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cutting through complexity

Business combination accounting for interests in a joint operation

Proposal seeks an end to confusion

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IN THE HEADLINES

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> "The proposal increases the focus on the (often difficult) judgement as to whether a transaction represents the acquisition of an interest in a business or a collection of assets."

– Jimmy Daboo
KPMG's global head of Energy & Natural Resources – Audit

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

There has been some confusion regarding whether the business combinations standard applies when an entity acquires an interest in a joint operation that meets the definition of a business under IFRS 3 *Business Combinations*.

A key sector that has become associated with the issue is Energy & Natural Resources.

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

Business combination accounting	Applied	Not applied
Recognition of goodwill	✓	✗
Recognition of deferred tax on uplift of asset carrying amounts to fair value	✓	✗

In response to the diversity in practice, on 13 December 2012 the IASB issued Exposure Draft *Acquisition of an Interest in a Joint Operation* (the ED).

Proposal seeks an end to confusion

The proposal would require business combination accounting to be applied to acquisitions of interests in a joint operation by joint controllers. The accounting is illustrated in the following example.

Fact pattern

- Company P acquires a 50% interest in an existing joint operation (JO) for cash of 1,100, and incurs transaction costs of 20.
- JO operates a producing oil field and is considered by P to be a business.
- The fair value of JO's identifiable net assets is 2,000. This includes a fair value uplift of 500 on an asset that has a nil tax base; the relevant tax rate is 20%.

How the proposal applies

In accordance with the proposal, P would recognise the following entries.

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

Judgement still required

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

Definition

A 'joint operation' is a joint arrangement in which the joint controllers have rights to the assets, and obligations for the liabilities, relating to the arrangement. This is a new term introduced by IFRS 11 *Joint Arrangements* (effective on 1 January 2013). Click here to find out more.

Adoption and comments

The ED does not propose an effective date, but indicates that early adoption would be allowed. Prospective application is proposed. Comments are due to the IASB by 23 April 2013.

Find out more

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

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