

Business combination accounting for interests in a joint operation

Amendments answer long-
standing question

May 2014, Issue 2014/07

IN THE HEADLINES

kpmg.com/ifrs



“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 × 50%)	1,000	
Goodwill (1,100 - (1,000 - 50))	150	
Deferred tax ((500 × 20%) × 50%)		50
Cash		1,100
<i>To record acquisition</i>		
Profit or loss	20	
Cash		20
<i>To record acquisition costs</i>		

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.

© 2014 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

The KPMG name, logo and “cutting through complexity” are registered trademarks or trademarks of KPMG International.

Publication name: *In the Headlines – Business combination accounting for interests in a joint operation*

Publication number: Issue 2014/07

Publication date: May 2014

KPMG International Standards Group is part of KPMG IFRG Limited.

KPMG International Cooperative (“KPMG International”) is a Swiss entity that serves as a coordinating entity for a network of independent firms operating under the KPMG name. KPMG International provides no audit or other client services. Such services are provided solely by member firms of KPMG International (including sublicensees and subsidiaries) in their respective geographic areas. KPMG International and its member firms are legally distinct and separate entities. They are not and nothing contained herein shall be construed to place these entities in the relationship of parents, subsidiaries, agents, partners, or joint venturers. No member firm has any authority (actual, apparent, implied or otherwise) to obligate or bind KPMG International or any other member firm, in any manner whatsoever.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.