PROPOSED FINANCIAL REPORTING STANDARD	ED/FRS

EXPOSURE DRAFT OF PROPOSED
Amendments to
FRS 103 Business Combinations

Comments to be received by 28 September 2005

This exposure draft (ED) contains proposed amendments to FRS 103 "*Business Combinations".*

This ED should be read in the context of the Preface to Financial Reporting Standards published by the Council on Corporate Disclosure and Governance (CCDG).

This ED is issued by the CCDG for comment only and does not necessarily represent the views of the CCDG.

Since this ED may be modified as a result of comments received, the CCDG would like to hear both from those who agree with the proposals contained in the ED and from those who do not.

Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, clearly explain the problem and provide a suggestion for alternative wording with supporting reasoning.

Comments should be submitted in writing, so as to be received by **28 September 2005**, preferably by email to: accounting_stds@acra.gov.sg or addressed to:

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INVITATION TO COMMENT

The Council on Corporate Disclosure and Governance (CCDG) invites comments on all matters in the Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

(a) comment on the questions as stated

(b) indicate the specific paragraph or paragraphs to which the comments relate

(c) contain a clear rationale

(d) include any alternative for consideration.

Respondents need not comment on all of the questions presented and are encouraged to comment on additional issues.

Respondents must submit comments in writing by **28 September 2005**.

Until a final FRS based on the Exposure Draft becomes effective, FRS 103 *Business Combinations* remains effective.

Question 1—Objective, definition and scope

The proposed objective of the Exposure Draft is:

> …that all business combinations be accounted for by applying the acquisition method. A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses (the acquiree). In accordance with the acquisition method, the acquirer measures and recognises the acquiree, as a whole, and the assets acquired and liabilities assumed at their fair values as of the acquisition date. [paragraph 1]

The objective provides the basic elements of the acquisition method of accounting for a business combination (formerly called the purchase method) by describing:

(a) what is to be measured and recognised. An acquiring entity would measure and recognise the acquired business at its fair value, regardless of the percentage of the equity interests of the acquiree it holds at the acquisition date. That objective also provides the foundation for determining whether specific assets acquired or liabilities assumed are part of an acquiree and would be accounted for as part of the business combination.

(b) when to measure and recognise the acquiree. Recognition and measurement of a business combination would be as of the acquisition date, which is the date the acquirer obtains control of the acquiree.

(c) the measurement attribute as fair value, rather than as cost accumulation and allocation. The acquiree and the assets acquired and liabilities assumed would be measured at fair value as of the acquisition date, with limited exceptions. Consequently, the consideration transferred in exchange for the acquiree, including contingent consideration, would also be measured at fair value as of the acquisition date.

The objective and definition of a business combination would apply to all business combinations in the scope of the proposed FRS, including business combinations:

(a) involving only mutual entities

(b) achieved by contract alone

(c) achieved in stages (commonly called step acquisitions)

(d) in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date.

(See paragraphs 52-58)

Question 1—Are the objective and the definition of a business combination appropriate for accounting for all business combinations? If not, for which business combinations are they not appropriate, why would you make an exception, and what alternative do you suggest?

Question 2—Definition of a business

The Exposure Draft proposes to define a *business* as follows:

> A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing either:
>
> (1) a return to investors, or
>
> (2) dividends, lower costs, or other economic benefits directly and proportionately to owners, members, or participants. [paragraph 3(d)]

Paragraphs A2-A7 of Appendix A provide additional guidance for applying this definition. The proposed FRS would amend the definition of a business in FRS 103.

Question 2—Are the definition of a business and the additional guidance appropriate and sufficient for determining whether the assets acquired and the liabilities assumed constitute a business? If not, how would you propose to modify or clarify the definition or additional guidance?

Questions 3-7—Measuring the fair value of the acquiree

The Exposure Draft proposes that in a business combination that is an exchange of equal values, the acquirer should measure and recognise 100 per cent of the fair value of the acquiree as of the acquisition date. This applies even in business combinations in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at that date. In those business combinations, the acquirer would measure and recognise the non-controlling interest as the sum of the non-controlling interest's proportional interest in the acquisition-date values of the identifiable assets acquired and liabilities assumed plus the goodwill attributable to the non-controlling interest. (See paragraphs 19 and 58)

Question 3—In a business combination in which the acquirer holds less than 100 per cent of the equity interests of the acquiree at the acquisition date, is it appropriate to recognise 100 per cent of the acquisition-date fair value of the acquiree, including 100 per cent of the values of identifiable assets acquired, liabilities assumed and goodwill, which would include the goodwill attributable to the non-controlling interest? If not, what alternative do you propose and why?

The Exposure Draft proposes that a business combination is usually an arm's length transaction in which knowledgeable, unrelated willing parties are presumed to exchange equal values. In such transactions, the fair value of the consideration transferred by the acquirer on the acquisition date is the best evidence of the fair value of the acquirer's interest in the acquiree, in the absence of evidence to the contrary. Accordingly, in most business combinations, the fair value of the consideration transferred by the acquirer would be used as the basis for measuring the acquisition-date fair value of the acquirer's interest in the acquiree. However, in some business combinations, either no consideration is transferred on the acquisition date or the evidence indicates that the consideration transferred is not the best basis for measuring the acquisition-date fair value of the acquirer's interest in the acquiree. In those business combinations, the acquirer would measure the acquisition-date fair value of its interest in the acquiree and the acquisition-date fair value of the acquiree using other valuation techniques. (See paragraphs 19, 20 and A8-A26 and Appendix E)

Question 4—Do paragraphs A8-A26 in conjunction with Appendix E provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

The Exposure Draft proposes a presumption that the best evidence of the fair value of the acquirer's interest in the acquiree would be the fair values of all items of consideration transferred by the acquirer in exchange for that interest measured as of the acquisition date, including:

(a) contingent consideration;

(b) equity interests issued by the acquirer; and

(c) any non-controlling equity investment in the acquiree that the acquirer owned immediately before the acquisition date.

(See paragraphs 20-25)

Question 5—Is the acquisition-date fair value of the consideration transferred in exchange for the acquirer's interest in the acquiree the best evidence of the fair value of that interest? If not, which forms of consideration should be measured on a date other than the acquisition date, when should they be measured, and why?

The Exposure Draft proposes that after initial recognition, contingent consideration classified as:

(a) equity would not be remeasured.

(b) liabilities would be remeasured with changes in fair value recognised in profit or loss unless those liabilities are in the scope of FRS 39 *Financial Instruments: Recognition and Measurement* or [draft] FRS 37 *Non-financial Liabilities*. Those liabilities would be accounted for after the acquisition date in accordance with those FRSs.

(See paragraphs 26)

Question 6—Is the accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?

The Exposure Draft proposes that the costs that the acquirer incurs in connection with a business combination (also called acquisition-related costs) should be excluded from the measurement of the consideration transferred for the acquiree because those costs are not part of the fair value of the acquiree and are not assets. Such costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; the cost of issuing debt and equity instruments; and general administrative costs, including the costs of maintaining an internal acquisitions department. The acquirer would account for those costs separately from the business combination accounting. (See paragraphs 27)

Question 7—Do you agree that the costs that the acquirer incurs in connection with a business combination are not assets and should be excluded from the measurement of the consideration transferred for the acquiree? If not, why?

Questions 8 and 9—Measuring and recognising the assets acquired and the liabilities assumed

The Exposure Draft proposes that an acquirer measure and recognise as of the acquisition date the fair value of the assets acquired and liabilities assumed as part of the business combination, with limited exceptions. (See paragraphs 28-41) That requirement would result in the following significant changes to accounting for business combinations:

(a) Receivables (including loans) acquired in a business combination would be measured at fair value. Therefore, the acquirer would not recognise a separate valuation allowance for uncollectible amounts as of the acquisition date.

(b) An identifiable asset or liability (contingency) would be measured and recognised at fair value at the acquisition date even if the amount of the future economic benefits embodied in the asset or required to settle the liability are contingent (or conditional) on the occurrence or non-occurrence of one or more uncertain future events. After initial recognition, such an asset would be accounted for in accordance with FRS 38 *Intangible Assets* or FRS 39 *Financial Instruments: Recognition and Measurement*, as appropriate, and such a liability would be accounted for in accordance with [draft] FRS 37 or other FRSs as appropriate.

Question 8—Do you believe that these proposed changes to the accounting for business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?

The Exposure Draft proposes limited exceptions to the fair value measurement principle. Therefore, some assets acquired and liabilities assumed (for example, those related to deferred taxes, assets held for sale, or employee benefits) would continue to be measured and recognised in accordance with other FRSs rather than at fair value. (See paragraphs 42-51)

Question 9—Do you believe that these exceptions to the fair value measurement principle are appropriate? Are there any exceptions you would eliminate or add? If so, which ones and why?

Questions 10-12—Additional guidance for applying the acquisition method to particular types of business combinations

The Exposure Draft proposes that, for the purposes of applying the acquisition method, the fair value of the consideration transferred by the acquirer would include the fair value of the acquirer's non-controlling equity investment in the acquiree at acquisition date that the acquirer owned immediately before the acquisition date. Accordingly, in a business combination achieved in stages (step acquisition) the acquirer would remeasure its non-controlling equity investment in the acquiree at fair value as of the acquisition date and recognise any gain or loss in profit or loss. If, before the business combination, the acquirer recognised changes in the value of its non-controlling equity investment directly in equity (for example, the investment was designated as available for sale), the amount that was recognised directly in equity would be reclassified and included in the calculation of any gain or loss as of the acquisition date. (See paragraphs 55 and 56)

Question 10—Is it appropriate for the acquirer to recognise in profit or loss any gain or loss on previously acquired non-controlling equity investments on the date it obtains control of the acquiree? If not, what alternative do you propose and why?

The Exposure Draft proposes that in a business combination in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest (referred to as a bargain purchase) any excess of the fair value of the acquirer's interest in the acquiree over the fair value of the consideration transferred for that interest would reduce goodwill until the goodwill related to that business combination is reduced to zero, and any remaining excess would be recognised in profit or loss on the acquisition date. (See paragraphs 59-61) However, the proposed FRS would not permit the acquirer to recognise a loss at the acquisition date if the acquirer is able to determine that a portion of the consideration transferred represents an overpayment for the acquiree. It is acknowledged that an acquirer might overpay to acquire a business, but it is concluded that it is not possible to measure such an overpayment reliably at the acquisition date.

Question 11—Do you agree with the proposed accounting for business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest? If not, what alternative do you propose and why?

Question 12—Do you believe that there are circumstances in which the amount of an overpayment could be measured reliably at the acquisition date? If so, in what circumstances?

Question 13—Measurement period

The Exposure Draft proposes that an acquirer should recognise adjustments made during the measurement period to the provisional values of the assets acquired and liabilities assumed as if the

accounting for the business combination had been completed at the acquisition date. Thus, comparative information for prior periods presented in financial statements would be adjusted, including any change in depreciation, amortisation or other profit or loss effect recognised as a result of completing the initial accounting. (See paragraphs 62-68)

Question 13—Do you agree that comparative information for prior periods presented in financial statements should be adjusted for the effects of measurement period adjustments? If not, what alternative do you propose and why?

Question 14—Assessing what is part of the exchange for the acquiree

The Exposure Draft proposes that an acquirer assess whether any portion of the transaction price (payments or other arrangements) and any assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree. Only the consideration transferred by the acquirer and the assets acquired or liabilities assumed or incurred that are part of the exchange for the acquiree would be included in the business combination accounting. (See paragraphs 69, 70 and A87-A109)

Question 14—Do you believe that the guidance provided is sufficient for making the assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed or incurred are not part of the exchange for the acquiree? If not, what other guidance is needed?

Question 15—Disclosures

The Exposure Draft proposes broad disclosure objectives that are intended to ensure that users of financial statements are provided with adequate information to enable them to evaluate the nature and financial effects of business combinations. Those objectives are supplemented by specific minimum disclosure requirements. In most instances, the objectives would be met by the minimum disclosure requirements that follow each of the broad objectives. However, in some circumstances, an acquirer might be required to disclose additional information necessary to meet the disclosure objectives. (See paragraphs 71-81)

Question 15—Do you agree with the disclosure objectives and the minimum disclosure requirements? If not, how would you propose amending the objectives or what disclosure requirements would you propose adding or deleting, and why?

Questions 16-18 — Convergence with FASB

The Exposure Draft is the result of a project to improve the accounting for business combinations. One objective is to develop a common and comprehensive standard for the accounting for business combinations that could be used for both domestic and cross-border financial reporting. This version and the FASB's version of the Exposure Draft provide different guidance on certain limited matters. A comparison, by paragraph, of the different guidance accompanies the draft FRS. Most of the differences arise because of the decision to provide business combinations guidance that is consistent with the other standards. Even though those differences are candidates for future convergence projects, there are no plans to eliminate those differences before final standards on business combinations are issued.

The Exposure Draft proposes to resolve a difference with SFAS 141 relating to the criteria for recognising an intangible asset separately from goodwill. It was concluded that an intangible asset must be identifiable (arising from contractual-legal rights or separable) to be recognised separately from goodwill. In its deliberations that led to SFAS 141, the FASB concluded that, when acquired in a business combination, all intangible assets (except for an assembled workforce) that are identifiable can be measured with sufficient reliability to warrant recognition separately from goodwill. In addition to the identifiability criterion, FRS 103 and FRS 38 required that an intangible asset acquired in a business combination be reliably measurable to be recognised separately from goodwill. Paragraphs 35-41 of FRS 38 provide guidance for determining whether an intangible asset acquired in a business combination is reliably measurable. FRS 38 presumes that the fair value of an intangible asset with a finite useful life can be measured reliably. Therefore, a difference between FRS 103 and SFAS 141 would arise only if the intangible asset has an indefinite life. Convergence with the FASB was decided by:

(a) eliminating the requirement that an intangible asset be reliably measurable to be recognised separately from goodwill; and

(b) precluding the recognition of an assembled workforce acquired in a business combination as an intangible asset separately from goodwill.

(See paragraph 40)

Question 16—Do you believe that an intangible asset that is identifiable can always be measured with sufficient reliability to be recognised separately from goodwill? If not, why? Do you have any examples of an intangible asset that arises from legal or contractual rights and has both of the following characteristics:

(a) the intangible asset cannot be sold, transferred, licensed, rented, or exchanged individually or in combination with a related contract, asset, or liability; and

(b) cash flows that the intangible asset generates are inextricably linked with the cash flows that the business generates as a whole?

For the Exposure Draft, the provisions of FRS 12 *Income Taxes* and FASB Statement No. 109 *Accounting for Income Taxes*, relating to an acquirer's deferred tax benefits that become recognisable because of a business combination, were considered. FRS 12 requires the acquirer to recognise separately from the business combination accounting any changes in its deferred tax assets that become recognisable because of the business combination. Such changes are recognised in post-combination profit or loss, or equity. On the other hand, SFAS 109 requires any recognition of an acquirer's deferred tax benefits (through the reduction of the acquirer's valuation allowance) that results from a business combination to be accounted for as part of the business combination, generally as a reduction of goodwill. The decision was to amend SFAS 109 to require the recognition of any changes in the acquirer's deferred tax benefits (through a change in the acquirer's previously recognised valuation allowance) as a transaction separately from the business combination. As amended, SFAS 109 would require such changes in deferred tax benefits to be recognised either in income from continuing operations in the period of the combination or directly to contributed capital, depending on the circumstances. The decision was to require disclosure of the amount of such acquisition-date changes in the acquirer's deferred tax benefits in the notes to the financial statements. (See paragraph D4)

Question 17—Do you agree that any changes in an acquirer's deferred tax benefits that become recognisable because of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination? If not, why?

The disclosure requirements in FRS 103 and SFAS 141 were reconsidered for the purposes of convergence. For some of the disclosures, the decision was to converge. However, divergence continues to exist for some disclosures as described in the accompanying note *Differences between the Exposure Drafts* included in the Exposure Draft. It was concluded that some of this divergence stems from differences that are broader than the Business Combinations project.

Question 18—Do you believe it is appropriate to retain those disclosure differences? If not, which of the differences should be eliminated, if any, and how should this be achieved?

Question 19—Style of the Exposure Draft

The Exposure Draft was prepared in a style similar to previous style in which paragraphs in **bold type** state the main principles. All paragraphs have equal authority.

Question 19—Do you find the bold type-plain type style of the Exposure Draft helpful? If not, why? Are there any paragraphs you believe should be in bold type, but are in plain type, or vice versa?

[Draft] Financial Reporting Standard 103 *Business Combinations* (revised 200X) ([draft] FRS 103) is set out in paragraphs 1-88 and Appendices A and C-E. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in paragraph 3 are underlined the first time they appear in the [draft] FRS. [Draft] FRS 103 should be read in the context of its objective, the *Preface to Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

INTRODUCTION

IN1 A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses (the acquiree). The objective of this [draft] FRS is that all business combinations be accounted for by applying the acquisition method. In accordance with the acquisition method, the acquirer measures and recognises the acquiree, as a whole, and the assets acquired and liabilities assumed at their fair values as of the acquisition date.

IN2 This [draft] FRS replaces FRS 103 *Business Combinations* (as issued in 2004). This [draft] FRS is to be applied at the same time as [draft] FRS 27 *Consolidated and Separate Financial Statements* (as revised in 200X) and [draft] FRS 37 *Non-financial Liabilities.*

Background

IN3 This [draft] FRS is issued to improve financial reporting while promoting the international convergence of accounting standards. It is believed that developing a common set of high quality financial accounting standards improves the comparability of financial information around the world and simplifies the accounting for entities that issue financial statements in accordance with financial accounting standards and US generally accepted accounting principles or reconcile from one set of standards to the other.

IN4 It was decided that the financial accounting for business combinations would be addressed in two phases. The primary conclusion in the first phase was that virtually all business combinations are acquisitions. Accordingly, the decision was to require the use of one method of accounting for business combinations—the purchase method (called the *acquisition method* in this [draft] FRS).

IN5 The second phase addresses guidance for applying the acquisition method. It was decided that a significant improvement could be made to financial reporting if there were similar standards for accounting for business combinations. Thus, the decision was to conduct the second phase as a joint effort with the objective of reaching the same conclusions.

Reasons for issuing this [draft] FRS

IN6 This [draft] FRS seeks to improve financial reporting by requiring the acquisition method to be applied to more business combinations, including those involving only mutual entities and those achieved by contract alone. It was believed that applying a single method of accounting to all business combinations will result in more comparable and transparent financial statements.

IN7 This [draft] FRS requires an acquirer to recognise an acquired business at its fair value at the acquisition date rather than at its cost. It also requires the acquirer to measure and recognise the individual assets acquired and liabilities assumed at their fair values at the acquisition date, with limited exceptions. It was concluded that requiring the recognition of the acquiree and the assets acquired and liabilities assumed at fair value as of the acquisition date improves the relevance and reliability of financial information. This is true even in business combinations in which the acquirer obtains control of a business by acquiring less than 100 per cent of the equity interests in the acquiree or in business combinations achieved in stages (step acquisitions). Relevance and reliability are characteristics that make financial information more useful to users.

Main features of this [draft] FRS

IN8 This [draft] FRS retains the fundamental requirements in the previous version of FRS 103 for the acquisition method of accounting to be used for all business combinations and for an acquirer to be identified for every business combination. Additionally, this [draft] FRS requires:

(a) the acquirer to measure the fair value of the acquiree, as a whole, as of the acquisition date.

(b) for the purposes of applying the acquisition method, the consideration transferred by the acquirer in exchange for the acquiree to be measured at its fair value as of the acquisition date calculated as the sum of:

  (i) the assets transferred by the acquirer, liabilities incurred by the acquirer, and equity interests issued by the acquirer, including contingent consideration, and

  (ii) any non-controlling equity investment in the acquiree owned by the acquirer immediately before the acquisition date.

(c) the acquirer to assess whether any portion of the transaction price paid and any assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree. Only the consideration transferred or the assets acquired or liabilities assumed or incurred that are part of the exchange for the acquiree are to be accounted for as part of the business combination accounting.

(d) the acquirer to account for acquisition-related costs incurred in connection with the business combination separately from the business combination (generally as expenses).

(e) the acquirer to measure and recognise the acquisition-date fair value of the assets acquired and liabilities assumed as part of the business combination, with limited exceptions. Those exceptions are:

  (i) goodwill is to be measured and recognised as the excess of the fair value of the acquiree, as a whole, over the net amount of the recognised identifiable assets acquired and liabilities assumed. If the acquirer owns less than 100 per cent of the equity interests in the acquiree at the acquisition date, goodwill attributable to the non-controlling interest is recognised.

  (ii) non-current assets (or disposal group) classified as held for sale, deferred tax assets or liabilities, and assets or liabilities related to the acquiree's employee benefit plans are measured in accordance with other FRSs.

  (iii) if the acquiree is a lessee to an operating lease, no asset or related liability is recognised if the lease is at market terms.

(f) the acquirer to recognise separately from goodwill an acquiree's intangible assets that meet the definition of an intangible asset in FRS 38 Intangible Assets and are identifiable (i.e. arise from contractual-legal rights or are separable).

(g) *Not used*.

(h) in a business combination in which the acquisition-date fair value of the acquirer's interest in the acquiree exceeds the fair value of the consideration transferred for that interest (referred to as a bargain purchase), the acquirer to account for that excess by reducing goodwill until the goodwill related to that business combination is reduced to zero and then by recognising any remaining excess in profit or loss.

(i) the acquirer to recognise any adjustments made during the measurement period to the provisional values of the assets acquired and liabilities assumed as if the accounting for the business combination had been completed at the acquisition date. Thus, comparative information for prior periods presented in financial statements is to be adjusted.

Significant changes to FRS 103

IN9 The main changes between this [draft] FRS and the previous version of FRS 103 are described below.

Scope

(a) The requirements of this [draft] FRS are applicable to business combinations involving only mutual entities and business combinations achieved by contract alone.

Definition of a business combination

(b) This [draft] FRS amends the definition of a *business combination* provided in the previous version of FRS 103. This [draft] FRS defines a business combination as 'a transaction or other event in which an acquirer obtains control of one or more businesses'.

Definition of a business

(c) This [draft] FRS provides a definition of a *business* and additional guidance for identifying when a group of assets constitutes a business. This [draft] FRS amends the definition provided in the previous version of FRS 103.

Measuring the fair value of the acquiree

(d) This [draft] FRS requires business combinations to be measured and recognised as of the acquisition date at the fair value of the acquiree, even if the business combination is achieved in stages or if less than 100 per cent of the equity interests in the acquiree are owned at the acquisition date. The previous version of FRS 103 required a business combination to be measured and recognised on the basis of the accumulated cost of the combination.

(e) This [draft] FRS requires the costs the acquirer incurs in connection with the business combination to be accounted for separately from the business combination accounting. The previous version of FRS 103 required direct costs of the business combination to be included in the cost of the acquiree.

(f) This [draft] FRS requires all items of consideration transferred by the acquirer to be measured and recognised at fair value at the acquisition date. Therefore, this [draft] FRS requires the acquirer to recognise contingent consideration arrangements at fair value as of the acquisition date. Subsequent changes in the fair value of contingent consideration classified as liabilities are recognised in accordance with FRS 39 *Financial Instruments: Recognition and Measurement*, FRS 37 or other FRSs, as appropriate.

(g) This [draft] FRS requires the acquirer in a business combination in which the acquisition-date fair value of the acquirer's interest in the acquiree exceeds the fair value of the consideration transferred for that interest (referred to as a bargain purchase) to account for that excess by first reducing the goodwill related to that business combination to zero, and then by recognising any excess in income. The previous version of FRS 103 required the excess of the acquirer's interest in the net fair values of the acquiree's assets and liabilities over cost to be recognised immediately in profit or loss.

Measuring and recognising the assets acquired and the liabilities assumed

(h) This [draft] FRS requires the assets acquired and liabilities assumed to be measured and recognised at their fair values as of the acquisition date, with limited exceptions. The previous version of FRS 103 required the cost of an acquisition to be allocated to the individual assets acquired and liabilities assumed based on their estimated fair values. However, it also provided guidance for measuring some assets and liabilities that was inconsistent with fair value measurement objectives. Thus, those assets or liabilities may not have been recognised at fair value as of the acquisition date in accordance with that version of FRS 103.

