate, and will result in more consistent accounting for the acquisition of interests in a joint operation.”

– Mike Metcalf, KPMG’s global IFRS business combinations and consolidation leader

Does business combination accounting apply to interests in a joint operation?

There has long been a question, particularly in the energy and natural resources sector, over whether IFRS 3 *Business Combinations* applies when an entity acquires an interest in a joint operation that meets that standard’s definition of a business.

The following table highlights the key differences that have become a focus of the issue in practice.

Was business combination accounting applied?	Yes	No
Recognise goodwill	✓	✗
Recognise deferred tax arising from the initial recognition of identifiable assets acquired and liabilities assumed	✓	✗
Expense acquisition-related costs	✓	✗

In response to the diversity in practice, on 6 May 2014 the IASB issued *Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)*.

Amendments end the confusion

The amendments require business combination accounting to be applied to acquisitions of interests in a joint operation that constitutes a business.

Fact pattern

- Company P acquires a 50% interest in an existing joint operation (JO) for cash of 1,100, and incurs transaction costs of 20.
- JO operates a producing oil field and is considered by P to be a business.
- The fair value of JO’s identifiable net assets is 2,000, which includes a fair value uplift of 500 on the assets. The tax base of the net assets in JO’s financial statements is equal to their carrying amount at the acquisition date – i.e. 1,500. The tax rate is 20%.

How the amendments apply

Under the amendments, P recognises the following entries.

	Debit	*Credit*
Identifiable assets acquired (2,000 x 50%)	1,000	
Goodwill (1,100 - (1,000 - 50))	150	
Deferred tax ((500 x 20%) x 50%)		50
Cash		1,100
To record acquisition		
Profit or loss	20	
Cash		20
To record acquisition costs		

Same treatment for the acquisition of additional interests

Business combination accounting also applies to the acquisition of additional interests in a joint operation while the joint operator retains joint control. The additional interest acquired will be measured at fair value. The previously held interests in the joint operation will not be remeasured.

Judgement still required

The amendments place the focus firmly on the definition of a business, because this is key to determining whether the acquisition is accounted for as a business combination or as the acquisition of a collection of assets. As a result, this places pressure on the judgement applied in making this determination.

The IASB is also seeking formal feedback on the practical issues that constituents have faced in applying IFRS 3, including applying the definition of a business, as part of its post-implementation review of the standard. For further information, see our In the Headlines 2014/02.

Effective date

The amendments apply prospectively for annual periods beginning on or after 1 January 2016. Early adoption is permitted.

Find out more

For more information on the amendments, please go to the IASB press release or speak to your usual KPMG contact.

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