(i) This [draft] FRS requires an identifiable asset or liability to be measured and recognised at fair value at the acquisition date even if the amount of the future economic benefits embodied in the asset or required to settle the liability are contingent (or conditional) on the occurrence or non-occurrence of one or more uncertain future events. The previous version of FRS 103 required the recognition of contingent liabilities at fair value as of the acquisition date.

(j) *Not used.*

(k) This [draft] FRS requires the acquirer in business combinations in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date to recognise the identifiable assets and liabilities at the full amount of their fair values, with limited exceptions, and goodwill as the difference between the fair value of the acquiree, as a whole, and the fair value of the identifiable assets acquired and liabilities assumed. The previous version of FRS 103 required the identifiable assets acquired and liabilities assumed to be recognised at fair value but goodwill to be recognised as the difference between the cost of the interest acquired and the acquirer's proportional interest in the fair value of the identifiable assets acquired and liabilities assumed. If the business combination was achieved in stages, FRS 103 previously required goodwill to be determined by a step-by-step comparison of the cost of the individual investments with the acquirer's interest in the fair values of the identifiable assets acquired and liabilities assumed at each step.

(l) Acquisitions of additional non-controlling equity interests after the business combination are not permitted to be accounted for using the acquisition method. In accordance with [draft] FRS 27 (as revised in 200X), acquisitions (or disposals) of non-controlling equity interests after the business combination are accounted for as equity transactions.

(m) The acquirer is required to recognise separately from goodwill an acquiree's intangible assets if they meet the definition of an intangible asset in FRS 38 *Intangible Assets*. The previous version of FRS 103 required the recognition of intangible assets separately from goodwill only if they met the FRS 38 definition and were reliably measurable. For the purposes of this [draft] FRS, an assembled workforce is not to be recognised as an intangible asset separately from goodwill.

(n) *Not used.*

Benefits and costs

IN10 This [draft] FRS will, for the reasons previously noted, make several improvements to financial reporting that would benefit investors, creditors, and other users of financial statements.

IN11 Reduction of costs of applying this [draft] FRS was considered. This [draft] FRS (a) requires particular assets and liabilities (for example, those related to deferred taxes, assets held for sale, and employee benefits) to continue to be measured and recognised in accordance with existing FRSs rather than at fair value and (b) requires its provisions to be applied prospectively rather than retrospectively. It was acknowledged that those two steps may diminish some benefits of improved reporting provided by this [draft] FRS. However, it was concluded that the complexities and related costs that would result from imposing a fair value measurement requirement at this time to all assets acquired and liabilities assumed in a business combination and requiring retrospective application of the provisions of this [draft] FRS are not justified.

IN12 In addition, improving the consistency of the procedures used in accounting for business combinations, including international consistency, should help alleviate concerns that an entity's competitive position as a potential bidder is affected by differences in accounting for business combinations. Consistency in the accounting procedures can also reduce the costs to prepare financial statements, especially for entities with global operations. Moreover, such consistency also will enhance comparability of information among entities, which can lead to a better understanding of the resulting financial information and reduce the costs to users of analysing that information.

Effective date

IN13 This [draft] FRS applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual period beginning on or after 1 January 2007. Earlier application is encouraged. However, this [draft] FRS is to be applied only at the beginning of an annual period that begins on or after the date on which this [draft] FRS was issued. If this [draft] FRS is applied before its effective date, that fact is to be disclosed and [draft] FRS 27 (as revised in 200X) and [draft] FRS 37 (as revised in 200X) is/are to be applied at the same time.

[DRAFT] FINANCIAL REPORTING STANDARD 103

Business Combinations

OBJECTIVE

1 This [draft] FRS requires that all business combinations be accounted for by applying the acquisition method. A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses (the acquiree). In accordance with the acquisition method, the acquirer measures and recognises the acquiree, as a whole, and the assets acquired and liabilities assumed at their fair values as of the acquisition date.

SCOPE

2 An entity shall apply this [draft] FRS when accounting for business combinations. However, this [draft] FRS does not apply to:

(a) formations of joint ventures

(b) combinations involving only entities or businesses under common control (see paragraphs C6-C10 of Appendix C).

(c) *Not used.*

KEY TERMS

3 The following terms are used with specific meanings and are integral to understanding and applying this [draft] FRS.

(a) The acquiree is the business or businesses the acquirer obtains control of in a business combination.

(b) The acquirer is the entity that obtains control of the acquiree.

(c) The acquisition date is the date the acquirer obtains control of the acquiree.

(d) A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing either:

(1) a return to investors, or

(2) dividends, lower costs, or other economic benefits directly and proportionately to owners, members or participants.

(e) A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses.

(f) Control is defined in [draft] FRS 27 *Consolidated and Separate Financial Statements*.

(g) Contingencies is used with the same meaning as in [draft] FRS 37 *Non-financial Liabilities*.

(h) For the purposes of this [draft] FRS, the term equity interests is used broadly to mean ownership interests of investor-owned entities and owner, member, or participant interests of mutual entities.

(i) For the purposes of this [draft] FRS, <u>fair value</u> is the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties.[*]

(j) <u>Goodwill</u> is the future economic benefits arising from assets that are not individually identified and separately recognised.

(k) An asset is <u>identifiable</u> if it either:

(1) is separable, that is, capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, asset, or liability, regardless of whether the entity intends to do so; or

(2) Arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

(l) <u>Impracticable</u> is defined in FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

(m) A <u>mutual entity</u> is an entity other than an investor-owned entity that provides dividends, lower costs, or other economic benefits directly and proportionately to its owners, members, or participants.

(n) For the purposes of this [draft] FRS, the term <u>owners</u> is used broadly to include holders of equity interests of investor-owned entities and owners, members, or participants of mutual entities.

(o) <u>Non-controlling interest</u> is used with the same meaning as in [draft] FRS 27 (revised 200X).

IDENTIFYING A BUSINESS COMBINATION

4 **A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses.**

5 A transaction or other event is accounted for as a business combination only if the assets acquired and liabilities assumed constitute a business (an acquiree). Paragraphs A2-A7 of Appendix A provide guidance for identifying whether the assets acquired and liabilities assumed constitute a business. If the assets acquired and liabilities assumed do not constitute a business, the acquirer shall account for the transaction as an asset acquisition. The accounting for an asset acquisition is set out in paragraphs C3-C5.

6 In a business combination, an acquirer might:

(a) acquire the <u>equity interests</u> of a business.

(b) acquire some or all of an entity's assets (net assets) that constitute a business.

(c) assume some or all of the liabilities of an acquiree.

An acquirer might obtain control of an acquiree:

(d) by transferring cash, cash equivalents, or other assets (including net assets that constitute a business).

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[*] The definition of fair value is based on the definition in the FASB's Proposed Statement *Fair Value Measurements*. The FASB plans to issue a final Statement on fair value measurements in the fourth quarter of 2005. The definition of fair value may change in that final Statement.

(e) by issuing equity interests.

(f) by providing more than one type of consideration.

(g) by contract alone (see paragraph 54).

(h) without transferring any consideration.

(i) without a transaction involving the acquirer. One example is a business combination that occurs when an entity (the acquiree) repurchases its own shares and, as a result, an existing investor (the acquirer) obtains control of that entity. Another example is a business combination that occurs when an acquirer obtains control of an acquiree through the lapse of minority veto rights that previously kept the acquirer from controlling the acquiree even though the acquirer held the majority voting interest in the acquiree.

7 A business combination may be structured in a variety of ways for legal, taxation, or other reasons. Accordingly, this [draft] FRS applies equally to business combinations in which:

(a) one or more businesses are merged with or become subsidiaries of an acquirer.

(b) one entity transfers net assets or its owners transfer their equity interests to another entity or the owners of another entity.

(c) all entities transfer net assets or the owners of those entities transfer their equity interests to a newly formed entity (some of which are referred to as roll-up or put-together transactions).

All those transactions are business combinations regardless of:

(d) whether the acquiree is incorporated.

(e) the form of consideration transferred in exchange for the acquiree.

(f) whether a group of former owners of one of the combining entities retains or receives a majority of the voting rights of the combined entity.

THE ACQUISITION METHOD

8 All business combinations shall be accounted for by applying the acquisition method.

9 The acquisition method has four steps:

(a) identifying the acquirer

(b) determining the acquisition date

(c) measuring the fair value of the acquiree

(d) measuring and recognising the assets acquired and the liabilities assumed.

Identifying the acquirer

10 An acquirer shall be identified for all business combinations.

11 The guidance in [draft] FRS 27 (revised 200X) shall be used to identify the acquirer, which is the entity that obtains control of the acquiree. If an acquirer cannot be determined solely on the basis of the guidance in [draft] FRS 27 paragraphs 12-16 shall be considered in making that determination.

12 The form of the consideration transferred may provide evidence about which entity is the acquirer. For example:

(a) in a business combination effected solely through the transfer of cash or other assets or by incurring liabilities, the entity that transfers the cash or other assets or incurs the liabilities is likely to be the acquirer.

(b) in a business combination effected through an exchange of cash or other assets for voting equity interests, the entity that gives up the cash or other assets is likely to be the acquirer.

(c) in a business combination effected through an exchange of equity interests, the entity that issues the equity interests is normally the acquirer. However, in some business combinations, commonly called reverse acquisitions, the issuing entity is the acquiree. Paragraphs A111-A136 provide guidance for accounting for reverse acquisitions. Commonly in an exchange of equity interests, the acquirer is the larger entity; however, the facts and circumstances surrounding a combination sometimes indicate that a smaller entity acquires a larger entity. Therefore, in identifying the acquirer in a business combination effected through an exchange of equity interests, all pertinent facts and circumstances shall be considered, in particular:

(1) *the relative voting rights in the combined entity after the business combination*—All else being equal, the acquirer is the combining entity whose owners as a group retained or received the largest portion of the voting rights in the combined entity. In determining which group of owners retained or received the largest portion of the voting rights, consideration shall be given to the existence of any unusual or special voting arrangements and options, warrants, or convertible securities.

(2) *the existence of a large minority voting interest in the combined entity when no other owner or organised group of owners has a significant voting interest*—All else being equal, the acquirer is the combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity.

(3) *the composition of the governing body of the combined entity*—All else being equal, the acquirer is the combining entity whose owners or governing body has the ability to elect or appoint a voting majority of the governing body of the combined entity.

(4) *the terms of the exchange of equity interests*—All else being equal, the acquirer is the combining entity that pays a premium over the pre-combination market value of the equity securities of the other combining entity or entities.

13 If the fair value of one of the combining entities is significantly greater than that of the other combining entity or entities, the entity with the greatest fair value is likely to be the acquirer.

14 If the business combination results in the management of one of the combining entities being able to dominate the selection of the management team of the resulting combined entity, the entity whose management is able to dominate is likely to be the acquirer.

15 In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination and whether the assets, revenues, or profit or loss of one of the combining entities significantly exceeds those of the others.

16 If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the

acquirer based on the evidence available. The guidance in paragraphs 11-15 shall be used to identify the acquirer.

Determining the acquisition date

17 **The acquisition date is the date the acquirer obtains control of the acquiree.**

18 The acquirer generally obtains control of the acquiree on the closing date, which is the date that the acquirer transfers the consideration, acquires the assets, and assumes the liabilities of the acquiree. In some cases, the acquisition date may precede the closing date of the business combination or the date the business combination is finalised in law. All pertinent facts and circumstances surrounding a business combination shall be considered in assessing when the acquirer has obtained control of the acquiree. For example, the acquisition date may precede the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date.

Measuring the fair value of the acquiree

19 **The acquirer shall measure the fair value of the acquiree, as a whole, as of the acquisition date.**

20 Business combinations are usually arm's length exchange transactions in which knowledgeable, unrelated willing parties exchange equal values. Therefore, in the absence of evidence to the contrary, the exchange price (referred to in this [draft] FRS as the consideration transferred) paid by the acquirer on the acquisition date is presumed to be the best evidence of the acquisition-date fair value of the acquirer's interest in the acquiree. In some business combinations, either no consideration is transferred on the acquisition date or the evidence indicates that the consideration transferred is not the best basis for measuring the acquisition-date fair value of the acquirer's interest in the acquiree. In those business combinations, the acquirer should measure the acquisition-date fair value of its interest in the acquiree using other valuation techniques. Paragraphs A8-A26 provide additional guidance for performing the fair value measurement described in this paragraph.

Consideration transferred

21 For the purposes of applying the acquisition method, the fair value of the consideration transferred in exchange for the acquirer's interest in the acquiree is calculated as the sum of:

(a) the acquisition-date fair values of the assets transferred by the acquirer, liabilities assumed or incurred by the acquirer, and equity interests issued by the acquirer. Examples include cash, other assets, contingent consideration (see paragraph 25), a business or a subsidiary of the acquirer, common or preferred equity instruments, options, warrants, and member interests of mutual entities; and

(b) the acquisition-date fair value of any non-controlling equity investment in the acquiree that the acquirer owned immediately before the acquisition date (see paragraph 56).

22 The consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, non-monetary assets or a business of the acquirer). In that case, the acquirer shall remeasure those transferred assets or liabilities to their fair values as of the acquisition date and recognise any gains or losses in profit or loss. However, if those assets or liabilities are transferred to the acquiree and, therefore, remain within the combined entity after the business combination, the acquirer shall eliminate any gains or losses on those transferred assets or liabilities in the consolidated financial statements.

23 If the information necessary to measure the fair value of some or all of the consideration transferred is not available at the acquisition date, the measurement period guidance in paragraphs 62-68 applies.

24 The acquirer shall assess whether any portion of the transaction price includes payments or other arrangements that are not consideration transferred in exchange for the acquiree. Paragraphs 69 and 70 provide guidance for making that assessment. Only the consideration transferred in exchange for the acquiree shall be accounted for as part of the business combination.

Contingent consideration

25 As described in paragraph 21(a), the fair value of the consideration transferred in exchange for the acquiree includes the acquisition-date fair value of any obligations of the acquirer to transfer additional assets or equity interests if specified future events occur or conditions are met (commonly called contingent consideration). For example, the acquirer may agree to transfer additional equity interests, cash, or other assets to the former owners of the acquiree after the acquisition date if the acquiree meets specified financial or non-financial targets in the future. The acquirer shall measure and recognise the fair value of such contingent consideration as of the acquisition date and shall classify that obligation as either a liability or equity on the basis of other FRSs. An arrangement to transfer additional assets or equity interests if specified events or conditions occur may be incorporated in an acquirer's share-based payment awards exchanged for awards held by the acquiree's employees. The acquirer shall measure the portion of such awards included in consideration transferred for the acquiree in accordance with paragraphs A102-A109.

26 After initial recognition, the acquirer shall account for changes in the fair value of contingent consideration that do not qualify as measurement period adjustments (see paragraphs 62-68) as follows:

(a) contingent consideration classified as equity shall not be remeasured.

(b) contingent consideration classified as liabilities that:

(1) are financial instruments and within the scope of FRS 39 *Financial Instruments: Recognition and Measurement,* shall be accounted for in accordance with that FRS.

(2) are non-financial liabilities that include a contingency shall be accounted for in accordance with [draft] FRS 37, or other FRSs as appropriate.

Costs incurred in connection with a business combination

27 Costs the acquirer incurs in connection with a business combination (also called acquisition-related costs) are not part of the consideration transferred in exchange for the acquiree. For example, such costs include finder's fees, advisory, legal, accounting, valuation, other professional or consulting fees, general administrative costs, including the costs of maintaining an internal acquisitions department, and costs of registering and issuing debt and equity securities. The acquirer shall not include such costs in the measure of the fair value of the acquiree or the assets acquired or liabilities assumed as part of the business combination. The acquirer shall account for acquisition-related costs, separately from the business combination, in accordance with other FRSs.

Measuring and recognising the assets acquired and the liabilities assumed

28 The acquirer shall measure and recognise as of the acquisition date the assets acquired and liabilities assumed as part of the business combination. Except as provided in paragraphs 42-51, the identifiable assets acquired and liabilities assumed shall be measured at fair value and recognised separately from goodwill.

29 As part of the business combination accounting, the acquirer recognises assets acquired or liabilities assumed that are part of the exchange for the acquiree and meet the definition of assets and liabilities in the *Framework for the Preparation and Presentation of Financial Statements*. The assets and liabilities the acquirer recognises as part of the business combination may include assets and liabilities the acquiree had not recognised previously in its financial statements. For example, the acquirer often recognises the acquired identifiable intangible assets that were internally developed by the acquiree and did not meet the criteria for recognition in the acquiree's financial statements. The acquirer does not recognise any assets or liabilities other than the assets acquired or the liabilities assumed as part of the business combination.

30 A business combination does not affect the measurement of the acquirer's assets and liabilities, except for those assets or liabilities that are not recognised at fair value by the acquirer before the business combination and are part of the consideration transferred in exchange for the acquiree (see paragraph 22).

31 If the information necessary to measure the fair value of some or all of the assets acquired or liabilities assumed is not available at the acquisition date, the measurement period guidance in paragraphs 62-68 applies.

32 The acquirer shall assess whether any of the assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree (that is, not included in the business combination accounting). Paragraphs 69 and 70 provide guidance for making that assessment.

Guidance for measuring and recognising particular assets acquired and liabilities assumed

33 Paragraphs 34-41 provide guidance for measuring and recognising particular assets acquired and liabilities assumed at fair value as of the acquisition date.

Valuation allowances

34 The acquirer shall not recognise a separate valuation allowance as of the acquisition date for assets required to be recognised at fair value in accordance with this [draft] FRS. For example, an acquirer would recognise receivables (including loans) acquired in a business combination at fair value as of the acquisition date and would not recognise a separate valuation allowance for uncollectible receivables at that date. Uncertainty about collections and future cash flows is included in the fair value measure.

Contingencies

35 The acquirer shall recognise, separately from goodwill, the acquisition-date fair value of an identifiable asset acquired or liability assumed as part of the business combination even if the amount of the future economic benefits embodied in the asset or required to settle the liability are contingent (or conditional) on the occurrence or non-occurrence of one or more uncertain future events. Such an asset or liability is called a <u>contingency</u> in this [draft] FRS.

36 After initial recognition, the acquirer shall account for such assets in accordance with FRS 38 *Intangible Assets* or FRS 39, as appropriate, and such liabilities in accordance with [draft] FRS 37 or other FRSs, as appropriate.

Liabilities associated with restructuring or exit activities

37 The acquirer shall recognise, separately from goodwill, the acquisition-date fair value of liabilities for restructuring or exit activities acquired in a business combination only if they meet the recognition criteria in [draft] FRS 37 as of the acquisition date. Costs associated with restructuring or exit activities that do not meet the recognition criteria in [draft] FRS 37 as of the acquisition date are not liabilities at the acquisition date and, therefore, are recognised

separately from the business combination, generally as post-combination expenses of the combined entity when incurred. For example, costs the acquirer expects to incur in the future pursuant to its plan (a) to exit an activity of an acquiree, (b) to involuntarily terminate the employment of an acquiree's employees, or (c) to relocate employees of an acquiree are not assumed liabilities of the acquiree and, therefore, are not accounted for as part of the business combination.

Leases

38 In accordance with FRS 17 *Leases*, a lease of the acquiree (regardless of whether the acquiree is the lessee or lessor) retains the lease classification determined by the acquiree at the lease inception, unless the provisions of a lease are modified as a result of the business combination in a way that would require the acquirer to consider the revised agreement a new lease agreement in accordance with paragraph 13 of FRS 17. In that circumstance, the acquirer would classify the new lease according to the criteria set out in FRS 17 on the basis of the conditions of the modified lease.

39 The acquirer shall account for the acquiree's operating leases in which the acquiree is the lessee in accordance with paragraph 47. For all other leases, the acquirer shall measure and recognise separately the asset and any related liability embodied in a lease at their acquisition-date fair values. After initial recognition, assets and liabilities related to leases shall be accounted for in accordance with FRS 17.

Intangible assets

40 The acquirer shall recognise, separately from goodwill, the acquisition-date fair value of intangible assets acquired in a business combination that meet the definition of an intangible asset in FRS 38. For the purposes of this [draft] FRS, an assembled workforce shall not be recognised as an intangible asset separately from goodwill. Paragraphs A27-A61 provide additional guidance about measuring and recognising intangible assets acquired in a business combination.

41 As part of a business combination, an acquirer may reacquire a right that it had previously granted to the acquiree to use the acquirer's recognised or unrecognised intangible assets (such as a right to use the acquirer's trade name under a franchise agreement or a right to use the acquirer's technology under a technology licensing agreement). Such a right is an identifiable intangible asset that shall be recognised separately from goodwill as part of the business combination accounting. If the contract giving rise to the reacquired right includes pricing terms that are favourable or unfavourable when compared with pricing for current market transactions for the same or similar items, the acquirer shall recognise a settlement gain or loss. Paragraph A92 provides guidance for measuring that settlement gain or loss. After initial recognition, reacquired rights shall be amortised over the remaining contractual period of the pre-combination contract that granted those rights.

Assets acquired and liabilities assumed that are not recognised at fair value as of the acquisition date

42 The following assets acquired and liabilities assumed shall be measured and recognised as of the acquisition date as follows.

Assets held for sale

43 The acquirer shall measure and recognise, separately from goodwill, an acquired non-current asset (or disposal group) that is classified as held for sale as of the acquisition date in accordance with paragraphs 7-11 of FRS 105 *Non-current Assets Held for Sale and Discontinued Operations*.

Deferred taxes

44 The acquirer shall measure and recognise, separately from goodwill, a deferred tax asset or liability in accordance with FRS 12 *Income Taxes* as amended by paragraph D4 of this [draft] FRS.

45 FRS 12, as amended by this [draft] FRS, sets out the subsequent accounting for deferred tax assets (including unrecognised deferred tax assets) and liabilities that were acquired in a business combination.

46 The acquirer shall account for the potential tax effects of (a) temporary differences and carry-forwards of an acquiree that exist at the acquisition date and (b) income tax uncertainties related to the acquisition (for example, an uncertainty related to the tax basis of an acquired asset that ultimately will be agreed to by the taxing authority or positions taken in prior tax returns of the acquiree) in accordance with the provisions of FRS 12, as amended.

Operating leases

47 If the acquiree is the lessee to an operating lease, the acquirer shall not recognise separately the asset and related liability embodied in the lease. If the acquiree is the lessor to an operating lease, the acquirer shall measure and recognise the asset subject to the operating lease at its acquisition-date fair value in accordance with paragraph 39. The acquirer shall also assess whether each of the acquiree's operating leases are at market terms as of the acquisition date, regardless of whether the acquiree is the lessee or lessor. If an operating lease is not at market terms as of the acquisition date, the acquirer shall recognise:

(a) an intangible asset if the terms of the operating lease are favourable relative to market terms.

(b) a liability if the terms of the operating lease are unfavourable relative to market terms.

Employee benefit plans

48 The acquirer shall measure and recognise, separately from goodwill, any asset or liability related to the acquiree's employee benefit plans that is within the scope of FRS 19 *Employee Benefits* in accordance with paragraph 108 of that standard.

Goodwill

49 Except as provided by paragraph 61, the acquirer shall measure and recognise goodwill as of the acquisition date as the excess of the fair value of the acquiree, as a whole, over the net amount of the recognised identifiable assets acquired and liabilities assumed. This requirement applies even if the acquirer owns less than 100 per cent of the equity interests in the acquiree at the acquisition date (that is, even if a non-controlling interest in the acquiree exists at the acquisition date).

50 The amount recognised as goodwill includes synergies and other benefits that are expected from combining the activities of the acquirer and acquiree. Because goodwill is measured as a residual, the amount recognised as goodwill also includes (a) intangible assets that do not meet the criteria in paragraph 40 for recognition separately from goodwill and (b) any difference between the fair values of the assets acquired and liabilities assumed and the amount recognised in accordance with paragraphs 42-48.

51 After initial recognition, the acquirer shall measure goodwill at the amount recognised as of the acquisition date less any accumulated impairment losses. Goodwill shall not be amortised. The acquirer shall test goodwill for impairment in accordance with FRS 36 *Impairment of Assets* as amended by paragraph D10 of this [draft] FRS.

Additional guidance for applying the acquisition method to particular types of business combinations

52 Paragraphs 53-61 provide additional guidance for applying the acquisition method to the following types of business combinations:

(a) business combinations involving only mutual entities

(b) business combinations achieved by contract alone

(c) business combinations achieved in stages

(d) business combinations in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date

(e) business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest.

Business combinations involving only mutual entities

53 In a business combination involving only mutual entities in which the only consideration exchanged is the member interests of the acquiree for the member interests of the acquirer (or the member interests of the newly combined entity), the amount equal to the fair value of the acquiree shall be recognised as a direct addition to capital or equity, not retained earnings.

Business combinations achieved by contract alone

54 In rare circumstances, an acquirer (a) obtains control of an acquiree by contract, (b) transfers no consideration for control of the acquiree or for the net assets of the acquiree, and (c) obtains no equity interests in the acquiree, either on the acquisition date or previously. An example of such a business combination is one in which two businesses are brought together to form a dual listed corporation. This type of business combination is referred to in this [draft] FRS as a business combination achieved by contract alone. In such a business combination, the fair value of the acquiree shall be attributed to the non-controlling interests of the acquiree (that is, the equity holders of the acquiree) in the consolidated financial statements of the acquirer.

Business combinations achieved in stages

55 A business combination in which an acquirer holds a non-controlling equity investment in the acquiree immediately before obtaining control of that acquiree is a business combination achieved in stages. This type of business combination is also commonly called a step acquisition.

56 As described in paragraph 21(b), for the purposes of applying the acquisition method, the fair value of the consideration transferred by the acquirer includes the acquisition-date fair value of any non-controlling equity investment in the acquiree that the acquirer owned immediately before the acquisition date. In a business combination achieved in stages, the acquirer shall remeasure its non-controlling equity investment in the acquiree at fair value as of the acquisition date and recognise any gain or loss in profit or loss. If, before the business combination, the acquirer recognised changes in the value of its non-controlling equity investment directly in equity (for example, the investment was designated as available for sale), the amount that was recognised directly in equity shall be reclassified and included in the calculation of any gain or loss as of the acquisition date.

57 Once an acquirer has obtained control of an acquiree, subsequent acquisitions (or dispositions) of any non-controlling interests in the acquiree shall be accounted for as equity transactions in accordance with [draft] FRS 27.

Business combinations in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date

58 In a business combination in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date, the acquirer shall:

(a) recognise identifiable assets acquired and liabilities assumed at their acquisition date values measured in accordance with paragraphs 28-48.

(b) recognise goodwill at the amount measured in accordance with paragraph 49.

(c) allocate the amount of goodwill determined in accordance with paragraph 49 to the acquirer and the non-controlling interest. Paragraphs A62 and A63 provide additional guidance for allocating goodwill between the acquirer and the non-controlling interest.

(d) measure and recognise the non-controlling interest as the sum of the non-controlling interest's proportional interest in the identifiable assets acquired and liabilities assumed plus the non-controlling interest's share of goodwill, if any.

Business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest

59 In rare circumstances, the acquisition-date fair value of the acquirer's interest in the acquiree exceeds the fair value of the consideration transferred for that interest (as might be the case, for example, in a business combination that is a forced sale in which the seller is acting under compulsion). This type of business combination is referred to in this [draft] FRS as a bargain purchase. However, this type of business combination may occur also because of the requirements in paragraphs 43-48 to measure and recognise particular assets acquired or liabilities assumed in accordance with other [draft] FRSs rather than at fair value.

60 If the fair value of the acquirer's interest in the acquiree is initially determined to exceed the fair value of the consideration transferred for that interest, the acquirer shall assess whether it has correctly identified all assets acquired and liabilities assumed and shall review the procedures used to measure and remeasure, if necessary, all of the following:

(a) the acquisition-date fair value of the acquiree

(b) the acquisition-date fair value of the acquirer's interest in the acquiree

(c) the acquisition-date fair value of the consideration transferred

(d) the acquisition-date values of the identifiable assets acquired and liabilities assumed recognised in accordance with the requirements of this [draft] FRS.

The objective of this review is to ensure that appropriate consideration has been given to all available information in performing the measurements.

61 If, after performing any remeasurements required by paragraph 60, the fair value of the acquirer's interest in the acquiree still exceeds the fair value of the consideration transferred for that interest, the acquirer shall account for that excess by reducing the amount of goodwill that otherwise would be recognised in accordance with paragraph 49. If the goodwill related to that business combination is reduced to zero, any remaining excess shall be recognised as a gain attributable to the acquirer on the acquisition date. Paragraphs A64-A70 provide additional guidance and examples for applying this requirement.

Measurement period

62 The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised at the acquisition date in accounting for a business combination. The measurement period provides the acquirer a reasonable time to obtain the information necessary to identify and measure the following:

(a) the acquisition-date fair value of the acquiree

(b) the acquisition-date fair value of the acquirer's interest in the acquiree

(c) the acquisition-date fair value of the consideration transferred for the acquiree

(d) the acquisition-date values of the assets acquired and liabilities assumed recognised in accordance with the requirements of this [draft] FRS.

63 If any of those measurements can be determined only provisionally by the end of the reporting period in which the business combination occurs, the acquirer shall report those provisional amounts in its financial statements.

64 During the measurement period, the acquirer shall adjust the provisional amounts recognised at the acquisition date to reflect any new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date. During the measurement period, the acquirer also shall recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date.

65 The measurement period ends as soon as the acquirer receives the necessary information about facts and circumstances that existed as of the acquisition date or learns that the information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

66 Generally, adjustments to the provisional amounts recognised for identifiable assets and liabilities during the measurement period are recognised through an offsetting adjustment to goodwill. However, the offsetting adjustment (or part of the offsetting adjustment) may be to an asset or liability other than goodwill. For example, assume that an acquirer's contingent consideration obligation is directly related to the value of an acquired intangible asset and, during the measurement period, the acquirer obtains new information about the fair value of that intangible asset as of the acquisition date. In this case, the adjustment to the provisional amount recognised for that asset may be offset (or partially offset) by a corresponding adjustment to the provisional amount recognised for the contingent consideration liability.

67 The acquirer shall recognise any adjustments to the provisional values during the measurement period as if the accounting for the business combination had been completed at the acquisition date. Thus, comparative information for prior periods presented in financial statements shall be adjusted, including any change in depreciation, amortisation, or other profit or loss effect recognised as a result of completing the initial accounting. Paragraphs A71-A86 provide additional guidance and illustrative examples for applying the measurement period requirements.

68 After the end of the measurement period, the accounting for a business combination shall be restated only to correct an error in accordance with FRS 8.

Assessing what is part of the exchange for the acquiree

69 The acquirer shall assess whether any portion of the transaction price (payments or other arrangements) and any assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree. Only the consideration transferred and the

assets acquired or liabilities assumed or incurred that are part of the exchange for the acquiree shall be included in the business combination accounting. Any portion of the transaction price or any assets acquired or liabilities assumed or incurred that are not part of the exchange for the acquiree shall be accounted for separately from the business combination.

70 Examples of payments or other arrangements that are not part of the exchange for the acquiree include:

(a) payments that effectively settle pre-existing relationships between the acquirer and acquiree (see paragraphs A91-A97).

(b) payments to compensate employees or former owners of the acquiree for future services (see paragraphs A98-A101).

(c) payments to reimburse the acquiree or its former owners for paying the acquirer's costs incurred in connection with the business combination.

Paragraphs A87-A109 provide guidance for assessing whether a portion of the transaction price and any assets and liabilities are not part of the exchange for the acquiree.

DISCLOSURES

71 The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of business combinations that occur:

(a) during the reporting period; and

(b) after the balance sheet date but before the financial statements are authorised for issue.

72 To meet the objective in paragraph 71, the acquirer shall disclose the following information for each material business combination that occurs during the reporting period:

(a) the name and a description of the acquiree.

(b) the acquisition date.

(c) the percentage of voting equity instruments acquired.

(d) the primary reasons for the business combination, including a description of the factors that contributed to the recognition of goodwill.

(e) the acquisition-date fair value of the acquiree and the basis for measuring that value.

(f) the acquisition-date fair value of the consideration transferred, including the fair value of each major class of consideration, such as:

(1) cash

(2) other tangible or intangible assets, including a business or subsidiary of the acquirer

(3) contingent consideration

(4) debt instruments

(5) equity or member interests of the acquirer, including the number of instruments or interests issued or issuable, and the method of determining the fair value of those instruments or interests

(6) the acquirer's previously acquired non-controlling equity investment in the acquiree in a business combination achieved in stages.

(g) the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed in the form of a condensed balance sheet (see paragraph A110).

(h) the maximum potential amount of future payments (undiscounted) the acquirer could be required to make under the terms of the acquisition agreement. If there is no limitation on the maximum potential amount of future payments, that fact shall be disclosed.

(i) in a business combination in which the consideration transferred for the acquiree is less than fair value, the amount of any gain recognised in accordance with paragraph 61, the line item in the income statement in which the gain is recognised, and a description of the reasons why the acquirer was able to achieve a gain.

(j) in a business combination achieved in stages, the amount of any gain or loss recognised in accordance with paragraph 56 and the line item in the income statement in which that gain or loss is recognised.

(k) in a business combination in which the acquirer and acquiree have a pre-existing relationship:

(1) the nature of the pre-existing relationship.

(2) the measurement of the settlement amount of the pre-existing relationship, if any, and the valuation method used to determine the settlement amount.

(3) the amount of any settlement gain or loss recognised and the line item in the income statement in which that gain or loss is recognised.

(l) the amount of costs incurred in connection with the business combination, the amount recognised as an expense and the line item or items in the income statement in which those expenses are recognised.

73 The acquirer also shall disclose the information required by:

(a) paragraphs 72(e)-(l) in aggregate for individually immaterial business combinations that are material collectively.

(b) paragraph 72 if a material business combination is completed after the balance sheet date but before the financial statements are authorised for issue unless disclosure of any of the information is impracticable. If disclosure of any of the information required by paragraph 72 is impracticable, that fact and the reasons shall be disclosed.

74 An acquirer shall also disclose the following information for each material business combination that occurs during the reporting period or in the aggregate for individually immaterial business combinations that are material collectively and occur during the reporting period:

(a) the amounts of revenue and profit or loss of the acquiree since the acquisition date that are included in the consolidated income statement for the reporting period.

(b) the following information:

(1) the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that

occurred during the year had been as of the beginning of the annual reporting period.

(2) *Not used.*

If disclosure of any of the information required by this paragraph is impracticable, that fact and the reasons shall be disclosed.

75 **The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period relating to business combinations that were effected in the current or previous reporting periods.**

76 To meet the objective in paragraph 75, the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:

(a) if the amounts recognised in the financial statements for the business combination have been determined only provisionally:

(1) the reasons why the initial accounting for the business combination is not complete.

(2) the assets acquired or the liabilities assumed for which the measurement period is still open.

(3) the nature and amount of any measurement period adjustments recognised during the reporting period.

(b) a reconciliation of the beginning and ending balances of liabilities for contingent consideration and contingencies that are required to be remeasured to fair value after initial recognition in accordance with paragraphs 26(b)(2) and 36, showing separately the changes in fair value during the reporting period and amounts paid or otherwise settled in accordance with FRS 37 and FRS 39.

(c) a description of the discrete event or circumstance that occurred after the acquisition date that resulted in deferred tax assets acquired as part of the business combination being recognised as income within 12 months after the acquisition date (see paragraph 86).

(d) the amount and an explanation of any gain or loss recognised in the current reporting period that both:

(1) relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or a previous reporting period, and

(2) is of such a size, nature, or incidence that disclosure is relevant to understanding the combined entity's financial statements.

77 **The acquirer shall disclose information that enables users of its financial statements to evaluate changes in the carrying amount of goodwill during the reporting period.**

78 To meet the objective in paragraph 77, if the total amount of goodwill is significant in relation to the fair value of the acquiree, the acquirer shall disclose the following information for each material business combination that occurs during the reporting period:

(a) the total amount of goodwill and the amount that is expected to be deductible for tax purposes.

(b) *Not used.*

79 The acquirer also shall disclose the information required by paragraph 78:

(a) in aggregate for individually immaterial business combinations that are material collectively.

(b) if a material business combination is completed after the balance sheet date but before the financial statements are authorised for issue unless such disclosure is impracticable. If disclosure of any of the information required by paragraph 78 is impracticable, that fact and the reasons shall be disclosed.

80 The acquirer shall disclose a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period, showing separately:

(a) the gross amount and accumulated impairment losses at the beginning of the reporting period.

(b) additional goodwill recognised during the reporting period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with FRS 105 .

(c) adjustments resulting from the subsequent recognition of deferred tax assets during the reporting period in accordance with paragraph 86.

(d) goodwill included in a disposal group classified as held for sale in accordance with FRS 105 and goodwill derecognised during the reporting period without having previously been included in a disposal group classified as held for sale.

(e) impairment losses recognised during the reporting period in accordance with FRS 36. (FRS 36 requires disclosure of information about the recoverable amount and impairment of goodwill in addition to this requirement.)

(f) net exchange differences arising during the reporting period in accordance with FRS 21 *The Effects of Changes in Foreign Exchange Rates*.

(g) any other changes in the carrying amount during the reporting period.

(h) the gross amount and accumulated impairment losses at the end of the reporting period.

81 If the specific disclosures required by this and other FRSs do not meet the objectives set out in paragraphs 71, 75, or 77, the acquirer shall disclose any additional information necessary to meet those objectives.

EFFECTIVE DATE AND TRANSITION

82 This [draft] FRS shall apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual period beginning on or after 1 January 2007. Earlier application is encouraged. However, this [draft] FRS shall be applied only at the beginning of an annual period that begins on or after this [draft] FRS is issued. If this [draft] FRS is applied before the effective date, that fact shall be disclosed and [draft] FRS 27 (revised 200X) and [draft] FRS 37 (revised 200X) shall be applied at the same time.

83 Except as provided in paragraphs 86 and 87, assets and liabilities that arose from business combinations whose acquisition dates preceded the application of this [draft] FRS shall not be adjusted upon application of this [draft] FRS.

84 Entities that have not applied FRS 36 and FRS 38 shall apply those [draft] FRSs at the same time as they apply this FRS.

85 Entities, such as mutual entities, that have not applied FRS 103 and have had one or more business combinations that were accounted for using the purchase method shall apply the transitional provisions in paragraphs C11 and C12.

Subsequent recognition of acquired deferred tax benefits

86 For the recognition of deferred tax assets acquired in a business combination in which the acquisition date was before this [draft] FRS is applied:

(a) the acquirer shall apply the requirements of paragraph 68 of FRS 12, as amended by paragraph D4 of this [draft] FRS, prospectively. Therefore, an acquirer shall not adjust the accounting for prior business combinations if tax benefits failed to satisfy the criteria for separate recognition as of the acquisition date and are recognised after the acquisition date, unless the rebuttable presumption in paragraph 68 of FRS 12 applies.

(b) the acquirer shall credit tax benefits recognised more than one year after the acquisition date to profit or loss or, if FRS 12 so requires, to equity.

Previously recognised contingent liabilities

87 Any contingent liability recognised relating to a business combination for which the acquisition date was before this [draft] FRS is applied shall be assessed to determine whether it satisfies the definition of a liability (see [draft] FRS 37 (revised 200X)). If not, any recognised amount shall be derecognised with an offsetting adjustment to any goodwill that arose from that business combination. The adjustment to goodwill is limited to the lesser of the carrying amount of goodwill or the amount originally recognised at the acquisition date for the contingent liability. Any remaining recognised amount (that is, any balance in excess of the carrying amount of goodwill that arose in that business combination and any changes in the measurement of the contingent liability after the acquisition date) shall be derecognised as an adjustment to the opening balance of retained earnings.

WITHDRAWAL OF OTHER PRONOUNCEMENTS

88 This [draft] FRS supersedes FRS 103 (as issued in 2004).

Appendix A

Application guidance

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Appendix A

Application guidance

This appendix is an integral part of the [draft] FRS.

INTRODUCTION

A1 This appendix discusses generalised situations and provides examples that incorporate simplified assumptions to illustrate how to apply some of the provisions of this [draft] FRS.

Definition of a business (application of paragraph 3(d))

A2 A *business* is defined as an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing either (a) a return to investors or (b) dividends, lower costs, or other economic benefits directly and proportionately to owners, members, or participants (paragraph 3(d)). A business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business. The three elements of a business are defined as follows:

(a) *Input*: Any economic resource that creates or has the ability to create outputs when one or more processes are applied to it. Examples include long-lived assets (including intangible assets or rights to use long-lived assets), intellectual property, ability to obtain access to necessary materials or rights, and employees.

(b) *Process:* Any system, standard, protocol, convention or rule that when applied to an input, or inputs, creates or has the ability to create outputs. Examples include strategic management processes, operational processes, and resource management processes. These processes typically are documented; however, an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll, and other administrative systems typically are not processes that are used to create outputs.)

(c) *Output:* The result of inputs and processes applied to those inputs that provide or have the ability to provide a return to investors or dividends, lower costs, or other economic benefits directly and proportionately to owners, members or participants.

A3 To be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs, which together are or will be used to create outputs. However, a business need not include all of the inputs or processes that the seller used in operating that business if a willing party is capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with its own inputs and processes. Paragraph E4 of Appendix E states that willing parties are 'presumed to be marketplace participants representing unrelated buyers and sellers that are (a) knowledgeable, having a common level of understanding about factors relevant to the asset or liability and the transaction, and (b) willing and able to transact in the same market(s), having the legal and financial ability to do so.'

A4 The nature of the elements of a business varies by industry and by the structure of an entity's operations (activities), including the entity's stage of development. Established businesses often have many, and different, kinds of inputs, processes, and outputs, whereas new businesses often have few inputs and processes, and sometimes only a single output (product). Nearly all businesses also have liabilities, but a business need not have any liabilities.

A5 An integrated set of activities and assets in the development stage may not have outputs. In that case, other factors should be assessed to determine whether the set is a business. Those factors would include whether the set:

(a) has begun planned principal activities;

(b) has employees, intellectual property, and other inputs and processes that could be applied to those inputs;

(c) is pursuing a plan to produce outputs; or

(d) has the ability to obtain access to customers that will purchase the outputs.

A6 The determination of whether a particular set of assets and activities is a business should be based on whether the integrated set is capable of being conducted and managed as a business by a willing acquirer. Thus, in evaluating whether a particular set is a business, it is not relevant whether a seller operated the set as a business or whether the acquirer intends to operate the set as a business.

A7 If goodwill is present in a particular set of assets and activities then in the absence of evidence to the contrary the set shall be presumed to be a business. However, a business need not have goodwill.

Measuring the fair value of the acquiree (application of paragraphs 19–27)

A8 As noted in paragraph 19, the acquirer is required to measure the fair value of the acquiree, as a whole, as of the acquisition date. The objective of measuring the fair value of the acquiree is to estimate the price at which 100 per cent of the acquiree could be exchanged in a current transaction between knowledgeable, unrelated willing parties when neither party is acting under compulsion.

Measuring the fair value of the acquiree using the consideration transferred

A9 In the absence of evidence to the contrary, the acquisition-date fair value of the consideration transferred is presumed to be the best basis for measuring the fair value of the acquirer's interest in the acquiree on that date.

A10 In a business combination between willing parties in which the acquirer purchases 100 per cent of the equity interests or net assets that constitute a business (an acquiree), the fair value of the consideration transferred usually is more clearly evident and reliably measurable than the fair value of the acquiree in the absence of evidence to the contrary. Therefore, the acquirer usually should use the acquisition-date fair value of the consideration transferred in exchange for the acquiree to measure the fair value of the acquiree on that date.

A11 If the acquirer purchases less than 100 per cent of the equity interests of an acquiree on the acquisition date (either in a single transaction or in multiple transactions), the acquisition-date fair value of the consideration transferred is usually the best basis for measuring the fair value of the acquirer's interest in the acquiree on that date. However, the consideration transferred by itself is most likely not to be representative of the fair value of the acquiree as a whole. The following examples illustrate how the fair value of consideration transferred for less than 100 per cent of the equity interests of an acquiree, together with other available information, might be used to estimate the fair value of the acquiree as a whole.

Example 1
Acquisition of less than 100 per cent of the equity interests of an acquiree

A12 Acquirer Company (AC) offers to purchase all of the 10 million outstanding shares of Target Company (TC) for CU10.00 per share, provided that at least 80 per cent of TC's shares are tendered. Shares of TC are publicly traded and widely dispersed. On the acquisition date, 90 per cent of TC's shares are tendered and acquired by AC for CU90 million. In the week before the announcement of the offer, TC's shares were trading at CU8.85–CU9.15 per share. During the first week after the acquisition date, the remaining 1 million outstanding shares of TC continue to trade with significantly lower volume and greater volatility (at prices ranging from CU8.50 to CU13.00 per share).

A13 In this example, the consideration transferred by AC for 90 per cent of the equity interests of TC is determined to be the best basis for estimating the fair value of TC as CU100 million (10 million shares × CU10.00). First, there is no evidence to suggest that the price of CU10.00 per share exchanged for the 90 per cent interest is not representative of the price that knowledgeable, unrelated willing parties would pay at the acquisition date in exchange for a 100 per cent ownership interest in TC. In fact, AC offered to pay CU10.00 for all of the outstanding shares. Second, because the shares were widely dispersed, there is no evidence that it would be necessary to pay an amount other than CU10.00 per share to obtain 100 per cent of the shares.

Example 2
Acquisition of less than 100 per cent of the equity interests of an acquiree in a business combination achieved in stages

A14 Assume the same facts as in paragraph A12, except that AC owns 100,000 shares (1 per cent) of TC that it originally purchased at CU8.50 per share. The shares are classified as available-for-sale securities and carried at fair value. For the reasons described in paragraph A13, the amount paid (CU10.00 per share) to obtain a 90 per cent interest (an additional 8.9 million shares) continues to be the best basis for measuring the fair value of TC as CU100 million. However, consistently with the provisions of paragraph 56, AC recognises a gain of CU150,000 [(CU10.00–CU8.50) × 100,000 shares] on its original 1 per cent non-controlling equity investment in profit or loss. The carrying amount of CU1 million for that 1 per cent investment, like the CU89 million investment for the 8.9 million shares acquired, is eliminated in consolidation.

Example 3
Acquisition of less than 100 per cent of the equity interests of an acquiree with evidence of a control premium

A15 Assume that a single Founding Shareholder (FS) owns 60 per cent of TC's shares, and the remaining 40 per cent of TC's 10 million shares are widely dispersed and have been publicly trading in the CU9.85–CU10.15 range. Also assume that FS desires to sell its controlling 60 per cent interest in TC, and, on the basis of its knowledge of the industry, FS identifies AC as the highest bidder if FS was interested in making TC available for sale to all potential buyers. Following private negotiations, AC buys all of FS's holdings in TC for CU81 million (CU13.50 per share), a premium of about CU3.50 per share over the market price of the publicly traded non-controlling shares on the acquisition date. During the first week following the acquisition, the non-controlling shares of TC traded in a range of CU8.50–CU13.00. AC willingly paid a premium over the market price of the publicly traded shares on the basis of its assessment that:

(a) TC, as a whole, would be worth between CU110 million and CU130 million to other marketplace participants (based on market comparisons of companies similar to TC and its best estimate as to the likely synergies that those marketplace participants might be able to achieve).

(b) AC can extract synergies similar to those of other marketplace participants, as well as generate additional savings by making proprietary technology available to TC.

A16 At issue is whether the consideration transferred by AC for the less than 100 per cent equity interest, by itself, can be presumed to provide the best basis for measuring the fair value of TC (i.e. the fair value that knowledgeable, unrelated willing parties would exchange for a 100 per cent equity interest in TC).

A17 In this example, AC has information that suggests that CU135 million is not necessarily representative of the amount that other knowledgeable, unrelated willing parties would pay for TC as a whole. Moreover, the market prices for the non-controlling shares at the acquisition date (CU9.85–CU10.15 per share) and during the first week following the acquisition (CU8.50–CU13.00) suggest that CU13.50 per share is not representative of the fair value of TC, as a whole. In this case, the fair value of TC may be estimated on a preliminary basis to be CU121 million based on (a) the CU81 million paid for the controlling 60 per cent interest plus CU40 million for the value of the non-controlling shares (4 million × CU10.00) and (b) the fact that CU121 million falls within the CU110 million–CU130 million range used in AC's preliminary assessments of the value of TC. However, before AC concludes that CU121 million is its best estimate of the fair value of TC, consistently with the objective of measuring the fair value for 100 per cent of the equity interests in the acquiree and with the guidance in Appendix E, AC should refine its initial estimate of fair value using other relevant valuation techniques, as appropriate. Thus, AC might refine its preliminary assessment of the fair value of TC using, for example, the market and income approaches discussed in paragraphs A20–A23.

Measuring the fair value of the acquiree using valuation techniques

A18 In some circumstances, the measurement of the fair value of the acquiree should not be based on the consideration transferred. These circumstances include the following:

(a) The acquirer does not transfer any consideration on the acquisition date (for example, a business combination in which an entity (the acquiree) repurchases its own shares and, as a result, an existing investor (the acquirer) obtains control of that entity).

(b) There is evidence that the transaction is not an exchange of equal values by willing parties (for example, a business combination in which the seller is acting under duress).

(c) The fair value of the total consideration transferred is not more reliably measurable than the fair value of the acquiree (for example, a business combination in which two private business entities or two mutual entities combine through an exchange of equity or member interests and the fair value of the acquiree is more clearly evident and, thus, more reliably measurable than the fair value of the equity or member interests transferred by the acquirer).

A19 When the measurement of the fair value of the acquiree is not based on the consideration transferred, that measurement should be based on observable prices for a business that is similar to the acquiree, if such information is available. Otherwise, fair value should be estimated using multiple techniques that are relevant and for which reliable data are available. The results of the multiple techniques would then be evaluated considering the relevance and reliability of the inputs used to estimate the fair value of the acquiree. The techniques applied and evaluated might be the market approach, the income approach, or several variations of each on the basis of the relevance of the approach and the extent of the available data.

Market approach

A20 In applying the market approach, the basic steps are (a) define and assess the available marketplace data (and adjust, if necessary) to derive one or more valuation ratios and (b) apply the appropriate valuation ratios to the acquiree. As applied to measuring the fair value of a business for the purposes of applying this [draft] FRS, the market approach typically is based on prices of publicly traded equity shares or prices in other business combinations involving comparable businesses for which the terms of the arrangements are disclosed. Identifying comparable businesses requires judgements about the degree to which operational, market, financial and non-financial factors are similar between the acquiree and comparable businesses. Factors to be considered in making this assessment might include products and services (operational factors); markets served, competitors, and position within the industry (market factors); capital structure and historical and forecast financial performance (financial factors); and the depth of management, the expertise of personnel, and the maturity of the business (non-financial factors). Other factors might be considered, depending on the nature of the business being valued.

A21 Ideally, marketplace data are based on other entities within the same industry. In the absence of that information, marketplace data might be based on economically similar businesses. Thus, the degree of comparability between other businesses and the acquiree varies and it may be necessary to adjust the valuation ratios to reflect differences. Such adjustments should be consistent with the objective of measuring fair value.

Income approach

A22 In applying an income approach, the basic steps involve estimating the value of future cash flows or other income-related valuation measures such as residual income profit or loss. Paragraph E6(b) summarises key aspects of the income approach and states:

> The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The estimate of fair value is based on the value indicated by marketplace expectations about those future amounts.

A23 Appendix A of FRS 36 discusses the use of present value techniques to estimate value in use. If an entity estimates fair value using such present value techniques, inputs should be consistent with the objective of measuring fair value rather than value in use.

Special considerations in applying the market and income approaches to mutual entities

A24 When two mutual entities combine, the fair value of the acquiree may be more reliably measurable than the fair value of member interests transferred by the acquirer. In a business combination involving only mutual entities in which the only consideration is an exchange of the acquirer's member interests for the acquiree's member interests, the fair value of the acquiree and the fair value of the member interests exchanged as consideration are presumed to be equal.

A25 Mutual entities, although similar in many ways to other businesses, have distinct characteristics that arise primarily because the members of a mutual entity are both customers and owners. Members of mutual entities generally expect to receive benefits for their membership, often in the form of reduced fees charged for goods and services or patronage dividends. The portion of patronage dividends allocated to each member is often based on the amount of business the member did with the mutual entity during the year.

A26 A fair value measurement of a mutual entity should include the assumptions that marketplace participants would make about future member benefits as well as any other relevant assumptions marketplace participants would make about the mutual entity. For example, in determining the fair value of a mutual entity, an estimated cash flow model may be used. In

that case, the cash flows should be based on the expected cash flows of the mutual entity, which are likely to include adjustments for member benefits, such as the cost of reduced fees charged for goods and services.

INTANGIBLE ASSETS (APPLICATION OF PARAGRAPHS 40 AND 41)

Research and development assets

A27 An acquirer recognises and measures the acquisition-date fair value of all identifiable intangible assets acquired in a business combination that are used in research and development activities. After initial recognition, the provisions of FRS 38 *Intangible Assets* apply.

Recognition of intangible assets separately from goodwill

A28 In accordance with paragraph 40, the acquirer recognises separately from goodwill the acquisition-date fair value of intangible assets acquired in a business combination that meet the definition of an intangible asset in FRS 38, which requires the asset to be identifiable. An intangible asset is identifiable if it arises from contractual or other legal rights (the contractual-legal criterion) or is separable (separability criterion). Intangible assets that meet the contractual-legal criterion are identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations. For example:

(a) An acquiree leases a manufacturing facility under an operating lease that has terms that are favourable relative to market prices. The lease terms explicitly prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favourable relative to market prices is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even though the lease contract cannot be sold or otherwise transferred.

(b) An acquiree owns and operates a nuclear power plant. The licence to operate that power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even if it cannot be sold or transferred apart from the acquired power plant. An acquirer may recognise the fair value of the operating licence and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.

(c) An acquiree owns a technology patent. It has licensed that patent to others for their exclusive use outside the United States in exchange for which the acquired business receives a specified percentage of future non-US revenue. Both the technology patent and the related licence agreement meet the contractual-legal criterion for recognition separately from goodwill even if selling or exchanging the patent and the related licence agreement apart from one another would not be practical.

A29 The separability criterion means that the acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, asset, or liability. Exchange transactions provide evidence that an intangible asset is separable from the acquiree and might provide information that can be used to estimate its fair value. An acquired intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type (even if those exchange transactions are infrequent and regardless of whether the acquirer is involved in them). For example, customer and subscriber lists are frequently licensed and thus meet the separability criterion. Even if an acquiree believes its customer lists have different characteristics from other customer lists, the fact that customer lists are frequently licensed generally means that the acquired customer list meets the separability criterion.

A30 An intangible asset that meets the separability criterion should be recognised separately from goodwill even if the acquirer does not intend to sell, license, or otherwise exchange that asset. The separability criterion is met because the asset is capable of being separated from the acquiree or combined entity and sold, transferred, licensed, rented or otherwise exchanged for something else of value. For example, because an acquired customer list is generally capable of being licensed, it meets the separability criterion regardless of whether the acquirer intends to license it.

A31 An intangible asset that is not separable from the acquiree or combined entity individually meets the separability criterion if it is separable in combination with a related contract, asset or liability. For example:

(a) Deposit liabilities and related depositor relationship intangible assets are exchanged in observable exchange transactions. Therefore, the depositor relationship intangible asset should be recognised separately from goodwill.

(b) An acquiree owns a registered trademark, a related secret formula, and unpatented technical expertise used to manufacture the trademarked product. To transfer ownership of a trademark, the owner is also required to transfer everything else necessary for the new owner to produce a product or service indistinguishable from that produced by the former owner. Because the unpatented technical expertise must be separated from the acquiree or combined entity and sold if the related trademark is sold, it meets the separability criterion.

A32 An acquirer subsumes into goodwill the value of any acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the potential contracts the acquiree is negotiating with prospective new customers at the acquisition date. Because those potential contracts are not identifiable intangible assets at the acquisition date, they are not recognised separately from goodwill. The value of those contracts should not be reclassified from goodwill for events that occur after the acquisition date. However, the acquirer should assess the facts and circumstances surrounding events occurring shortly after the acquisition to determine whether a separately recognisable intangible asset existed at the acquisition date.

A33 After initial recognition, intangible assets acquired in a business combination are accounted for in accordance with the provisions of FRS 38. However, as described in paragraph 3 of FRS 38, the accounting for some acquired intangible assets after initial recognition is prescribed by other FRSs.

A34 The identifiability criterion is used to determine whether an intangible asset should be recognised separately from goodwill. It does not provide guidance for measuring the fair value of an intangible asset. That criterion does not restrict the assumptions used in estimating the fair value of an intangible asset. For example, assumptions that marketplace participants would consider, such as expectations of future contract renewals, are considered in arriving at a fair value measurement even though those renewals do not meet the identifiability criterion.

Examples of intangible assets that are identifiable

A35 The following are examples of identifiable intangible assets acquired in a business combination. Some of the examples may have characteristics of assets other than intangible assets. Accordingly, those assets should be accounted for on the basis of their substance. These examples are not intended to be all-inclusive.

A36 Intangible assets designated with the symbol # are those that arise from contractual or other legal rights. Those designated with the symbol * do not arise from contractual or other legal rights, but are separable. Intangible assets designated with the symbol # might also be separable; however, separability is not a necessary condition for the asset to meet the contractual-legal criterion.

Marketing-related intangible assets

A37 Marketing-related intangible assets are those assets that are primarily used in the marketing or promotion of products or services. Examples of marketing-related intangible assets are:

(a) trademarks, trade names, service marks, collective marks, certification marks #

(b) trade dress (unique colour, shape, or package design) #

(c) newspaper mastheads #

(d) Internet domain names #

(e) non-competition agreements #.

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

A38 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.

A39 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 be recognised separately from goodwill provided the separability criterion is met, which would normally be the case.

A40 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, as a single asset apart from goodwill, a group of complementary intangible assets commonly referred to as a brand if the assets that make up that group have similar useful lives.

Internet domain names #

A41 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 meets the contractual-legal criterion.

Customer-related intangible assets

A42 Examples of customer-related intangible assets are:

(a) customer lists *

(b) order or production backlog #

(c) customer contracts and related customer relationships #

(d) non-contractual customer relationships *.

Customer lists *

A43 A customer list consists of information about customers, such as their names and contact information. A customer list also may be in the form of a database that includes other information about the customers, such as their order histories and demographic information. A customer list does not generally arise from contractual or other legal rights. However, customer lists are frequently leased or exchanged. Therefore, a customer list acquired in a business combination normally meets the separability criterion. However, a customer list acquired in a business combination would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its customers.

Order or production backlog

A44 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, even if the purchase or sales orders are cancellable.

Customer contracts and the related customer relationships

A45 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. This will be the case even if confidentiality or other contractual terms prohibit the sale or transfer of a contract separately from the acquiree.

A46 A customer contract intangible asset and the related customer relationship intangible asset may represent two distinct intangible assets. Both the useful lives and the pattern in which the economic benefits of the two assets are consumed may differ.

A47 A customer relationship exists between an entity and its customer if (a) the entity has information about the customer and has regular contact with the customer and (b) the customer has the ability to make direct contact with the entity. Customer relationships meet the contractual-legal criterion when an entity has a practice of establishing contracts with its customers, regardless of whether a contract exists at the acquisition date. Customer relationships also may arise through means other than contracts, such as through regular contact by sales or service representatives. As noted in paragraph A44, an order or a production backlog arises from contracts such as purchase or sales orders, and therefore is also regarded as 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.

Non-contractual customer relationships *

A48 If a customer relationship acquired in a business combination does not arise from a contract, the relationship may be separable. 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.

Examples illustrating customer contract and customer relationship intangible assets acquired in a business combination

A49 The following examples illustrate the recognition of customer contract and customer relationship intangible assets acquired in a business combination.

(a) AC acquires TC in a business combination on 31 December 20X5. TC has a five-year agreement to supply goods to Customer. Both TC and AC believe that Customer will renew the supply agreement at the end of the current contract. The supply

agreement is not separable. The supply agreement, whether cancellable or not, meets the contractual-legal criterion. Additionally, because TC establishes its relationship with Customer through a contract, the customer relationship with Customer meets the contractual-legal criterion. In determining the fair value of the customer relationship, AC considers assumptions such as the expected renewal of the supply agreement.

(b) AC acquires TC in a business combination on 31 December 20X5. TC manufactures goods in two distinct lines of business: sporting goods and electronics. Customer purchases both sporting goods and electronics from TC. TC 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 TC and AC believe only one overall customer relationship exists between TC and Customer.

The contract to be Customer's exclusive supplier of sporting goods, whether cancellable or not, meets the contractual-legal criterion. Additionally, because TC establishes its relationship with Customer through a contract, the customer relationship with Customer meets the contractual-legal criterion. Because there is only one customer relationship with Customer, the fair value of that relationship incorporates assumptions regarding TC's relationship with Customer related to both sporting goods and electronics. However, if both AC and TC believe 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 AC to determine whether it meets the separability criterion for identification as an intangible asset.

(c) AC acquires TC in a business combination on 31 December 20X5. TC does business with its customers solely through purchase and sales orders. At 31 December 20X5, TC 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 TC's customers also are recurring customers. However, as of 31 December 20X5, TC does not have any open purchase orders or other contracts with those customers.

The purchase orders from 60 per cent of TC's customers, whether cancellable or not, meet the contractual-legal criterion. Additionally, because TC has established its relationship with 60 per cent of its customers through contracts, those customer relationships meet the contractual-legal criterion. Because TC 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, even though TC does not have contracts with those customers at 31 December 20X5.

(d) AC acquires TC, an insurer, in a business combination on 31 December 20X5. TC has a portfolio of one-year motor insurance contracts that are cancellable by policyholders. Annual renewal rates are reasonably predictable. Because TC establishes its relationships with policyholders through insurance contracts, the customer relationship with policyholders meets the contractual-legal criterion. In determining the fair value of the customer relationship intangible asset, AC considers estimates of renewals and cross-selling. FRS 36 *Impairment of Assets* and 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, AC considers estimates of cancellations by policyholders. FRS 104 *Insurance Contracts* permits, but does not require, an expanded presentation that splits the fair value of acquired insurance contracts into two components:

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

(2) 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 FRS 36 and FRS 38. After the business combination, AC is required to measure that intangible asset on a basis consistent with the measurement of the related insurance liability.

Artistic-related intangible assets

A50 Examples of artistic-related intangible assets are:

(a) plays, operas, ballets #

(b) books, magazines, newspapers, other literary works #

(c) musical works such as compositions, song lyrics, advertising jingles #

(d) pictures, photographs #

(e) video and audiovisual material, including motion pictures or films, music videos, television programmes #.

A51 Artistic-related assets acquired in a business combination meet the identifiability criterion 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. In determining the fair value of an intangible asset protected by copyright, an entity considers the existence of any assignments or licences of the acquired copyrights. An acquirer 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.

Contract-based intangible assets

A52 Contract-based intangible assets represent the value of rights that arise from contractual arrangements. Customer contracts are one particular type of contract-based intangible asset. If the terms of a contract give rise to a liability (which might be the case if the terms of an operating lease or customer contract are unfavourable relative to market prices), that liability is recognised as a liability assumed. Examples of contract-based intangible assets are:

(a) licensing, royalty, standstill agreements #

(b) advertising, construction, management, service or supply contracts #

(c) lease agreements (whether the acquiree is the lessee or lessor) #

(d) construction permits #

(e) franchise agreements #

(f) operating and broadcast rights #

(g) servicing contracts such as mortgage servicing contracts #

(h) employment contracts #.

Servicing contracts such as mortgage servicing contracts

A53 Contracts to service financial assets are one type of contract-based intangible asset. Although servicing is inherent in all financial assets, it becomes a distinct asset by one of the following:

(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.

A54 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.

Employment contracts

A55 Employment contracts that are beneficial contracts from the perspective of the employer are one type of contract-based intangible asset because the pricing of those contracts is favourable relative to market prices.

Technology-based intangible assets

A56 Examples of technology-based intangible assets are:

(a) patented technology #

(b) computer software and mask works #

(c) unpatented technology *

(d) databases, including title plants *

(e) trade secrets, such as secret formulas, processes, recipes #.

Computer software and mask works

A57 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.

A58 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 meet the contractual-legal criterion for identification as intangible assets.

Databases, including title plants *

A59 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. 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.

A60 Title plants constitute a historical record of all matters affecting title to parcels of land in a particular geographical area. Title plant assets are bought and sold in exchange transactions (either in whole or in part) or are licensed. Therefore, title plant assets acquired in a business combination meet the separability criterion.

Trade secrets such as secret formulas, processes, recipes

A61 A trade secret is 'information, including a formula, pattern, recipe, compilation, program, device, method, technique, or process that (1) derives independent economic value, actual or potential, from not being generally known and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.[*] If the future economic benefits from a trade secret acquired in a business combination are legally protected, that asset meets the contractual-legal criterion. Otherwise, trade secrets acquired in a business combination are identifiable only if the separability criterion is met, which is likely to be the case.

INITIAL CALCULATION AND ALLOCATION OF GOODWILL IN A BUSINESS COMBINATION IN WHICH THE ACQUIRER HOLDS LESS THAN 100 PER CENT OF THE EQUITY INTERESTS IN AN ACQUIREE AT THE ACQUISITION DATE (APPLICATION OF PARAGRAPH 58)

A62 In accordance with paragraph 58, in a business combination in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date, the acquirer allocates the amount of goodwill determined in accordance with paragraph 49 to the acquirer and the non-controlling interests. The amount of goodwill allocated to the acquirer shall be measured as the difference between the acquisition-date fair value of the acquirer's equity interest in the acquiree and the acquirer's share in the acquisition-date fair value of the separately recognised assets acquired and liabilities assumed. The remainder of the goodwill shall be allocated to the non-controlling interests. The goodwill allocated to the acquirer shall not exceed the total goodwill calculated in accordance with paragraph 49. The acquisition-date fair value of the acquirer's equity interest in the acquiree includes the fair value of any equity interests the acquirer owned immediately before the acquisition date. The following example illustrates those requirements.

Example 4
Initial calculation and allocation of goodwill to the acquirer and non-controlling interests in the acquiree

A63 On 1 January 20X5, AC acquires 80 per cent of the equity interests in TC for CU160. There is no evidence to suggest that this transaction is not an exchange of equal values. Therefore, the consideration transferred of CU160 is presumed to be the fair value of the 80 per cent interest acquired by AC. Through valuation techniques, the fair value of TC as a whole is determined to be CU195. As of the acquisition date, the fair value of the separately recognisable identifiable assets acquired is CU210 and the fair value of the liabilities assumed is CU60. On the basis of those facts, the amount of goodwill is measured as follows:

	CU
Fair value of TC	195
Less: net amount of the fair values of the separately recognised identifiable assets acquired and liabilities assumed [CU210 – CU60]	(150)
Goodwill	45

As described in paragraph A62, the amount of goodwill allocated to AC and to the non-controlling interests of TC is calculated as follows:

Continued…

[*] Melvin, Simensky, and Lanning Bryer, *The New Role of Intellectual Property in Commercial Transactions* (New York: John Wiley & Sons, 1998), page 293.

	CU
Fair value of AC's 80 per cent interest in TC	160
Less: AC's share of the fair value of the identifiable net assets acquired (80 per cent x [CU210 – CU60])	(120)
Goodwill allocated to AC	40
Goodwill allocated to the non-controlling interests in TC [CU45 – CU40]	5

BUSINESS COMBINATIONS IN WHICH THE CONSIDERATION TRANSFERRED FOR THE ACQUIRER'S INTEREST IN THE ACQUIREE IS LESS THAN THE FAIR VALUE OF THAT INTEREST (APPLICATION OF PARAGRAPHS 59–61)

Example 5
Business combinations in which the consideration transferred for 100 per cent of the equity interests in the acquiree is less than the fair value

A64 On 1 January 20X5, AC acquires 100 per cent of the equity interests of TC in exchange for AC's shares with a value of CU190. Because of a regulatory requirement, the former owner of TC did not have sufficient time to market TC to multiple potential buyers. The management of AC initially measures the acquisition-date fair value of the separately recognisable identifiable assets acquired at CU250 and the fair value of the liabilities assumed at CU50. Management of AC estimates the fair value of TC as between CU215 and CU230. Because the fair value of TC exceeds the fair value of the consideration transferred, AC reviews the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair values of both the consideration transferred and TC on the acquisition date and decides that they were appropriate. Nonetheless, management of AC also engages an independent valuation firm to review its estimates. That firm, using multiple valuation techniques, determines that the fair value of TC as a whole is CU225 because of economies of scale that any likely acquirer could achieve in TC's operations. On the basis of those facts, the amount of goodwill and the gain on the bargain purchase are measured as follows:

	CU
Fair value of TC	225
Less: net amount of the fair values of the separately recognised identifiable assets acquired and liabilities assumed [CU250 – CU50]	(200)
Goodwill that tentatively would be recognised under paragraph 49	25
Fair value of TC	225
Less: fair value of the consideration transferred for TC	(190)
Excess of the fair value of TC over the fair value of the consideration transferred for TC	35
Less: reduction of tentative goodwill (to zero)	(25)
Adjusted 'gain' on bargain purchase for any excess remaining after reducing goodwill to zero	10

A65 Alternatively, because the fair value of the consideration transferred for TC of CU190 is less than the fair value of the separately recognised identifiable assets acquired and liabilities assumed of CU200 [CU250 – CU50], the amount of the gain may be calculated as follows:

	CU
Fair value of the consideration transferred for TC	190
Less: net amount of the fair values of the separately recognised identifiable assets acquired and liabilities assumed [CU250 – CU50]	(200)
Gain on bargain purchase	10

A66 AC would record its acquisition of TC in its consolidated financial statements as follows:

Identifiable assets acquired (at fair value)	CU250	
Goodwill	0	
Liabilities assumed (at fair value)		CU50
Equity (for issue of shares of AC)		190
Gain on the bargain purchase		10

Example 6
Business combinations in which the consideration transferred for less than 100 per cent of the equity interests in the acquiree is less than the fair value

A67 Consider the same facts as in the previous example, except that AC acquires 80 per cent of the equity interests in TC for CU152 in AC's shares. If the goodwill measured in accordance with paragraph 49 is reduced to zero, any remaining excess is recognised as a gain attributable to the acquirer on the acquisition date. No gain is attributable to the non-controlling interest. On the basis of those facts, the amount of goodwill and the gain on bargain purchase are measured as follows:

	TC, as a whole CU	AC's interest CU	Non-controlling interest CU
Fair value of TC (and related 80 per cent controlling and 20 per cent non-controlling interests)	225	180	45
Less: net amount of the fair values of the separately recognised identifiable assets acquired and liabilities assumed [CU250 – CU50]	(200)	(160)	(40)
Goodwill that tentatively would be recognised under paragraph 49 (and tentative allocations)*	25	20	5
Fair value of AC's 80 per cent interest in TC [CU225 × 0.80]		180	
Less: fair value of the consideration transferred for AC's interest		(152)	
Excess of the fair value of AC's interest in TC over the consideration exchanged for that interest		28	
Less: Adjustment to reduce goodwill that tentatively would have been recognised under paragraph 49 [CU25 × 0.80]		(20)	

* In a business combination in which the consideration transferred for a less than 100 per cent equity interest in the acquiree is less than the fair value of that interest, goodwill measured in accordance with paragraph 49 is allocable to the acquirer and non-controlling interests based on their relative equity interests since presumably the acquirer did not pay a control premium to obtain its interest.

Adjusted 'gain' for the 80 per cent interest acquired in a bargain purchase after reducing goodwill to zero	8

A68 In this case, goodwill of CU25 that otherwise would be attributable to AC and the non-controlling interest is reduced to zero.

A69 Alternatively, because the fair value of the consideration transferred for AC's 80 per cent interest in TC of CU152 is less than the fair value of AC's 80 per cent interest in the separately recognised identifiable assets acquired and liabilities assumed of CU160 [(CU250 – CU50) × 0.80], the amount of the gain on AC's purchase of the 80 per cent interest may be calculated as follows:

	CU
Fair value of the consideration transferred for AC's 80 per cent interest in TC	152
Less: net amount of the fair values of the separately recognised identifiable assets acquired and liabilities assumed [(CU250 – CU50) × 0.8]	(160)
Gain on bargain purchase of 80 per cent interest	8

A70 AC would record its acquisition of TC in its consolidated financial statements as follows:

Identifiable assets acquired (at fair value)	CU250	
Goodwill	0	
Liabilities assumed (at fair value)		CU50
Equity (for issue of shares of AC)		152
Gain on the bargain purchase		8
Equity-non-controlling interest [(CU250 – CU50) x 0.20]		40

MEASUREMENT PERIOD (APPLICATION OF PARAGRAPHS 62–68 AND 76(a))

A71 During the measurement period, the acquirer adjusts the provisional amounts recognised at the acquisition date or recognises additional assets or liabilities to reflect any new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement or recognition of the amounts as of that date. Some factors to consider in determining whether new information should result in a measurement period adjustment to the provisional amounts recognised are:

(a) *The timing of the receipt of subsequent information.* Generally, new information that is obtained shortly after the acquisition date is more likely to reflect circumstances that existed at the acquisition date.

(b) *The type of subsequent information*. An actual exchange with a third party generally provides the best evidence of fair value.

(c) *The size of the adjustment and the ability to identify the reason for the adjustment*. Significant gains and losses that do not have identifiable causes and that are recognised shortly after the acquisition date may be an indication of circumstances that existed at the acquisition date.

Example 7 Lawsuit

A72 AC acquires TC on 31 December 20X5. One of the liabilities assumed in the business combination is a liability for a lawsuit against TC. At the acquisition date, AC initially

measures the fair value of the liability on the basis of the information obtained during the due diligence procedures and recognises a provisional fair value for the liability of CU95,000. Within the measurement period, AC discovers information about the lawsuit against TC. AC determines that the information relates to facts that existed as of the acquisition date, and AC revises its fair value measure of the liability as of the acquisition date to CU80,000.

A73 In this example, the adjustment to the fair value of the liability (CU15,000 reduction) would be accounted for as part of completing the initial accounting in the business combination because the new information (a) is obtained within the measurement period and (b) relates to facts and circumstances that existed as of the acquisition date. The adjustment would result in an offsetting adjustment to goodwill.

A74 In contrast, instead assume that a lawsuit is settled late in the measurement period for an amount that is different from the initial estimate. After assessing all of the facts and circumstances causing the difference, AC determines there is no new information about facts that existed at the acquisition date. In that case, the difference would not be an adjustment to the initial accounting for the business combination, but instead would be recognised as an adjustment to profit or loss of the post-combination period.

Example 8
Disposal of an asset during the measurement period

A75 AC acquires TC on 15 September 20X5. AC measures and recognises a provisional fair value of CU1,000 for TC's specialised (non-wasting) Asset A. AC also seeks an independent appraisal of the fair value of Asset A. On 15 December 20X5 AC sells Asset A to Third Party Co. for CU1,750. The sale provides information about the fair value of Asset A. Depending on the circumstances, the adjustment or adjustments to the provisional fair value of Asset A (CU750 increase) would be accounted for as part of completing the initial accounting for the business combination, as current-period income or, perhaps, partly as each. That determination would depend on whether the sale at CU1,750 is indicative of the fair value that existed at the acquisition date or indicative of an increase in value that resulted from events and circumstances that occurred after the acquisition date.

A76 In this example, also assume that before agreeing to sell Asset A to Third Party Co., AC receives the independent appraisal indicating a fair value of Asset A of CU1,500 as of the acquisition date. In these circumstances, AC would adjust the fair value of Asset A to the appraised value of CU1,500 as of the acquisition date. The CU500 adjustment to Asset A would result in an offsetting adjustment to goodwill. The incremental CU250 would be recognised as a gain on the sale of Asset A.

Consideration transferred and contingent consideration

A77 The measurement period guidance also applies to the consideration transferred, including contingent consideration. The objective of the measurement period in relation to the consideration transferred is the same, i.e. allow the acquirer a reasonable time to obtain the information necessary to measure the items of consideration transferred on the basis of facts and circumstances that existed at the acquisition date. Subsequent changes in the fair value of consideration transferred, especially contingent consideration, usually result from events and changes in circumstances that occur after the acquisition date and, therefore, should not be recognised as measurement period adjustments.

Example 9
Contingent payout based on future earnings

A78 AC acquires TC on 31 December 20X5 for cash and contingent consideration. The contingent consideration arrangement provides that if TC's 20X6 earnings exceed CU100,000, TC's former owners will receive CU10,000 on 31 March 20X7.

A79 At the acquisition date, AC had obtained information about the historical profitability of TC and projected its future cash flows and profitability on the basis of AC's assessment of economic conditions, TC's prospects, and its plans for TC. On the basis of that information, AC recognises a provisional fair value of its liability for the contingent consideration of CU3,700. Three months after the acquisition, TC unexpectedly obtains a profitable contract from a new customer, and first quarter 20X6 earnings are substantially greater than AC's projections for TC as of the acquisition date. AC determines that the fair value of its liability is now CU7,000.

A80 In this example, the increase in the liability for the contingent consideration should be recognised in profit or loss in the first quarter 20X6. AC had the information necessary to measure the liability as of the acquisition date on the basis of the circumstances that existed at that time. In this case, the change in projections (and the increased likelihood of the contingent consideration payment) is identifiable with an event that occurred after the acquisition date.

Example 10
Contingent payout based on the outcome of a lawsuit

A81 AC acquires TC on 31 December 20X5 for cash and contingent consideration. The fair value of the contingent consideration liability depends on assessments about the outcome of a lawsuit against TC that AC assumes in the combination. The values of the liabilities for the lawsuit and for the contingent consideration are directly related. A decrease in the fair value of the liability for the lawsuit leads to an equal increase in the fair value of the liability for the contingent consideration. However, if the lawsuit results in a judgement or settlement of CU200,000 or more, TC's former owners will receive no additional consideration.

A82 At the acquisition date, AC measures and recognises a provisional fair value of the liability for the lawsuit at CU95,000 and a provisional fair value of the liability for the contingent consideration at CU3,000 on the basis of the information obtained during the due diligence procedures. After the acquisition date and during the measurement period, AC discovers information in the records about the lawsuit that relates to facts that existed as of the acquisition date. On the basis of that information, AC revises its estimates of the fair value of the liability for the lawsuit to CU93,000 and the fair value of the liability for the contingent consideration to CU5,000.

A83 In this example, the adjustments to the liabilities should be accounted for as part of completing the initial accounting for the business combination because the new information was (a) obtained during the measurement period and (b) related to facts and circumstances that existed as of the acquisition date. The adjustments equally affect the fair values of the contingent consideration and the liability for the lawsuit. Therefore, in this example the offsetting adjustments result in no change to the amount recognised for goodwill.

Example 11
Illustration of paragraphs 64 and 76(a)—incomplete appraisal

A84 AC acquires TC on 30 September 20X5. AC seeks an independent appraisal for an item of property, plant and equipment acquired in the combination. However, the appraisal was not completed by the time AC completed its 20X5 annual financial statements. AC recognised in its 20X5 annual financial statements a provisional fair value for the asset of CU30,000. 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, AC received the independent appraisal, which estimated the asset's fair value at the acquisition date at CU40,000.

A85 As described in paragraph 64, AC is required to recognise any adjustments to provisional values as a result of completing the initial accounting for the business combination as if the initial accounting for the business combination had been completed at the acquisition date. In its 20X6 financial statements, AC presents a current period balance sheet and a two-year comparative income statement. Therefore, in the 20X6 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). The carrying amount of goodwill also is adjusted for the reduction in value at the acquisition date of CU10,000, and the 20X5 comparative information is adjusted to include additional depreciation of CU500.

A86 In accordance with paragraph 76(a), AC discloses:

(a) in its 20X5 financial statements, that the initial accounting for the business combination has not been completed, and explains why this is the case.

(b) in its 20X6 financial statements, the amounts and explanations of the adjustments to the provisional values recognised during the current reporting period. Therefore, AC 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. The 20X5 comparative information is adjusted to include additional depreciation of CU500.

ASSESSING WHAT IS PART OF THE EXCHANGE FOR THE ACQUIREE (APPLICATION OF PARAGRAPHS 69 AND 70)

A87 In accordance with paragraph 69, the acquirer assesses whether any portion of the transaction price and any assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree. Because only the consideration transferred and the assets acquired or liabilities assumed or incurred that are part of the exchange for the acquiree are included in the business combination accounting any portion that is not part of the exchange for the acquiree is accounted for separately from the business combination.

A88 Judgement is required to determine whether a portion of the transaction price paid, or the assets acquired and liabilities assumed or incurred, are part of the exchange for the acquiree. A transaction or event arranged primarily for the economic benefit of the acquirer or the combined entity is not part of the exchange for the acquiree and is accounted for separately from the business combination. One arranged primarily for the benefit of the acquiree or its former owners generally is part of the exchange and is included in the business combination accounting. The acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, to determine whether a transaction or event is arranged primarily for the economic benefit of the acquirer or combined entity, rather than for the acquiree or its former owners.

(a) *The reasons for the transaction or event*—Understanding the reasons why the parties to the combination (the acquirer, the acquiree, and their owners, directors, managers, and their agents) entered into a particular transaction or arrangement may provide insight into whether it should be accounted for as part of the exchange for the acquiree. For example, if a transaction is arranged primarily for the economic benefit of the acquirer or combined entity with little or no benefit received by the acquiree or its former owners, that portion of the transaction price paid (and any related assets or liabilities) is unlikely to be part of the exchange for the acquiree and would be accounted for separately from the business combination.

(b) *Who initiated the transaction or event*—Understanding who initiated the transaction or event may also provide insight into whether it should be accounted for as part of the exchange for the acquiree. For example, a transaction or other event that is initiated by the acquirer may be entered into for the purpose of providing future economic benefits to the acquirer or combined entity with little or no benefit received by the acquiree or its former owners. On the other hand, a transaction or arrangement initiated by the owners of the acquiree is unlikely to be for the benefit of the acquirer or combined entity.

(c) *The timing of the transaction or event*—The timing of the transaction or event may also provide insight into whether it should be accounted for as part of the exchange for the acquiree. For example, a transaction between the acquirer and the acquiree that takes place during the negotiations of the terms of a business combination may be entered into in contemplation of the business combination for the purpose of providing future economic benefits to the acquirer or combined entity with little or no benefit received by the acquiree or its former owners.

Example 12
Regulatory asset acquired that is included in the business combination accounting

A89 To induce the acquisition of WB (Weak Bank) by SB (Strong Bank), as a condition of the combination between WB and SB, a regulatory authority agrees to provide financial assistance in the form of cash, a receivable, or guarantees. That assistance is transferred to SB (the combined entity) upon the closing of the combination agreement. The regulatory authority, as part of its mission and public purpose, has an interest in supporting the soundness of financial institutions, which includes protecting the interests of the depositors of WB. From the perspective of the regulatory body, the assistance provided to induce WB and SB to combine is in the furtherance of its mission.

A90 In this case, the transaction was not arranged primarily to achieve economic benefits favourable to the acquirer or combined entity. If SB did not receive the financial assistance, it might not have acquired WB or would have paid less to acquire WB (presumably by an amount equal to the financial assistance). Thus, SB is indifferent whether it pays less to acquire WB or if it pays more to acquire WB and also receives the financial assistance. Thus, that assistance would be an asset acquired at the acquisition date that is recognised as part of accounting for the business combination. The portion of the consideration transferred for the financial assistance is also accounted for as part of the business combination accounting even though it is transferred to the former owners of WB not to the regulator that provided it.

Effective settlement of pre-existing relationships between the acquirer and acquiree in a business combination

A91 The acquirer and acquiree may have a relationship that existed before the business combination was contemplated. For the purposes of this [draft] FRS, those relationships are called *pre-existing relationships*. A pre-existing relationship between the acquirer and acquiree may be contractual (for example, vendor and customer or licensor and licensee), or non-contractual (for example, plaintiff and defendant).

A92 In general, the effective settlement of a pre-existing relationship between the acquirer and acquiree should be accounted for in the same way whether it is settled as part of a business combination or separately from a business combination. Therefore, if the business combination results in the effective settlement of a pre-existing relationship, the acquirer recognises a gain or loss and measures it as follows:

(a) a non-contractual pre-existing relationship (such as a lawsuit) should be measured at fair value.

(b) A contractual pre-existing relationship should be measured as the lesser of the following:

(1) the amount by which the contract is favourable or unfavourable from the perspective of the acquirer when compared with pricing for current market transactions for the same or similar items.

(2) any stated settlement provisions in the contract available to the counterparty to whom the contract is unfavourable.

To the extent that (2) is less than (1), the difference should be included as part of the business combination accounting. Also, an unfavourable contract is not necessarily a loss contract for the acquirer.

A93 A pre-existing relationship may be a contract between the acquirer and the acquiree in which the acquirer had previously granted to the acquiree the right to use the acquirer's recognised or unrecognised intangible assets (for example, a right to use the acquirer's trade name under a franchise agreement). In that case, paragraph 41 requires the acquirer to recognise an intangible asset for that right separately from goodwill as part of the business combination accounting. However, if the contract includes terms that are favourable or unfavourable when compared with pricing for current market transactions for the same or similar items, the acquirer should recognise a gain or loss separately from the business combination for the effective settlement of the contract. The gain or loss is measured in accordance with paragraph A92.

Example 13
Effective settlement of a supply contract as a result of a business combination

A94 AC purchases electronic components from TC under a five-year supply contract at fixed rates. Currently, the fixed rates are higher than rates at which AC could purchase similar electronic components from another supplier. The supply contract includes provisions that AC can terminate the contract before the end of the initial five-year term only by paying a CU6 million penalty. With three years remaining under the supply contract, AC pays CU50 million to acquire TC, which is the fair value of TC based on what other marketplace participants would be willing to pay.

A95 Included in the total fair value of TC is CU8 million related to the fair value of the supply contract with AC. The CU8 million represents a CU3 million component that is 'at-market' because the pricing is comparable to pricing for current market transactions for the same or similar items (selling effort, customer relationships, and so forth) and a CU5 million component for pricing that is unfavourable to AC. TC has no other identifiable assets or liabilities related to the supply contract, and AC has not recognised any assets or liabilities related to the supply contract before the business combination.

A96 In this example, AC recognises separately from the business combination a settlement loss of CU5 million (the lesser of the stated settlement amount and the amount by which the contract is unfavourable to the acquirer).

Example 14
Effective settlement of a contract between the acquirer and acquiree in which the acquirer had recognised a liability before the business combination

A97 The amount recognised by AC as a gain or loss for the effective settlement of the pre-existing relationship will be affected if AC had previously recognised an amount in its financial statements related to that pre-existing relationship. Assume the same facts as in Example 13 except that before the business combination AC had recognised a CU6 million liability on the supply contract. AC recognises a CU1 million settlement gain on that contract at the acquisition date (the CU5 million measured loss on the contract less the CU6 million loss previously recognised) in profit or loss.

Arrangements to pay for employee services

A98 Judgement is often required to determine whether arrangements to pay for employee services (compensation arrangements) should be accounted for as part of the exchange for the acquiree or separately from the business combination. To assist in that determination, it is

important to understand whether the transaction includes payments or other arrangements for the economic benefit of the acquirer or combined entity with little or no benefit received by the acquiree or its former owners. To the extent that it is, that portion of the transaction price (and any related liabilities) should be accounted for separately from the business combination. As described in paragraph A88, understanding the reasons for the arrangement, who initiated the arrangement, and when the arrangement was entered into may also assist in determining whether the arrangement should be accounted for as part of the business combination accounting or separately.

A99 If it is not clear whether an arrangement to pay for employee services should be accounted for as part of the exchange for the acquiree or separately from the business combination, the following indicators also should be considered:

(a) *Continuing employment*—If future payments are automatically forfeited if employment ends, the arrangement may be compensation for post-combination services that will benefit the combined entity and should be accounted for separately from the business combination. In contrast, if future payments are not affected by employment termination, the arrangement may be part of the consideration transferred for the acquiree.

(b) *Duration of continuing employment*—An employment agreement with an employment period coinciding with or longer than the future payment period may indicate that the arrangement is compensation for post-combination services that will benefit the combined entity and should be accounted for separately from the business combination accounting.

(c) *Level of payment*—Reduced payments to owners who do not become employees may indicate that the incremental payments to selling owners who become employees are payments for post-combination services that will benefit the combined entity and should be accounted for separately from the business combination accounting. In contrast, payments in excess of reasonable levels paid to employees with similar responsibilities may indicate that the payment is part of the consideration transferred for the acquiree.

(d) *Formula for determining consideration*—Contingent payments that are based on multiples of future earnings, future cash flows, or other similar performance measures may indicate that the formula is intended to verify the fair value of the acquiree and, therefore, should be accounted for as part of the business combination. In contrast, contingent payments based on percentages of earnings may indicate a profit-sharing arrangement that should be accounted for separately from the business combination.

Example 15
Arrangement that is part of the exchange for the acquiree

A100 TC appointed a candidate as its new CEO under a ten-year contract. The contract required TC to pay the candidate CU5 million if TC is acquired before (a) the contract expires or (b) the termination of CEO's employment for specified causes within the control of TC. AC acquires TC eight years later. CEO remained an employee of TC through the acquisition date and, thus, will receive the additional payment under the existing contract.

A101 AC is required to assess whether a portion of the consideration transferred and the related liability incurred—required payment of CU5 million—is part of the exchange for the acquiree that should be included in the business combination accounting. The employment agreement was entered into by TC to secure the employment of CEO and by CEO to secure payment and security. The employment agreement was also entered into before the negotiations of the combination began. Thus, there is no reason to believe that the agreement was arranged primarily to achieve economic benefits for AC. Therefore, the consideration transferred and the related liability for the payment to CEO should be regarded as part of the exchange for the acquiree and included in the business combination accounting.

Acquirer share-based payment awards exchanged for awards held by the employees of the acquiree

A102 In a business combination, an acquirer may exchange its share-based payment awards (replacement awards) for awards held by employees of the acquiree. If the acquirer is obligated to replace the acquiree's awards, all or a portion of the acquirer's replacement awards shall be included in the measurement of the consideration transferred by the acquirer in the business combination, as explained in the following paragraph.

A103 For the purpose of determining the portion of a replacement award that is part of the consideration exchanged for the acquiree, the share-based payment awards made by the acquirer and acquiree shall be measured using the fair value-based measurement method of FRS 102 *Share-based Payment*. The portion of the replacement award that is part of the consideration transferred in exchange for the acquiree shall be determined as follows:

(a) On the acquisition date, the acquirer recognises an expense in post-combination profit or loss for any excess of (1) the fair value-based measure of the acquirer's replacement award over (2) the fair value-based measure of the replaced acquiree awards.

(b) The remaining fair value-based measure of the acquirer's replacement award is the amount that remains after deducting the excess, if any, recognised in post-combination profit or loss under (a). Of this amount, the portion attributable to past services is regarded as part of the consideration transferred in exchange for the acquiree. The portion, if any, attributable to future services is not part of the consideration transferred and is an expense to be recognised in post-combination profit or loss. The guidance in (c) and (d) shall be followed to determine the portion of the remaining fair value-based measure of the replacement award attributable to past and future services. Depending on the circumstances, the acquirer recognises the replacement award as a liability or an equity instrument, as required in accordance with FRS 102.

(c) Of the remaining fair value-based measure of the replacement award, the portion attributable to past services is equal to the remaining fair value-based measure of the replacement award (or settlement) multiplied by the ratio of the portion of the vesting period completed to the total vesting period. (The amount, if any, to be recognised in post-combination profit or loss is the remaining fair value-based measure of the replacement award (or settlement) multiplied by the ratio of the future vesting period to the total vesting period.)

(d) The vesting period is the period during which all the specified vesting conditions are to be satisfied. Vesting conditions are defined in FRS 102.

A104 The following examples illustrate the application of these provisions in circumstances in which AC makes replacement awards of CU100 (fair value-based measure) at the acquisition date for TC awards of CU100 (fair value-based measure) at the acquisition date. Because the fair value-based measure of replacement awards equals the fair value-based measure of the replaced awards, there is no excess value recognised as acquisition date expense in accordance with paragraph A103(a). Therefore, in accordance with paragraph A103(b), the remaining fair value-based measure of the replacement awards is (CU100).

Example 16

Acquirer replacement awards, for which no services are required after the acquisition date, are exchanged for awards of the acquiree, for which the required services were rendered before the acquisition date

A105 AC exchanges replacement awards for which no services are required after the acquisition of TC for share-based payment awards of TC, for which the required services were rendered before the business combination. When originally granted, the share-based payment awards of TC had a vesting period of four years. The required services were rendered before the business combination. Because no future service is required for AC's replacement award, the AC replacement award represents part of the consideration transferred by AC in the business combination. Thus, 100 per cent of the award is regarded as equity interest in the acquiree, and the CU100 replacement award is included as part of the consideration transferred by AC.

Example 17
Acquirer replacement awards, for which services are required after the acquisition date, are exchanged for awards of the acquiree, for which the required services were rendered before the acquisition date

A106 AC exchanges replacement awards that require three years of future service for share-based payment awards of TC, for which the vesting period was completed before the business combination. When originally granted, the share-based payment awards of TC had a vesting period of four years. Because the original vesting period was completed, the TC awards represent an equity interest. However, because the replacement awards require three years of future services, a portion of the replacement award is to be recognised in post-combination profit or loss in accordance with paragraph A103(b). In this case, the total vesting period is seven years—the vesting period of the original award and the vesting period of the replacement award. The portion attributable to past services is equal to the remaining fair value-based measure of the replacement award (CU100) multiplied by the ratio of the past vesting period (four years) to the total vesting period (seven years). Thus, CU57 would be attributable to the past services and CU43 to the future services.

Example 18
Acquirer replacement awards, for which services are required after the acquisition date, are exchanged for awards of the acquiree, for which the vesting period was not completed before the acquisition date

A107 AC exchanges replacement awards that require one year of future service for share-based payment awards of TC, for which the vesting period was not completed before the business combination. When originally granted, the awards of TC had a vesting period of four years. As of the acquisition date the TC employees had rendered a total of two years' service; thus, two years of service after the acquisition date would be required. Because all required service has not been rendered, the TC awards represent an equity interest in part (50 per cent, two of the required four years of service rendered as of the acquisition date).

A108 The replacement awards require only one year of future service. Thus, because two years of service have been rendered, the total vesting period is three years. Normally, the portion attributable to past services would be equal to the remaining fair value of the replacement award (CU100) multiplied by the ratio of the past vesting period (two years) to the total vesting period (three years). Thus, CU67 would be attributable to the past services (and therefore would be part of the consideration transferred for the acquiree) and CU33 to the future services. However, in accordance with paragraph A103(b), because the amount of the acquirer's replacement award attributable to past services (CU67) exceeds the amount of the replaced acquirer's awards attributable to those services (CU50, or CU100 × 2/4 years), the excess (CU17) is not part of the consideration transferred. Rather, that excess is an expense to be recognised in post-combination financial statements. Thus, CU50 would be attributable to past services (and included as part of the consideration transferred for the acquiree) and CU50 to future services.

Example 19
Acquirer replacement awards, for which no services are required after the acquisition date, are exchanged for awards of the acquiree, for which the vesting period was not completed before the acquisition date

A109 Assume the same facts as in the previous example except that AC exchanges replacement awards that require no service after the business combination. Like the previous example, the portion that could be attributable to past services cannot exceed the amount of the replaced TC awards attributable to those services. Thus, CU50 (which is calculated as CU100 × 2/4 years) is attributable to the past services and is part of the consideration transferred for the acquiree, and CU50 is an expense to be recognised in post-combination financial statements. Because this replacement award has no vesting period associated with it, the entire CU50 would be recognised as an expense immediately.

ILLUSTRATION OF DISCLOSURE REQUIREMENTS (APPLICATION OF PARAGRAPHS 71 AND 72)

A110 The following example of some of the disclosure requirements of this [draft] FRS is presented for illustrative purposes only and, therefore, may not be representative of actual transactions.

Footnote X: acquisitions

On 30 June 20X2 Alpha acquired 100 per cent of the outstanding common shares of Beta. Beta is a provider of data networking products and services in Canada and Mexico. As a result of the acquisition, Alpha is expected to be the leading provider of data networking products and services in those markets. It also expects to reduce costs through economies of scale.

The fair value of Beta on 30 June 20X2 was CU9,400, determined on the basis of the consideration paid. Alpha's consideration included CU6,000 of cash, 100,000 ordinary shares valued at CU2,400, and a contingent future payment arrangement with a fair value of CU1,000 at the acquisition date. The fair value of the 100,000 ordinary shares issued was determined on the basis of the closing market price of Alpha's ordinary shares at the acquisition date. The future payment arrangement is contingent on the levels of revenue that Omega, an unconsolidated equity investment owned by Beta, achieves over the 12-month period following the acquisition. The maximum potential undiscounted amount of all future payments that Alpha could be required to make under the future payment arrangement is CU2,000.

Alpha incurred CU500 of third-party expenses related to the acquisition of Beta. Those expenses are included in the selling, general, and administrative expenses in Alpha's consolidated statement of income.

The following table summarises the estimated fair values of the assets acquired and liabilities assumed at the acquisition date.

At 30 June 20X2	CU
Current assets	2,400
Property, plant and equipment	1,500
Intangible assets subject to amortisation	2,500
Intangible assets not subject to amortisation	2,400
Goodwill	2,200
Total assets acquired	11,000
Current liabilities	(1,100)
Non-current debt	(500)
Total liabilities assumed	(1,600)
Net assets acquired	9,400

REVERSE ACQUISITIONS (APPLICATION OF PARAGRAPH 12(c))

A112 In some business combinations, commonly called *reverse acquisitions*, the acquirer is the entity whose equity interests have been acquired and the issuing entity is the acquiree. For example, a private entity might initiate a combination and arrange to have itself 'acquired' by a smaller public entity as a means of obtaining a stock exchange listing. Although the public entity that issues equity interests is regarded as the legal parent and the private entity is regarded as the legal subsidiary, the private entity that initiated and arranged the combination is the acquirer if it is determined to have obtained control of the public entity in accordance with the requirements of paragraphs 11–16. Therefore, for financial reporting purposes in a reverse acquisition, the legal parent is the acquiree and the legal subsidiary is the acquirer.

A112 The requirement in this [draft] FRS for an acquirer to measure and recognise the fair value of the acquiree and the values of the assets acquired and liabilities assumed on the acquisition date applies to reverse acquisition accounting. In a reverse acquisition, the legal subsidiary is the acquirer that measures and recognises the legal parent, which is the acquiree. Paragraphs A113–A136 provide guidance for applying the acquisition method to reverse acquisitions.

Fair value of the acquiree

A113 In accordance with paragraph 20 of this [draft] FRS, the acquisition-date fair value of the consideration transferred by the acquirer is presumed to be the best basis for measuring the fair value of the acquirer's interest in the acquiree on that date, in the absence of evidence to the contrary. If the consideration transferred by the acquirer is not the best evidence of the fair value of the acquiree, the acquirer should use other valuation techniques to measure directly the fair value of the acquiree (see paragraphs A18–A26). When equity interests are issued as part of the consideration transferred in a business combination, the fair value of those equity interests is measured as of the acquisition date.

A114 In a reverse acquisition, the consideration is deemed to have been transferred by the legal subsidiary (i.e. the acquirer for financial reporting purposes) in the form of equity interests issued to the owners of the legal parent (i.e. the acquiree for financial reporting purposes). If the fair value of the equity interests of the legal subsidiary (acquirer) is used to determine the fair value of the consideration transferred for the acquiree, a method of calculating the fair value of the consideration is to determine the number of equity interests the legal subsidiary (acquirer) would have had to issue to provide the same percentage equity interest of the combined entity to the owners of the legal parent (acquiree) as they have in the combined entity as a result of the reverse acquisition. The fair value of the number of equity interests so calculated can be used as the fair value of consideration transferred for the acquiree in the combination.

A115 If the fair value of the consideration transferred by the acquirer (i.e. the fair value of the equity interests of the legal subsidiary) is not the best basis for measuring the fair value of the acquiree (legal parent), the acquirer should use other valuation techniques. In a reverse acquisition, the fair value of the issued equity interests of the legal parent (acquiree) as of the acquisition date, based on prices of the legal parent's publicly traded equity shares, may provide the best basis for measuring the fair value of the legal parent (acquiree).

Preparation and presentation of consolidated financial statements

A116 Consolidated financial statements prepared following a reverse acquisition are issued under the name of the legal parent, but described in the notes as a continuation of the financial statements of the legal subsidiary (i.e. the acquirer for financial reporting purposes). Because such consolidated financial statements represent a continuation of the financial statements of the legal subsidiary:

(a) the assets and liabilities of the legal subsidiary (acquirer) are measured and recognised in those consolidated financial statements at their pre-combination carrying amounts.

(b) the retained earnings and other equity balances recognised in those consolidated financial statements are the retained earnings and other equity balances of the legal subsidiary (acquirer) immediately before the business combination.

(c) the amount recognised as issued equity interests in those consolidated financial statements shall be determined by adding the issued equity of the legal subsidiary (acquirer) immediately before the business combination to the fair value of the legal parent (acquiree) determined in accordance with paragraphs A113–A115. However, the equity structure appearing in those consolidated financial statements (i.e. the number and type of equity interests issued) reflects the equity structure of the legal parent (acquiree), including the equity interests issued by the legal parent to effect the combination.

(d) comparative information presented in those consolidated financial statements is that of the legal subsidiary (acquirer).

A117 Reverse acquisition accounting applies only in the consolidated financial statements, and not in the separate financial statements. Therefore, in the legal parent's separate financial statements, if any, the investment in the legal subsidiary is accounted for in accordance with the requirements in FRS 27 *Consolidated and Separate Financial Statements*, on accounting for investments in an investor's separate financial statements.

A118 Consolidated financial statements prepared following a reverse acquisition reflect the values measured in accordance with this [draft] FRS for the assets and liabilities of the legal parent (i.e. the acquiree for financial reporting purposes). Therefore, the fair value of the assets and liabilities of the legal parent are recognised in accordance with paragraphs 28–51 of this [draft] FRS.

Non-controlling interest

A119 In a reverse acquisition, some of the owners of the legal subsidiary (acquirer) may not exchange their equity interests for equity interests of the legal parent (acquiree). Although the entity in which those owners hold equity interests (the legal subsidiary) acquired another entity (the legal parent), those owners are treated as a non-controlling interest in the consolidated financial statements prepared after the reverse acquisition. This is because the owners of the legal subsidiary that do not exchange their equity interests for equity interests of the legal parent have an interest only in the results and net assets of the legal subsidiary, and not in the results and net assets of the combined entity. Conversely, the owners of the legal parent, notwithstanding that the legal parent is the acquiree for financial reporting purposes, have an interest in the results and net assets of the combined entity.

A120 Because the assets and liabilities of the legal subsidiary are measured and recognised in the consolidated financial statements at their pre-combination carrying amounts, the non-controlling interest reflects the non-controlling shareholders' proportionate interest in the pre-combination carrying amounts of the legal subsidiary's net assets. This is unique to a reverse acquisition.

Earnings per share

A121 As noted in paragraph A116(c), the equity structure appearing in the consolidated financial statements prepared following a reverse acquisition reflects the equity structure of the legal parent (acquiree), including the equity interests issued by the legal parent to effect the business combination.

A122 For the purpose of calculating the weighted average number of ordinary shares outstanding (the denominator) during the period in which the reverse acquisition occurs:

(a) the number of ordinary shares outstanding from the beginning of that period to the acquisition date shall be deemed to be the number of ordinary shares issued by the legal parent (acquiree) to the owners of the legal subsidiary (acquirer); and

(b) the number of ordinary shares outstanding from the acquisition date to the end of that period shall be the actual number of ordinary shares of the legal parent (acquiree) outstanding during that period.

A123 The basic earnings per share disclosed for each comparative period before the acquisition date that is presented in the consolidated financial statements following a reverse acquisition shall be calculated by dividing the profit or loss of the legal subsidiary attributable to ordinary shareholders in each of those periods by the number of ordinary shares issued by the legal parent to the owners of the legal subsidiary in the reverse acquisition.

A124 The calculations outlined in paragraphs A132 and A133 assume that there were no changes in the number of the legal subsidiary's issued ordinary shares during the comparative periods and during the period from the beginning of the period in which the reverse acquisition occurred to the acquisition date. The calculation of earnings per share shall be adjusted appropriately to take into account the effect of a change in the number of the legal subsidiary's issued ordinary shares during those periods.

Example 20
Reverse acquisition

A125 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 20X6. This example ignores the accounting for any income tax effects.

A126 The following are the balance sheets of Entity A and Entity B immediately before the business combination:

	Entity A (legal parent, acquiree)	Entity B (legal subsidiary, acquirer)
	CU	CU
Current assets	500	700
Non-current assets	1,300	3,000
Total assets	1,800	3,700

Current liabilities	300	600
Non-current liabilities	400	1,100
Total liabilities	700	1,700
Owners' equity		
Retained earnings	800	1,400
Issued equity		
100 ordinary shares	300	-
60 ordinary shares	-	600
Total owners' equity	1,100	2,000
Total liabilities and owners' equity	1,800	3,700

A127 The following is other information used in this example:

(a) On 30 September 20X6 Entity A issues 2½ shares in exchange for each ordinary share of Entity B. All of Entity B's shareholders exchange their shares in Entity B. Therefore, Entity A issues 150 ordinary shares in exchange for all 60 ordinary shares of Entity B.

(b) The fair value of each ordinary share of Entity B at 30 September 20X6 is CU40. The quoted market price of Entity A's ordinary shares at that date is CU16.

(c) The fair values of Entity A's identifiable assets and liabilities at 30 September 20X6 are the same as their carrying amounts, except that the fair value of Entity A's non-current assets at 30 September 20X6 is CU1,500.

Calculating the fair value of the acquiree

A128 As a result of the issue of 150 ordinary shares by Entity A (legal parent, acquiree), Entity B's shareholders own 60 per cent of the issued shares of the combined entity (i.e. 150 of 250 issued shares). The remaining 40 per cent are owned by Entity A's shareholders. If the business combination had taken the form of Entity B issuing additional ordinary shares to Entity A's shareholders in exchange for their ordinary shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholders would then own 60 of the 100 issued shares of Entity B and, therefore, 60 per cent of the combined entity. As a result, the fair value of the consideration transferred by Entity B and the fair value of the Entity A is CU1,600 (i.e. 40 shares each with a fair value of CU40). If the fair value of the consideration transferred by Entity B is determined not to be the best evidence of the fair value of Entity A, then other valuation techniques should be used to measure the fair value of Entity A directly. The fair value of Entity A could be measured directly on the basis of the fair value of Entity A's shares outstanding.

Measuring goodwill

A129 Goodwill is measured as the excess of the fair value of the acquiree, Entity A, over the net amount of Entity A's recognised identifiable assets and liabilities. Therefore, goodwill is measured as follows:

	CU	CU
Fair value of Entity A (legal parent, acquiree)		1,600
Net recognised values of Entity 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 20X6

A130 The following is the consolidated balance sheet immediately after the business combination:

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

A131 In accordance with paragraph A116(c), the amount recognised as issued equity interests in the consolidated financial statements (CU2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination (CU600) and the fair value of the legal parent (acquiree) measured in accordance with paragraphs A113–A115 (CU1,600). However, the equity structure appearing in the consolidated financial statements (i.e. the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to effect the combination.

Earnings per share

A132 Assume that Entity B's profit for the annual period ended 31 December 20X5 was CU600, and that the consolidated profit for the annual period ended 31 December 20X6 is CU800. Assume also that there was no change in the number of ordinary shares issued by Entity B during the annual period ended 31 December 20X5, and during the period from 1 January 20X6 to the date of the reverse acquisition on 30 September 20X6. Earnings per share for the annual period ended 31 December 20X6 is calculated as follows:

Number of shares deemed to be outstanding for the period from 1 January 20X6 to the acquisition date (i.e. the number of ordinary shares issued by Entity A (legal parent, acquiree) in the reverse acquisition)	150
Number of shares outstanding from the acquisition date to 31 December 20X6	250
Weighted average number of ordinary shares outstanding [(150 × 9 ÷12) + (250 × 3 ÷12)]	175
Earnings per share [800 ÷ 175]	CU4.57

A133 Restated earnings per share for the annual period ended 31 December 20X5 is CU4.00 (i.e. the profit of Entity B of 600 divided by the number of ordinary shares issued by Entity A in the reverse acquisition).

Non-controlling interest

A134 Assume the same facts as above, except that only 56 of Entity B's 60 ordinary shares are exchanged. Because Entity A issues 2½ shares in exchange for each ordinary share of Entity B, Entity A issues only 140 (rather than 150) shares. As a result, Entity B's shareholders own 58.3 per cent of the issued shares of the combined entity (i.e. 140 shares of 240 issued shares). The fair value of the consideration transferred for Entity A, the acquiree, is calculated by assuming that the combination had taken place in the form of Entity B issuing

additional ordinary shares to the shareholders of Entity A in exchange for their ordinary shares in Entity A. In calculating the number of shares that would have to be issued by Entity B, the non-controlling interest is ignored. The majority shareholders own 56 shares of Entity B. For this to represent a 58.3 per cent equity interest, Entity B would have had to issue an additional 40 shares. The majority shareholders would then own 56 of the 96 issued shares of Entity B and, therefore, 58.3 per cent of the combined entity. As a result, the fair value of the consideration transferred for Entity A, the acquiree, is CU1,600 (i.e. 40 shares each with a fair value of CU40). This is the same amount as when all 60 of Entity B's ordinary shares are tendered for exchange. The fair value of Entity A, the acquiree, does not change if some of Entity B's shareholders do not participate in the exchange.

A135 The non-controlling interest is represented by the four shares of the total 60 shares of Entity B that are not exchanged for shares of Entity A. Therefore, the non-controlling interest is 6.7 per cent. The non-controlling interest reflects the non-controlling shareholders' proportionate interests in the pre-combination carrying amounts of the net assets of Entity B, the legal subsidiary. Therefore, the consolidated balance sheet is adjusted to show a non-controlling interest of 6.7 per cent of the pre-combination carrying amounts of Entity B's net assets (i.e. CU134 or 6.7 per cent of CU2,000).

A136 The consolidated balance sheet at 30 September 20X6, reflecting the non-controlling interest, is as follows:

	CU
Current assets [CU700 + CU500]	1,200
Non-current assets [CU3,000 + CU1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [CU600 + CU300]	900
Non-current liabilities [CU1,100 + CU400]	1,500
Total liabilities	2,400
Owners' equity	
Retained earnings [CU1,400 × 93.3 per cent]	1,306
Issued equity	
240 ordinary shares [CU560 + CU1,600]	2,160
Non-controlling interest	134
Total owners' equity	3,600
Total liabilities and owners' equity	6,000

Appendix C

Guidance on accounting for asset acquisitions, and on identifying business combinations between entities under common control, and transitional provisions for business combinations involving only mutual entities or by contract alone.

This appendix is an integral part of the [draft] FRS.

Introduction

C1 This appendix provides guidance on three matters:

(a) asset acquisitions,

(b) identifying business combinations between entities under common control, and

(c) transitional provisions for business combinations involving only mutual entities or by contract alone without obtaining any equity interests.

[The source of the guidance is given in square brackets.]

C2 The FASB's [draft proposed] SFAS 141(R) includes an appendix of continuing authoritative guidance; however, that guidance has been carried forward by the FASB from other sources. Therefore, the guidance provided in the FASB's appendix is not the same as the guidance provided in this appendix.

Accounting for asset acquisitions

C3 As noted in paragraph 5 a transaction or event is accounted for as a business combination only if the assets acquired and liabilities assumed constitute a business (an acquiree). If the assets acquired and liabilities assumed do not constitute a business, the acquirer shall account for the transaction as an asset acquisition. The accounting for an asset acquisition is described below in paragraphs C4 and C5. [Source: FRS 103, paragraph 4]

C4 The acquirer shall:

(a) identify the individual identifiable assets acquired and liabilities assumed, including those assets that meet the definition of, and recognition criteria for, intangible assets in FRS 38 *Intangible Assets*.

(b) allocate the cost of the group to the individual identifiable assets and liabilities based on their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill.

(c) recognise the identifiable assets acquired and liabilities assumed.

C5 Intangible assets acquired in an asset acquisition shall be recognised in accordance with the requirements of FRS 38.

Business combinations involving entities under common control

C6 Consistently with the previous version of FRS 103, the provisions of this [draft] FRS do not apply to combinations involving entities under common control.

C7 A business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by

the same party or parties both before and after the business combination, and that control is not transitory. [Source: FRS 103, paragraph 10]

C8 A group of individuals shall be regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities. Therefore, a business combination is outside the scope of this [draft] FRS when the same group of individuals has, as a result of contractual arrangements, ultimate collective power to govern the financial and operating policies of each of the combining entities so as to obtain benefits from their activities, and that ultimate collective power is not transitory. [Source: FRS 103, paragraph 11]

C9 An entity may be controlled by an individual or by a group of individuals acting together under a contractual arrangement, and that individual or group of individuals may not be subject to the financial reporting requirements of FRSs. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a business combination to be regarded as one involving entities under common control. [Source: FRS 103, paragraph 12]

C10 The extent of non-controlling interests in each of the combining entities before and after the business combination is not relevant to determining whether the combination involves entities under common control. Similarly, the fact that one of the combining entities is a subsidiary that has been excluded from the consolidated financial statements is not relevant to determining whether a combination involves entities under common control. [Source: FRS 103, paragraph 13]

Transitional provisions for business combinations involving only mutual entities or by contract alone without obtaining any equity interests

C11 Paragraph 82 provides that it applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual period beginning on or after 1 January 2007. Earlier application is encouraged. However, this [draft] FRS shall be applied only when an annual period begins on or after this [draft] FRS was issued. If this [draft] FRS is applied before its effective date, that fact shall be disclosed and [draft] FRS 27 and [draft] FRS 37 are to be applied at the same time.

C12 The requirement to apply this [draft] FRS prospectively has the following effect for a business combination involving only mutual entities or by contract alone (see paragraph 54) if the acquisition date for that business combination is before the beginning of the first annual period beginning on or after 1 January 2007:

(a) Classification

An entity shall continue to classify the prior business combination in accordance with the entity's previous accounting policies for such combinations.

(b) Previously recognised goodwill

At the beginning of the first annual period beginning on or after 1 January 2007 the carrying amount of goodwill arising from the prior business combination shall be its carrying amount at that date in accordance with the entity's previous accounting policies, after eliminating the carrying amount of any accumulated amortisation of that goodwill with a corresponding decrease in goodwill. No other adjustments shall be made to the carrying amount of goodwill.

(c) Goodwill previously recognised as a deduction from equity

If the entity's previous accounting policies resulted in goodwill arising from the prior business combination being recognised as a deduction from equity, the entity shall not recognise that goodwill as an asset at the beginning of the first annual period beginning on or after 1 January 2007. Furthermore, the entity shall not recognise any part of that goodwill in profit or loss when it disposes of all or part of the business to which that goodwill relates or when a cash-generating unit to which the goodwill relates becomes impaired.

(d) Subsequent accounting for goodwill

From the beginning of the first annual period beginning on or after 1 January 2007 an entity shall discontinue amortising goodwill arising from the prior business combination and shall test goodwill for impairment in accordance with FRS 36.

(e) Previously recognised negative goodwill

An entity that accounted for the prior business combination by applying the purchase method may have recognised a deferred credit for an excess of its interest in the net fair value of the acquiree's identifiable assets and liabilities over the cost of that interest (sometimes called negative goodwill). If so, the entity shall derecognise the carrying amount of that deferred credit at the beginning of the first annual period beginning on or after 1 January 2007 with a corresponding adjustment to the opening balance of retained earnings at that date.

Appendix D

Amendments to other FRSs

The amendments in this [draft] Appendix shall be applied for annual periods beginning on or after [1 January 2007]. If an entity applies this [draft] FRS for an earlier period, these amendments shall be applied for that earlier period. Amended paragraphs are shown with new text underlined and deleted text struck through.

D1 In Financial Reporting Standards (including Interpretations of Financial Accounting Standards) applicable at [1 January 2007]:

(a) references to 'the purchase method' are amended to 'the acquisition method'.

(b) references to 'identifiable assets, liabilities and contingent liabilities' are amended to 'identifiable assets and liabilities'.

(c) references to 'each identifiable asset, liability and contingent liability' are amended to 'each identifiable asset and liability'.

(d) references to 'goodwill acquired in a business combination' are amended to 'goodwill arising in a business combination'.

(e) references to 'acquired goodwill' are amended to 'goodwill arising in a business combination'.

D2 FRS 101 *First-time Adoption of Financial Reporting Standards* is amended as described below.

In Appendix B, paragraphs B1 and B2(g)(ii) are deleted.

In Appendix B, paragraph B2(g) is amended as follows:

(g) The carrying amount of goodwill in the opening FRS balance sheet shall be its carrying amount under previous GAAP at the date of transition to FRSs, after the following ~~three~~ two adjustments:

D3 In FRS 102 *Share-based Payment*, paragraph 5 is amended as follows:

5 As noted in paragraph 2, this FRS applies to share-based payment transactions in which an entity acquires or receives goods or services. Goods includes inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets. However, an entity shall not apply this FRS to transactions in which the entity acquires goods as part of the net assets acquired in a business combination to which FRS 103 *Business Combinations* applies. Hence, equity instruments issued in a business combination in exchange for control of the acquiree are not within the scope of this FRS. However, equity instruments granted to employees of the acquiree in their capacity as employees (e.g. in return for continued service) are within the scope of this FRS. Similarly, the cancellation, replacement or other modification of *share-based payment arrangements* because of a business combination or other equity restructuring shall be accounted for in accordance with this FRS. FRS 103 provides guidance on determining whether equity instruments issued in a business combination are part of the consideration transferred in exchange for control of the acquiree (and therefore within the scope of FRS 103) or are in return for continued service to be recognised in the post-combination period (and therefore within the scope of this FRS).

D4 FRS 12 *Income Taxes* is amended as described below.

The Objective is amended as follows:

Objective

…

This Standard requires an entity to account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in profit or loss, any related tax effects are also recognised in profit or loss. For transactions and other events recognised directly in equity, any related tax effects are also recognised directly in equity. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill arising in that business combination~~ or the amount of any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination~~.

…

Paragraphs 18, 19, 21, 22 and 26 are amended as follows:

18 Temporary differences also arise when:

(a) ~~the cost of a business combination is allocated by recognising~~ the identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values in accordance with FRS 103 *Business Combinations*, but no equivalent adjustment is made for tax purposes (see paragraph 19);

Business combinations

19 ~~The cost of a business combination is allocated by recognising~~ With limited exceptions, the identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values at the acquisition date. Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities assumed are not affected by the business combination or are affected differently. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill (see paragraph 66).

Goodwill

21 Goodwill arising in a business combination is measured as the excess of the fair value of the acquiree, as a whole, over the net amount of the recognised identifiable assets acquired and liabilities assumed~~cost of the combination over the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities~~. Many taxation authorities do not allow reductions in the carrying amount of goodwill as a deductible expense in determining taxable profit. Moreover, in such jurisdictions, the cost of goodwill is often not deductible when a subsidiary disposes of its underlying business. In such jurisdictions, goodwill has a tax base of nil. Any difference between the carrying amount of goodwill and its tax base of nil is a taxable temporary difference. However, this Standard does not permit the recognition of the resulting deferred tax liability because goodwill is measured as a residual and the recognition of the deferred tax liability would increase the carrying amount of goodwill.

Initial recognition of an asset or liability

22 A temporary difference may arise on initial recognition of an asset or liability, for example if part or all of the cost of an asset will not be deductible for tax purposes. The method of accounting for such a temporary difference depends on the nature of the transaction which led to the initial recognition of the asset:

(a) in a business combination, an entity recognises any deferred tax liability or asset and this affects the amount of goodwill ~~or the amount of any excess over the cost of the combination of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities~~ (see paragraph 19);

...

26 The following are examples of deductible temporary differences that result in deferred tax assets:

…

(c) ~~the cost of a business combination is allocated by recognising~~ with limited exceptions, the identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values at the acquisition date. When a liability assumed is recognised at the acquisition date but the related costs are not deducted in determining taxable profits until a later period, a deductible temporary difference arises which results in a deferred tax asset. A deferred tax asset also arises when the fair value of an identifiable asset acquired is less than its tax base. In both cases, the resulting deferred tax asset affects goodwill (see paragraph 66); and

…

After paragraph 31 a heading and a new paragraph 32 are added as follows:

Goodwill

32 If the carrying amount of goodwill arising in a business combination is less than its tax base, the difference gives rise to a deferred tax asset. The deferred tax asset arising from the initial recognition of goodwill should be recognised as part of the accounting for a business combination to the extent that it is probable that taxable profit will be available against which the deductible temporary difference could be utilised.

Paragraphs 66-68 are amended as follows:

Deferred tax arising from a business combination

66 As explained in paragraphs 19 and 26(c), temporary differences may arise in a business combination. In accordance with FRS 103 *Business Combinations*, an entity recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria in paragraph 24) or deferred tax liabilities as identifiable assets and liabilities at the acquisition date. Consequently, those deferred tax assets and deferred tax liabilities affect goodwill ~~or the amount of any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination~~. However, in accordance with paragraph 15(a), an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill.

67 As a result of a business combination, the probability of realising a deferred tax asset of the acquirer could change. A~~a~~n acquirer may consider it probable that it will

recover its own deferred tax asset that was not recognised before the business combination. For example, the acquirer may be able to utilise the benefit of its unused tax losses against the future taxable profit of the acquiree. Alternatively, as a result of the business combination it may no longer be probable that future taxable profit will allow the deferred tax asset to be recovered. In such cases, the acquirer recognises a change in the deferred tax asset in the period of the business combination~~deferred tax asset~~, but does not include it as part of the accounting for the business combination. ~~, and therefore~~ Therefore, the acquirer does not take it into account in ~~determining~~ measuring ~~the~~ goodwill on consolidation~~or the amount of any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination~~.

68 ~~If t~~The potential benefit of the acquiree's income tax loss carryforwards or other deferred tax assets ~~did~~ may not satisfy the criteria ~~in FRS 103~~ for separate recognition when a business combination is initially accounted for but ~~is~~ may be ~~subsequently~~ realised subsequently.~~, the acquirer shall recognise the resulting deferred tax income in profit or loss. In addition, the acquirer shall:~~

~~(a) reduce the carrying amount of goodwill to the amount that would have been recognised if the deferred tax asset had been recognised as an identifiable asset from the acquisition date; and~~

~~(b) recognises the reduction in the carrying amount of goodwill as an expense.~~

~~However, this procedure shall not result in the creation of an excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination, nor shall it increase the amount previously recognised for any such excess.~~ There is a rebuttable presumption that acquired deferred tax benefits recognised within one year after the acquisition date are an adjustment to any deferred tax benefits recognised at that date and will be applied to reduce the carrying amount of any goodwill related to that acquisition. If the carrying amount of that goodwill is zero, any remaining deferred tax benefits will be credited to profit or loss or, if this Standard so requires, to equity. The rebuttable presumption is overcome if the recognition of the tax benefits results from a discrete event that occurred after the acquisition date. If the rebuttable presumption is overcome, or if those tax benefits are recognised more than one year after the acquisition date, they shall be credited to profit or loss or, if this Standard so requires, to equity.

The example following paragraph 68 is deleted.

Paragraph 81 is amended as follows:

81 The following shall also be disclosed separately:

…

(h) in respect of discontinued operations, the tax expense relating to:

(i) the gain or loss on discontinuance; and

(ii) the profit or loss from the ordinary activities of the discontinued operation for the period, together with the corresponding amounts for each prior period presented; ~~and~~

(i) the amount of income tax consequences of dividends to shareholders of the entity that were proposed or declared before the financial statements were authorised for issue, but are not recognised as a liability in the financial statements~~.~~;

(j) if the probability of realising the acquirer's deferred tax asset changes as a result of a business combination (see paragraph 67), the amount of the resulting change in the deferred tax asset at the acquisition date; and

(k) a description of the event or change in circumstances that has resulted in deferred tax benefits acquired in a business combination being recognised.

Paragraphs 92 and 93 are added as follows:

92 Paragraph 68 shall be applied prospectively from the effective date of FRS 103 *Business Combinations* (as revised in 200X) to the recognition of deferred tax assets acquired in business combinations, including business combinations effected before FRS 103 (revised) is applied.

93 Therefore, entities shall not adjust the accounting for prior business combinations if tax benefits failed to satisfy the criteria for separate recognition as of the acquisition date and are recognised after the acquisition date, unless the rebuttable presumption in paragraph 68 applies. Tax benefits recognised more than one year after the acquisition date shall be credited to profit or loss or, if this Standard so requires, to equity.

In Appendix A, paragraph 12 of section A is amended as follows:

12 The carrying amount of an asset is increased to fair value in a business combination and no equivalent adjustment is made for tax purposes. *(Note that on initial recognition, the resulting deferred tax liability increases goodwill, if any~~or decreases the amount of any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination~~. See paragraph 66 of the Standard).*

In Appendix A, paragraph 9 of section B is amended as follows:

Business combinations and consolidation

9 A liability is recognised at its fair value in a business combination, but none of the related expense is deducted in determining taxable profit until a later period. *(Note that the resulting deferred tax asset decreases goodwill, if any~~or increases the amount of any excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the combination~~. See paragraph 66 of the Standard).*

In Appendix B, Example 3 is amended as follows:

Example 3 - Business combinations

...

	~~Cost of~~ Values recognised at acquisition	*Tax base*	*Temporary differences*
Property, plant and equipment	270	155	115
Accounts receivable	210	210	-
Inventory	174	124	50
Retirement benefit obligations	(30)	-	(30)
Accounts payable	(120)	(120)	-
Fair value of the identifiable assets acquired and liabilities assumed, excluding deferred tax	504	369	135

…

D5 In FRS 19 *Employee Benefits*, paragraph 108 is amended as follows:

Business combinations

108 In a business combination, an entity ~~recognises~~ measures assets and liabilities arising from post-employment benefits at the present value of the obligation less the fair value of any plan assets (see FRS 103 *Business Combinations*). The present value of the obligation includes all of the following, even if the acquiree had not yet recognised them at the acquisition date:

(a) actuarial gains and losses that arose before the acquisition date (whether or not they fell inside the 10% 'corridor');

(b) past service cost that arose from benefit changes, or the introduction of a plan, before the acquisition date; and

(c) amounts that, under the transitional provisions of paragraph 155(b), the acquiree had not recognised.

D6 In FRS 28 *Investments in Associates*, paragraph 23 is amended as follows:

23 An investment in an associate is accounted for using the equity method from the date on which it becomes an associate. On acquisition of the investment any difference between the cost of the investment and the investor's share of the net fair value of the associate's identifiable assets~~,~~ and liabilities ~~and contingent liabilities~~ is accounted for in accordance with FRS 103 *Business Combinations*. Therefore:

(a) goodwill relating to an associate is included in the carrying amount of the investment. However, amortisation of that goodwill is not permitted and is therefore not included in the determination of the investor's share of the associate's profits or losses.

(b) any excess of the investor's share of the net fair value of the associate's identifiable assets~~,~~ and liabilities ~~and contingent liabilities~~ over the cost of the investment is ~~excluded from the carrying amount of the investment and is instead~~ included as income in the determination of the investor's share of the associate's profit or loss in the period in which the investment is acquired.

…

D7 In FRS 32 *Financial Instruments: Disclosure and Presentation*, paragraph 4(c) is deleted.

D8 In FRS 33 *Earnings per Share*, paragraph 22 is amended as follows:

> 22 Ordinary shares issued as part of the ~~cost of~~ consideration transferred in a business combination are included in the weighted average number of shares from the acquisition date. This is because the acquirer incorporates into its income statement the acquiree's profits and losses from that date.

D9 In FRS 34 *Interim Financial Reporting*, paragraph 16(i) is amended as follows:

> **…**
>
> **(i) the effect of changes in the composition of the entity during the interim period, including business combinations, acquisition or disposal of subsidiaries and long-term investments, restructurings, and discontinued operations. In the case of business combinations, the entity shall disclose the information required to be disclosed ~~under~~ by ~~paragraphs 66-73 of~~ FRS 103 *Business Combinations*; and**
>
> **…**

D10 FRS 36 *Impairment of Assets* is amended as described below.

In paragraph 6, the definition of the agreement date is deleted.

Paragraph 81 is amended as follows:

> 81 Goodwill ~~acquired~~ arising in a business combination represents ~~a payment made by an acquirer in anticipation of~~ assets that provide future economic benefits ~~from assets that~~ but are not capable of being individually identified and separately recognised. Goodwill does not generate cash flows independently of other assets or groups of assets, and often contributes to the cash flows of multiple cash-generating units. Goodwill sometimes cannot be allocated on a non-arbitrary basis to individual cash-generating units, but only to groups of cash-generating units. As a result, the lowest level within the entity at which the goodwill is monitored for internal management purposes sometimes comprises a number of cash-generating units to which the goodwill relates, but to which it cannot be allocated. References in paragraphs 83-99 to a cash-generating unit to which goodwill is allocated should be read as references also to a group of cash-generating units to which goodwill is allocated.

After paragraph 90 the heading and paragraphs 91-95 are deleted. Those paragraphs are reproduced, with minor changes, as paragraphs C1-C5 in a new appendix (Appendix C). Appendix C also includes new paragraphs C6-C12. The appendix is inserted, as follows, with the changes highlighted being the differences between paragraphs 91-95 of FRS 36 and paragraphs C1-C5:

Appendix C

This appendix is an integral part of the Standard. It provides guidance on goodwill impairment testing for cash-generating units with goodwill and non-controlling interests.

Impairment testing cash-generating units with goodwill and non-controlling interests

Before [draft] FRS 103 (as revised in 200X) is applied, the following guidance is relevant when performing a goodwill impairment test for cash-generating units with non-controlling interests.

C1 In accordance with FRS 103, goodwill recognised in a business combination represents the goodwill acquired by a parent based on the parent's ownership interest, rather than the amount of goodwill controlled by the parent as a result of the business combination. Therefore, goodwill attributable to a ~~minority~~non-controlling interest is not recognised in the parent's consolidated financial statements. Accordingly, if there is a ~~minority~~non-controlling interest in a cash-generating unit to which goodwill has been allocated, the carrying amount of that unit comprises:

(a) both the parent's interest and the ~~minority~~non-controlling interest in the identifiable net assets of the unit; and

(b) the parent's interest in goodwill.

However, part of the recoverable amount of the cash-generating unit determined in accordance with this Standard is attributable to the ~~minority~~non-controlling interest in goodwill.

C2 Consequently, for the purpose of impairment testing a ~~non-whooly-owned~~ cash-generating unit with goodwill that is not wholly-owned, the carrying amount of that unit is notionally adjusted, before being compared with its recoverable amount. This is accomplished by grossing up the carrying amount of goodwill allocated to the unit to include the goodwill attributable to the ~~minority~~non-controlling interest. This notionally adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the cash-generating unit is impaired. If it is, the entity allocates the impairment loss in accordance with paragraph 104 first to reduce the carrying amount of goodwill allocated to the unit.

C3 However, because goodwill is recognised only to the extent of the parent's ownership interest, any impairment loss relating to the goodwill is apportioned between that attributable to the parent and that attributable to the ~~minority~~non-controlling interest, with only the former being recognised as a goodwill impairment loss.

C4 If the total impairment loss relating to goodwill is less than the amount by which the notionally adjusted carrying amount of the cash-generating unit exceeds its recoverable amount, paragraph 104 requires the remaining excess to be allocated to reduce the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit.

C5 Illustrative Example 7 illustrates the impairment testing of a ~~non-whooly-owned~~ cash-generating unit with goodwill that is not wholly-owned.

After [draft] FRS 103 (as revised in 200X) is applied, the following guidance is relevant when performing a goodwill impairment test for cash-generating units with non-controlling interests.

C6 In accordance with [draft] FRS 103 (revised), the acquirer measures and recognises goodwill as of the acquisition date as the excess of the fair value of the acquiree, as a whole, over the net amount of the recognised identifiable assets acquired and liabilities assumed. This requirement applies even if the acquirer owns less than 100 per cent of the equity interests in the acquiree at the acquisition date (i.e. even if a non-controlling interest in the acquiree exists then).

C7 In accordance with [draft] FRS 103 (revised), the acquirer allocates the carrying amount of goodwill as of the acquisition date between the acquirer and the non-controlling interest, if any. The carrying amount of goodwill allocated to the acquirer is the difference as of that date between the fair value of the acquirer's equity interest in the acquiree and the acquirer's share in the fair value of the separately recognised assets acquired and liabilities assumed. The rest of the goodwill is allocated to the non-controlling interests.

C8 In a cash-generating unit that includes a partially-owned subsidiary or is a stand-alone partially-owned subsidiary, goodwill impairment losses are allocated between the controlling and non-controlling interests pro rata using the relative carrying values of goodwill.

C9 If the partially-owned subsidiary is itself a cash-generating unit, the impairment loss is allocated to the controlling and non-controlling interests on the basis of the relative carrying values of goodwill allocated to them.

C10 If the partially-owned subsidiary is part of a larger cash-generating unit, goodwill impairment losses are allocated first to the components of the cash-generating unit and then to the controlling and non-controlling interests of the partially-owned subsidiary. The portion of the impairment loss allocated to the subsidiary is determined by multiplying the goodwill impairment loss for the unit by the carrying value of the goodwill assigned to that subsidiary, divided by the carrying value of the goodwill assigned to the cash-generating unit as a whole. The amount of the impairment loss allocated to the partially-owned subsidiary is then allocated to the controlling and non-controlling interests on the basis of the relative carrying values of goodwill allocated to those interests.

C11 If the total impairment loss relating to goodwill is less than the amount by which the carrying amount of the cash-generating unit exceeds its recoverable amount, paragraph 104 of FRS 36 requires the remaining excess to be allocated to reduce the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit.

C12 Illustrative Example 7A illustrates the impairment testing of a cash-generating unit with goodwill that is not wholly-owned.

Paragraph 138 is deleted.

Paragraph 139 is amended as follows:

139 ~~Otherwise, a~~An entity shall apply this Standard:

(a) to goodwill and intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004; and

(b) to all other assets prospectively from the beginning of the first annual period beginning on or after 31 March 2004.

The agreement date for a business combination is the date that a substantive agreement between the combining parties is reached and, in the case of publicly listed entities, announced to the public. In the case of a hostile takeover, the earliest date that a substantive agreement between the combining parties is reached is the date that a sufficient number of the acquiree's owners have accepted the acquirer's offer for the acquirer to obtain control of the acquiree.

In the Illustrative Examples, the heading of Example 7 is amended as follows:

Example 7 - Impairment testing cash-generating units with goodwill and ~~minority~~non-controlling interests

(applicable to business combinations effected before [draft] FRS 103 (revised 200X) is applied)

In the Illustrative Examples, paragraph IE65 of Example 7 is amended as follows.

IE65 A portion of Y's recoverable amount of CU1,000 is attributable to the unrecognised ~~minority~~non-controlling interest in goodwill. Therefore, in accordance with paragraph ~~92~~C2 of Appendix C of FRS 36, the carrying amount of Y must be notionally adjusted to include goodwill attributable to the ~~minority~~non-controlling interest, before being compared with the recoverable amount of CU1,000.

In the Illustrative Examples, a new Example 7A is added as follows:

Example 7A - Impairment testing cash-generating units with goodwill and non-controlling interests

(applicable to business combinations effected after [draft] FRS 103 (revised 200X) is applied)

In this example, tax effects are ignored.

Background

IE68A Entity X acquires an 80 per cent ownership interest in Entity Y for CU1,650 on 1 January 20X3. There is no evidence that this transaction is not an exchange of equal values. Therefore, the consideration transferred of CU1,650 is presumed to be the fair value of the 80 per cent interest. The fair value of Y is CU2,000. At 1 January 20X3, Y's identifiable net assets have a fair value of CU1,500.

IE68B Therefore, X recognises in its consolidated financial statements Y's identifiable net assets at their fair value of CU1,500.

X also recognises in its consolidated financial statements goodwill of CU500, measured as the excess of the fair value of Y, as a whole, of CU2,000 over the net amount of the recognised identifiable assets acquired and liabilities assumed of CU1,500.

The amount of goodwill attributable to the controlling interest and to the non-controlling interests in Y is calculated as follows:

	CU
Fair value of X's 80 per cent interest in Y	1,650
Less: X's share of the fair value of the identifiable net assets acquired (80 per cent × CU1,500)	(1,200)
Goodwill allocated to X	450
Goodwill allocated to the non-controlling interests in Y	

[CU500 - CU450]	50

Therefore, the fair value of Y is attributed to X and the non-controlling interest at the acquisition date as follows:

	Total	*Attributable to X*	*Attributable to the non-controlling interest*
	CU	CU	CU
Identifiable net assets	1,500	1,200	300
Goodwill	500	450	50
Total	2,000	1,650	350

IE68C The assets of Y together are the smallest group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Therefore Y is a cash-generating unit. Because this cash-generating unit includes goodwill within its carrying amount, it must be tested for impairment annually, or more frequently if there is an indication that it may be impaired (see paragraph 90 of FRS 36).

IE68D At the end of 20X3, X determines that the recoverable amount of cash-generating unit Y is CU1,650. X uses straight-line depreciation over a 10-year life for Y's identifiable assets and anticipates no residual value.

Allocating impairment loss between the parent and non-controlling interest

Schedule 1. Testing Y for impairment at the end of 20X3

End of 20X3	*Goodwill*	*Identifiable net assets*	*Total*
	CU	CU	CU
Gross carrying amount	500	1,500	2,000
Accumulated depreciation	-	(150)	(150)
Carrying amount	500	1,350	1,850
Recoverable amount			1,650
Impairment loss			200

IE68E In accordance with paragraph 104 of FRS 36, the impairment loss of CU200 is allocated to the assets in the unit by first reducing the carrying amount of goodwill to zero.

IE68F Therefore, the full amount of impairment loss of CU200 for the unit is allocated to the goodwill. In accordance with paragraph C9 of Appendix C of FRS 36, if the partially-owned subsidiary is itself a cash-generating unit, the goodwill impairment loss is allocated to the controlling and non-controlling interests on the basis of the relative carrying values of goodwill allocated to them.

Schedule 2. Allocating goodwill impairment loss to X and the non-controlling interest.

	Total amount	Attributable to X	Attributable to non-controlling interest
Goodwill before impairment loss	CU500	CU450	CU50
Percentage of the total	100%	90%	10%
Impairment loss	(CU200)	(CU180)	(CU20)
Goodwill after being reduced for impairment loss	CU300	CU270	CU30

D11 FRS 38 *Intangible Assets* is amended as follows:

In paragraph 8, the definition of the agreement date is deleted.

Paragraphs 11, 25 and 33 are amended as follows:

11 The definition of an intangible asset requires an intangible asset to be identifiable to distinguish it from goodwill. Goodwill ~~acquired~~ arising in a business combination represents ~~a payment made by the acquirer in anticipation of~~ future economic benefits from assets that are not capable of being individually identified and separately recognised. The future economic benefits may result from synergy between the identifiable assets acquired or from assets that, individually, do not qualify for recognition in the financial statements ~~but for which the acquirer is prepared to make a payment in the business combination~~.

25 Normally, the price an entity pays to acquire separately an intangible asset reflects expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, there will be an inflow of economic benefits, even if there could be uncertainty about the timing and the amount of the inflow~~the effect of probability is reflected in the cost of the asset~~. Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets.

33 In accordance with FRS 103 *Business Combinations*, if an intangible asset is acquired in a business combination, the cost of that intangible asset is its fair value at the acquisition date. ~~The fair value of an intangible asset reflects market expectations about the probability that the future economic benefits embodied in the asset will flow to the entity. In other words, the effect of probability is reflected in the fair value measurement of the intangible asset.~~ An intangible asset acquired in a business combination embodies an entity's unconditional right to future economic benefits. ~~Therefore~~Thus, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for intangible assets acquired in business combinations. Any uncertainty will relate to the timing and amount of the inflow.

Paragraphs 33A and 33B are inserted as follows:

33A A non-monetary asset without physical substance must be identifiable to meet the definition of an intangible asset. As outlined in paragraph 12, this will be the case when the asset is separable or arises from contractual or other legal rights. With one possible exception discussed in paragraph 33B, sufficient information should always

exist to measure reliably the fair value of an asset that has an underlying contractual or legal basis or is capable of being separated from the entity.

33B As discussed in paragraph 15, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training to conclude that these items meet the definition of an intangible asset. However, even in the unlikely event that an entity could demonstrate:

(a) control over the future economic benefits arising from an assembled workforce acquired in a business combination; and

(b) that the workforce meets one of the criteria in paragraph 12 for identifiability,

it is highly unlikely that the fair value of that workforce and the related intellectual capital could be measured with sufficient reliability. Accordingly, [draft] FRS 103 (revised) prohibits an acquirer from recognising an assembled workforce as an asset separately from goodwill.

Paragraphs 34 and 35 are amended as follows:

34 Therefore, in accordance with this Standard and [draft] FRS 103 (revised), an acquirer recognises at the acquisition date separately from goodwill an intangible asset of the acquiree (other than an assembled workforce) ~~if the asset's fair value can be measured reliably~~, irrespective of whether the asset had been recognised by the acquiree before the business combination. This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquiree if the project meets the definition of an intangible asset ~~and its fair value can be measured reliably~~. An acquiree's in-process research and development project meets the definition of an intangible asset when it:

(a) meets the definition of an asset; and

(b) is identifiable, i.e. is separable or arises from contractual or other legal rights.

Measuring the fair value of an intangible asset acquired in a business combination

35 With the exception of an assembled workforce, sufficient information always exists to measure reliably the fair value of an asset that has an underlying contractual or legal basis or is capable of being separated from the entity. ~~The fair value of intangible assets acquired in business combinations can normally be measured with sufficient reliability to be recognised separately from goodwill.~~ When, for the estimates used to measure an intangible asset's fair value, there is a range of possible outcomes with different probabilities, that uncertainty enters into the measurement of the asset's fair value~~, rather than demonstrates an inability to measure fair value reliably. If an intangible asset acquired in a business combination has a finite useful life, there is a rebuttable presumption that its fair value can be measured reliably~~.

Paragraphs 38-41 are deleted.

Paragraphs 68 and 69 are amended as follows:

68 Expenditure on an intangible item shall be recognised as an expense when it is incurred unless:

(a) it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 18-67); or

(b) the item is acquired in a business combination and cannot be recognised as an intangible asset. If this is the case, this expenditure

(included in the ~~cost of~~ consideration transferred in the business combination) shall form part of the ~~amount attributed to~~goodwill at the acquisition date (see FRS 103 *Business Combinations*).

69 In some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. In these cases, the expenditure is recognised as an expense when it is incurred. For example, except when it forms part of the ~~cost of~~assets acquired in a business combination, expenditure on research is recognised as an expense when it is incurred (see paragraph 54). Other examples of expenditure that is recognised as an expense when it is incurred include:

…

Paragraph 129 is deleted.

Paragraph 130 is amended as follows:

130 ~~Otherwise, a~~An entity shall apply this Standard:

(a) to the accounting for intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004; and

(b) to the accounting for all other intangible assets prospectively from the beginning of the first annual period beginning on or after 31 March 2004. Thus, the entity shall not adjust the carrying amount of intangible assets recognised at that date. However, the entity shall, at that date, apply this Standard to reassess the useful lives of such intangible assets. If, as a result of that reassessment, the entity changes its assessment of the useful life of an asset, that change shall be accounted for as a change in an accounting estimate in accordance with FRS 8.

The agreement date for a business combination is the date that a substantive agreement between the combining parties is reached and, in the case of publicly listed entities, announced to the public. In the case of a hostile takeover, the earliest date that a substantive agreement between the combining parties is reached is the date that a sufficient number of the acquiree's owners have accepted the acquirer's offer for the acquirer to obtain control of the acquiree.

D12 In FRS 39 *Financial Instruments: Recognition and Measurement*, paragraph 2(f) is deleted.

Appendix E

Fair Value Measurements

This appendix is an integral part of the [draft] FRS.

E1 This appendix provides guidance on how to measure fair value when accounting for a business combination. It shall be applied to all fair value measurements required by this [draft] FRS, including the fair values of the acquiree, the financial and non-financial identifiable assets acquired and liabilities assumed, and the consideration transferred. [The guidance in this Appendix is based on the FASB's Proposed Statement of Financial Accounting Standards *Fair Value Measurements.* The FASB plans to issue a final Statement on Fair Value Measurements in the fourth quarter of 2005. This guidance may change as a consequence of that final Statement.]

Definition of fair value

E2 For the purposes of this [draft] FRS, fair value is the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated, willing parties.

E3 The objective of a fair value measurement is to estimate an exchange price for the asset or liability being measured in the absence of an actual transaction for that asset or liability.[*] Thus, the estimate is determined by reference to a current hypothetical transaction between willing parties.

E4 Willing parties are presumed to be marketplace participants representing unrelated buyers and sellers that are:

(a) knowledgeable, having a common level of understanding about factors relevant to the asset or liability and the transaction: and

(b) willing and able to transact in the same market(s), having the legal and financial ability to do so.

E5 Fair value presumes the absence of compulsion (duress). Accordingly, the amount that forms the basis for the estimate is the price that would be observed in a transaction other than a forced liquidation transaction or distress sale. In all cases, that price shall be estimated without regard to an entity's current intention to enter into such a transaction.

Valuation techniques

E6 Valuation techniques consistent with the market approach, income approach and cost approach shall be considered for all estimates of fair value. However, for estimates of fair value that are developed using quoted prices in active markets (an application of the market approach), the results of other valuation techniques may not provide significant additional information (paragraphs E12-E22). Key aspects of those approaches are summarised below:

(a) The market approach requires observable prices and other information generated by actual transactions involving identical, similar or otherwise comparable assets or liabilities (including businesses). The estimate of fair value is based on the value indicated by those transactions. For example, paragraph 41 of FRS 38 refers to the use of valuation techniques consistent with the market approach in determining the fair value of an intangible asset.

(b) The income approach uses valuation techniques to convert future amounts (for example, cash flows or profit or loss) to a single present amount (discounted). The

[*] For a liability, the estimate of fair value shall consider the effect of the liability's credit standing so that the estimate reflects the amount that would be observed in an exchange between willing parties of the same credit quality.

estimate of fair value is based on the value indicated by marketplace expectations about those future amounts.

(c) For an asset, the cost approach considers the amount that would currently be required to replace its service capacity (often referred to as current replacement cost). The estimate of fair value considers the cost to acquire a substitute asset of comparable utility, adjusted for obsolescence. Obsolescence encompasses physical depreciation, functional obsolescence and economic obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (based on specified service lives).

E7 Valuation techniques used to estimate fair value shall be consistently applied. A change in the valuation technique(s) used is appropriate only if the change results in a more reliable estimate of fair value, for example as new markets develop or as new and improved valuation techniques become available.

Market inputs

E8 Market inputs refer to the assumptions and data that marketplace participants would use in their estimates of fair value. Valuation techniques used to estimate fair value shall emphasise market inputs, including those derived from active markets, whether using the market approach, income approach, or cost approach.

E9 In an active market, such as the Brussels Stock Exchange (Bourse), quoted prices that represent actual (observable) transactions are readily and regularly available; *readily available* means that pricing information is currently accessible and *regularly available* means that transactions occur with sufficient frequency to provide pricing information on an ongoing basis. In determining whether a market is active, the emphasis is on the level of activity for a particular asset or liability.

E10 Markets in which assets and liabilities are exchanged vary in structure and level of activity. Examples of such markets include the following:

(a) Exchange market—An exchange market provides high visibility and order to the trading of financial instruments. Typically, closing prices are readily and regularly available. In an exchange market, multiple identical exchange units are traded. An example of such a market is the London Stock Exchange.

(b) Dealer market—In a dealer market, dealers stand ready to trade (either buy or sell for their own account), thereby providing liquidity by using their capital to hold an inventory of the items for which they make a market. Typically, bid and asked prices are more readily and regularly available than closing prices. In a dealer market, multiple identical exchange units are traded. 'Over-the-counter' markets (where prices are publicly reported by, for example, the International Securities Market Association in Europe or US National Association of Securities Dealers Automated Quotations systems or the US National Quotation Bureau in the United States) are dealer markets. For example, the market for US Treasury securities is a dealer market. Dealer markets also exist for other assets and liabilities, such as financial instruments, commodities and physical assets (for example, certain used equipment).

(c) Brokered market—In a brokered market, brokers attempt to match buyers with sellers but do not stand ready to trade for their own account. In other words, brokers do not use their own capital to hold an inventory of the items for which they make a market. The broker knows the prices bid and asked by the respective parties, but each party is typically unaware of another party's price requirements. Prices of completed transactions are sometimes available. Brokered markets include electronic communication networks (ECNs), in which buy and sell orders are matched, and commercial and residential real estate markets.

(d) Principal-to-principal market—Principal-to-principal transactions, both originations and resales, are negotiated independently with no intermediary. Little information about those transactions may be released publicly.

E11 Market inputs shall be determined on the basis of information that is timely, originated from sources independent of the entity and used by marketplace participants in making pricing decisions. Examples of market inputs that may be used, directly or indirectly as a basis for deriving other relevant inputs, include the following:

(a) quoted prices, whether quoted in terms of completed transaction prices, bid and asked prices, or rates, adjusted as appropriate. The fair value hierarchy (paragraphs E12-E24) specifies whether and, if so, when adjustments to those prices are appropriate.

(b) information about interest rates, yield curve, volatility, prepayment speeds, default rates, loss severity, credit risk, liquidity and foreign exchange rates.

(c) specific and broad credit data and other relevant statistics (industry and other), including a current published index.

Fair value hierarchy

E12 The fair value hierarchy groups into three broad categories (levels) the inputs that should be used to estimate fair value. The hierarchy gives the highest priority to market inputs that reflect quoted prices in active markets for identical assets and liabilities (whether such prices are quoted in terms of completed transaction prices, bid and asked prices, or rates) and the lowest priority to entity inputs developed on the basis of an entity's own internal estimates and assumptions.

Level 1 estimates

E13 Fair value shall be estimated using quoted prices for identical assets or liabilities in active reference markets whenever that information is available. Quoted prices used for a Level 1 estimate shall not be adjusted.

E14 For an identical asset or liability, the Level 1 reference market is the active market to which an entity has immediate access (in many cases, the principal trading market for the asset or liability being measured). *Immediate access* means that an entity could exchange the asset or liability in its current condition at the quoted price in that market within a period that is usual and customary for transactions involving such assets or liabilities. If the entity has immediate access to multiple active markets with different prices, the Level 1 reference market is the most advantageous market, i.e. the market with the price that maximises (or minimises) the net amount that would be received (or incurred) in a current transaction for an asset (or liability). For the purposes of determining the most advantageous market, costs to transact in the respective markets shall be considered. However, the price used to estimate fair value, i.e. the price in the most advantageous market, shall not be adjusted for those costs. Transaction costs shall be accounted for in accordance with the provisions of other applicable pronouncements, generally in the period incurred.

E15 In an active dealer market where bid and asked prices are more readily and regularly available than closing prices, fair value shall be estimated using bid prices for long positions (assets) and asked prices for short positions (liabilities). For offsetting positions, mid-market prices shall be used for the matched portion. Bid and asked prices shall be used for the net open position, as appropriate.

E16 In some cases in which significant events (for example, principal-to-principal or brokered trades or significant announcements) occur after the close of the market but before the end of the reporting period, the closing price in that market might not be representative of fair value. An entity shall establish and apply consistently a policy for determining how those events affect estimates of fair value.

Level 2 estimates

E17 If quoted prices for identical assets or liabilities in active markets are not available, fair value shall be estimated using quoted prices for similar assets or liabilities in active markets, adjusted as appropriate for differences, whenever that information is available.

E18 For a Level 2 estimate, the price effect of the differences must be determinable objectively. For example, an observed price of securitised receivables can be used as a basis for estimating the fair value of unsecuritised receivables of the same type, but only if the price effect of the securitisation (the price effect of the liquidity, security, and other benefits added by securitisation) is determinable objectively. Otherwise, the estimate is a Level 3 estimate.

Level 3 estimates

E19 If quoted prices for identical or similar assets or liabilities in active markets are not available, or if differences between similar assets or liabilities are not determinable objectively, fair value shall be estimated using multiple valuation techniques consistent with the market approach, income approach, and cost approach whenever the information necessary to apply those multiple techniques is available without undue cost and effort.

E20 Level 3 estimates require judgement in the selection and application of valuation techniques and relevant inputs. Only multiple valuation techniques that are applicable or relevant in the circumstances shall be used. If multiple valuation techniques are used, the results of those techniques (i.e. the respective indications of fair value) shall be evaluated, considering the relevance and reliability of the inputs used. If information necessary to apply multiple valuation techniques is not available without undue cost and effort, the valuation technique that best approximates what an exchange price would be in the circumstances shall be used.

E21 Valuation techniques used for Level 3 estimates shall emphasise market inputs, including quoted prices generated by actual (observable) market transactions, adjusted as appropriate (see paragraph E11). The reasons for adjustments to quoted prices will vary. Examples include the following:

(a) A price might not be sufficiently current for a Level 1 or Level 2 estimate (stale price). In determining whether a price is stale, an entity shall consider the timing of the actual transaction, the frequency of other similar transactions, changes in credit conditions, interest rates, and other market conditions during the intervening period and other relevant factors.

(b) The price effect of differences between similar assets (liabilities) might not be sufficiently determinable for a Level 2 estimate.

(c) A price might be quoted in terms of bid and asked prices in a less active market (where the spread between the bid and asked prices is relatively wide).

(d) The underlying transaction might not be representative of a marketplace transaction. That could be the case if, for example, the transaction:

    (i) occurred under duress (in a forced liquidation transaction or distress sale);

    (ii) was between related parties; or

    (iii) was part of a series of other simultaneous planned or recent transactions between the parties and would have occurred at a different price if not for those other transactions.

(e) Contractual terms might affect the total transaction price (for example, contingent consideration).

(f) A price might need to be adjusted for differences in the unit of account, condition, or location.

Level 3 estimates with significant entity inputs

E22 In some cases, market inputs might not be available without undue cost and effort, requiring the use of significant entity inputs derived from an entity's own internal estimates and assumptions. In those cases, valuation techniques that rely on significant entity inputs may be used for Level 3 estimates, but only as a practical expedient (the fair value measurement objective remains the same).

Differences with the Exposure Draft published by the FASB

INTRODUCTION

This note accompanies, but is not part of, the draft FRS.

N1 The Exposure Draft is the result of a project to improve accounting and reporting for business combinations. The objective is to develop a common and comprehensive standard for the accounting for business combinations that could be used for both domestic and international financial reporting.

N2 This note identifies and compares those paragraphs that are substantively different. This note does not identify non-substantive differences such as differences in terminology: *profit or loss* and *income*. Nor does it identify differences in references to guidance. For example, this Exposure Draft refers to FRS 19 *Employee Benefits,* whereas the FASB's version refers to FASB Statement No. 87 *Employers' Accounting for Pensions.*

N3 Most of the differences identified in this note arise because of the decisions to produce guidance for accounting for business combinations that is consistent with other existing standards. There are no plans to eliminate the differences before the proposed standards on business combinations are issued.

Paragraph Reference	Proposed guidance	FASB's guidance
Paragraph 2(c)—Scope exception for not-for-profit organisations	Paragraph 2(c) is not used because there is no guidance provided for not-for-profit organisations. Therefore, this scope exception is not necessary.	Paragraph 2(c) specifies that this Statement does not apply to combinations between not-for-profit organisations or the acquisition of a for-profit business by a not-for-profit organisation. The FASB plans to issue a separate Exposure Draft that addresses business combinations between not-for-profit organisations.
Paragraph 11—Identification of the primary beneficiary as the acquirer	N/A—There is no guidance for primary beneficiaries because there is no consolidation guidance equivalent to FASB Interpretation No. 46 (revised December 2003) *Consolidation of Variable Interest Entities*.	The last two sentences of paragraph 11 state that for the purposes of this Statement, the primary beneficiary of a variable interest entity is always the acquirer. The determination of what party, if any, is the primary beneficiary of a variable interest entity is made solely in accordance with Interpretation 46(R), not based on the guidance in paragraphs 12–16.

continued…

Paragraph Reference	Proposed guidance	FASB's guidance
Paragraphs 35, 36 and 87—Contingencies	**Contingencies** Paragraph 35 requires the acquirer to recognise, separately from goodwill, the acquisition date fair value of an identifiable asset or liability even if the amount of the future economic benefits embodied in the asset or required to settle the liability is contingent (or conditional) on the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. Although different words are used to describe the accounting for contingencies acquired in a business combination, the guidance is expected to result in the identification and recognition of the same assets and liabilities at the same amounts. After initial recognition, paragraph 36 requires the acquirer to account for such assets in accordance with FRS 38 *Intangible Assets* or FRS 39 *Financial Instruments: Recognition and Measurement,* as appropriate, and such liabilities in accordance with [draft] FRS 37 *Non-financial Liabilities* or other FRSs, as appropriate. Paragraph 87 provides transition from the existing FRS 103 requirement for previously recognised contingent liabilities.	**Contingencies that meet the definition of assets or liabilities** Paragraph 35 requires the acquirer to recognise separately from goodwill the acquisition date fair value of assets and liabilities arising from contingencies that were acquired or assumed as part of the business combination. Therefore, the acquirer recognises as of the acquisition date an asset or a liability for a contingency even if that contingency does not meet the recognition criteria in SFAS 5. Although different words are used in these paragraphs, the guidance is expected to result in the identification and recognition of the same assets and liabilities and at the same amounts. After initial recognition, paragraph 36 requires contingencies to be accounted for in accordance with applicable generally accepted accounting principles, except for contingencies that would be accounted for in accordance with SFAS 5 if they were acquired or incurred in an event other than a business combination. Those contingencies should continue to be measured at fair value with changes in fair value recognised in income in each reporting period. N/A – FASB did not have similar guidance in Statement 141.

continued…

Paragraph Reference	Proposed guidance	FASB's guidance
Paragraph 74—Disclosures of the effects of a business combination	The disclosures required by paragraph 74 apply to all acquirers. Paragraph 74(b)(1) requires disclosure of the revenue and profit or loss of the combined entity *for the current period* as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period. Paragraph 74(b)(2) is not used because this disclosure is not required for the comparable prior period.	The disclosures required by paragraph 74 apply only to acquirers that are *public business enterprises*, as described in paragraph 9 of FASB Statement No. 131 *Disclosures about Segments of an Enterprise and Related Information.* Paragraph 74(b) requires disclosure of the following *supplemental pro forma* information: (1) The *results of operations*[*] of the combined entity for the current period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period. (2) If comparative financial statements are presented, the *results of operations* of the combined entity for the comparable prior period as though the acquisition date for all business combinations that occurred during the current year had occurred as of the beginning of the comparable prior fiscal year.

continued…

[*] For this disclosure, *results of operations* means revenue, income before extraordinary items and the cumulative effect of accounting changes, net income, and earnings per share. In determining the pro forma amounts, income taxes, interest expense, preferred share dividends and depreciation and amortisation of assets shall be adjusted to the accounting base recognised for each in recording the combination. Pro forma information related to results of operations of periods before the combination shall be limited to the results of operations for the immediately preceding period. Disclosure also shall be made of the nature and amount of any material, nonrecurring items included in the reported pro forma results of operations.

Paragraph Reference	Proposed guidance	FASB's guidance
Paragraph 76(d)—Disclosures of the financial effects of adjustments to the amounts recognised in a business combination	Paragraph 76(d) requires the acquirer to disclose the amount and an explanation of any gain or loss recognised in the current period that (1) relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or the previous annual period and (2) is of such a size, nature, or incidence that disclosure is relevant to understanding the combined entity's financial statements.	N/A—FASB does not require this disclosure.
Paragraph 78(b)—Goodwill by reportable segment	The disclosure in paragraph 78(b) is not required. Paragraph 134 of FRS 36 *Impairment of Assets* requires an entity to disclose the aggregate carrying amount of goodwill allocated to each cash generating unit (group of units) for which the carrying amount of goodwill allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill. This information is not required to be disclosed for each material business combination that occurs during the period or in the aggregate for individually immaterial business combinations that are material collectively and occur during the period.	Paragraph 78(b) requires that the acquirer disclose *for each material business combination that occurs during the period or in the aggregate for individually immaterial business combinations that are material collectively and that occur during the period*, the amount of goodwill by reportable segment, if the combined entity is required to disclose segment information in accordance with SFAS 131, unless such disclosure is impracticable. Like FRS 36, paragraph 45 of FASB Statement No. 142 *Goodwill and Other Intangible Assets* requires disclosure of this information in aggregate by each reportable segment, not for each material business combination that occurs during the period or in the aggregate for individually immaterial business combinations that are material collectively and that occur during the period.

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Paragraph Reference	**Proposed guidance**	**FASB's guidance**
Paragraph 80—Goodwill reconciliation	Paragraph 80 requires an acquirer to provide a goodwill reconciliation and provides a detailed list of items that should be shown separately.	Paragraph 80 requires an acquirer to provide a goodwill reconciliation in accordance with the requirements of SFAS 142. SFAS 142 requires a goodwill reconciliation; however, the requirement is less detailed. This Exposure Draft would amend the requirement in SFAS 142 to converge with the level of detail in the reconciliation.
Paragraph A49(d)—Customer contract intangible assets	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.	Paragraph D13 amends FASB Statement No. 60 *Accounting and Reporting by Insurance Enterprises* to *require* the expanded presentation permitted by FRS 104.
Footnote to paragraph A52(i)—Contract-based intangible assets	N/A	The footnote to paragraph A52(i) codifies FASB Staff Positions FAS 141-1 and 142-1, "Interaction of FASB Statements No. 141 *Business Combinations,* and No. 142, *Goodwill and Other Intangible Assets,* and EITF Issue No. 04-2, 'Whether Mineral Rights Are Tangible or Intangible Assets." The footnote to paragraph A56(i) incorporates the guidance in FSP 141-1. Also, the amendment that removes the parenthetical that reads "such as mineral rights to depleting assets" from paragraph 11 of SFAS 142 is carried forward in Appendix D of this Exposure Draft.

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Paragraph Reference	Proposed guidance	FASB's guidance
Paragraph A102-A109—Replacement share-based payment awards	If the acquirer is obligated to replace the acquiree's awards, all or a portion of the acquirer's replacement awards are included in the measurement of the consideration transferred by the acquirer. However, the amount included in the measurement of the consideration transferred by the acquirer is calculated consistently with the requirements of FRS 102 *Share-based Payment*. The portion attributable to past services, which is included in the measurement of the consideration transferred, is equal to the remaining fair value based measure of the replacement award (or settlement) multiplied by *the ratio of the portion of the vesting period completed to the total vesting period*. (The amount, if any, to be recognised in post-combination profit or loss is the remaining fair value based measure of the replacement award (or settlement) multiplied by the ratio of the future vesting period to the total vesting period.) The vesting period is the period during which all the specified vesting conditions are to be satisfied. Vesting conditions are defined in FRS 102. Paragraphs A104-A109 illustrate the requirements.	If the acquirer is obligated to replace the acquiree's awards, all or a portion of the acquirer's replacement awards are included in the measurement of the consideration transferred by the acquirer. However, the amount included in the measurement of the consideration transferred by the acquirer is calculated consistently with the requirements of FASB Statement No. 123 (revised 2004) *Share-Based Payment*. The portion attributable to past services, which is included in the measurement of the consideration transferred, is equal to the remaining fair value based measure of the replacement award (or settlement) multiplied by *the ratio of the past service period to the total service period* (that is, the period that begins with the service inception date for the award of the acquiree and ends with the service completion date for the replacement award). The past service period ends and the future service period begins on the acquisition date. (The amount, if any, which represents compensation expense to be recognised in post combination consolidated net income is the remaining fair value based measure of the replacement award (or settlement) multiplied by the ratio of the future service period to the total service period.)

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Paragraph Reference	**Proposed guidance**	**FASB's guidance**
		The requisite service period of awards issued by the acquirer shall reflect any explicit, implicit, and derived service periods (consistent with the requirements of SFAS 123(R)). Paragraphs A104-A109 illustrate the FASB's requirements.
Appendix C—Continuing authoritative guidance	Appendix C contains guidance and transition provisions that have been carried forward or adapted from the sources. Appendix C differs from the FASB's Appendix C.	Appendix C contains guidance and transition provisions that have been carried forward or adapted from FASB sources. Appendix C differs from the CCDG's Appendix C.
Appendix D—Amendments	Appendix D contains the amendments to FRSs that would result from the proposed FRS.	Appendix D contains the amendments to FASB standards that would result from the proposed Statement.
Appendix E—Fair value measurement / Related literature analysis	Appendix E provides guidance for measuring fair value. The FASB did not provide fair value measurement guidance in this appendix because the FASB's Exposure Draft refers to the FASB Exposure Draft *Fair Value Measurements,* which was published on 23 June 2004. That Exposure Draft provides the guidance that was provided in Appendix E.	The FASB's Appendix E addresses the impact of this Exposure Draft on authoritative accounting literature included in categories (b), (c), and (d) in the GAAP hierarchy and the relationship between this Exposure Draft and related SEC literature. As the authoritative guidance for entities under its jurisdiction was provided, there is no need for an equivalent appendix.

Table of Concordance

This table shows how the contents of FRS 103 and the Exposure Draft correspond. Paragraphs are treated as corresponding if they address broadly the same matter even though the guidance may differ.

FRS 103 paragraph	Exposure Draft paragraph	FRS 103 paragraph	Exposure Draft paragraph
1	1	54-55	51
2	2	57	59-61
3	2(a)-(c)	58-60	55-57
4	4	61-64	62-68
5	5	65	46
6	6	66	71
7	7	67	72
8	None	68	73(a)
9	None	69	74
10	C7	70	74
11	C8	71	73(b)
12	C9	72	75
13	C10	73	76
14	8	74	77
15	None	75	80
16	9	76	80(e)
17	10	77	81
18	None	78-85	82-87
19	None	86-87	88
20	13, 14	Appendix A	3
21	12	IE (A)	A37-A41
22	16	IE (B)	A42-A49
23	15	IE (C)	A50, A51
24	19	IE (D)	A52-A55
25	17	IE (E)	A56-A61
26	28	Example 1	A49(a)
27	Appendix E	Example 2	A49(b)
28	28	Example 3	A49(c)
29-31	27	Example 4	A49(d)
32-35	25, 26	Example 5	Example 20
36-44	None	Example 6	None
45-46	40, 41	Example 7	Example 11
47-50	37	Example 8	None
51-53	49, 50	Example 9	None