SOME ACCOUNTING ASPECTS OF BUSINESS COMBINATION

ASPECTE PRIVIND COMBINĂRILE DE ÎNTREPRINDERI

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Abstract*: Business combination is an important issues of present period. A business combination is a transaction or event in which an acquirer obtains control of one or more businesses. 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 a return directly to investors or other owners, members or participants.*

Key words**:** *acquier, acquiree, reporting, parent, subsidiary.*

INTRODUCTION

A business combination is the bringing together of separate entities or businesses into one reporting entity. The result of nearly all business combinations is that one entity, the acquirer, obtains *control* of one or more other businesses, the acquiree.

Necesity of a business combination may be structured in a variety of ways for legal, taxation or other reasons. It may involve:

- the purchase by an entity of the equity of another entity;
- the purchase of all the net assets of another entity:
- the assumption of the liabilities of another entity;
- or the purchase of some of the net assets of another entity that together form one or more businesses.

It may be effected by the issue of equity instruments, the transfer of cash, cash equivalents or other assets, or a combination thereof. The transaction may be between the shareholders of the combining entities or between one entity and the shareholders of another entity. It may involve the establishment of a new entity to control the combining entities or net assets

transferred, or the restructuring of one or more of the combining entities.

A business combination may result in a parent-subsidiary relationship in which the acquirer is the *parent* and the acquiree a *subsidiary* of the acquirer.

Also a business combination may involve the purchase of the net assets, including any goodwill, of another entity rather than the purchase of the equity of the other entity. Such a combination does not result in a parent-subsidiary relationship.

METHOD OF ACCOUNTING

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

The purchase method views a business combination from the perspective of the combining entity that is identified as the acquirer. The acquirer purchases net assets and recognises the assets acquired and liabilities and contingent liabilities assumed, including those not previously recognised by the acquiree. The measurement of the acquirer's assets and liabilities is not affected by the transaction, nor are any additional assets or liabilities of the acquirer recognised as a result of the transaction, because they are not the subjects of the transaction.

RESULTS AND DISCUTIONS

APPLICATION OF THE PURCHASE METHOD

Applying the purchase method involves the following steps:

1) identifying an acquirer;

2) measuring the cost of the business combination;

3) allocating, at the acquisition date, the cost of the business combination to the assets acquired and liabilities and contingent liabilities assumed.

1. Identifying the acquirer

An acquirer shall be identified for all business combinations. The acquirer is the combining entity that obtains
control of the other combining entities or businesses.

Because the purchase method views a business combination from the acquirer's perspective, it assumes that one of the parties to the transaction

can be identified as the acquirer.

Control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities. A combining entity shall be presumed to have obtained control of another combining entity when it acquires more than one-half of that other entity's voting rights, unless it can be demonstrated that such ownership does not constitute control.

Even if one of the combining entities does not acquire more than one-half of the voting rights of another combining entity, it might have obtained control of that other entity if, as a result of the combination, it obtains:

a) power over more than one-half of the voting rights of the other entity by virtue of an agreement with other investors;

b) power to govern the financial and operating policies of the other entity under a statute or an agreement;

c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body of the other entity;

d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body of the other entity.

Sometimes it may be difficult to identify an acquirer, there are usually indications that one exists.

For example:

a) if the fair value of one of the combining entities is significantly greater than that of the other combining entity, the entity with the greater fair value is likely to be the acquirer;

b) if the business combination is effected through an exchange of voting ordinary equity instruments for cash or other assets, the entity giving up cash or other assets is likely to be the acquirer;

c) 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 so to dominate is likely to be the acquirer.

In a business combination effected through an exchange of equity interests, the entity that issues the equity interests is normally the acquirer. However, all pertinent facts and circumstances shall be considered to determine which of the combining entities has the power to govern the

financial and operating policies of the other entity (or entities) so as to obtain benefits from its (or their) activities. In some business combinations, commonly referred to as reverse acquisitions, the acquirer is the entity whose equity interests have been acquired and the issuing entity is the acquiree. This might be the case when, for example, a private entity arranges to have itself 'acquired' by a smaller public entity as a means of obtaining a stock exchange listing. Although legally the issuing public entity is regarded as the parent and the private entity is regarded as the subsidiary, the legal subsidiary is the acquirer if it has the power to govern the financial and operating policies of the legal parent so as to obtain benefits from its activities.

Commonly the acquirer is the larger entity; however, the facts and circumstances surrounding a combination sometimes indicate that a smaller entity acquires a larger entity.

When a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination shall be identified as the acquirer on the basis of the evidence available. Similarly, when a business combination involves more than two combining entities, one of the combining entities that existed before the combination shall be identified as the acquirer on the basis of the evidence available.

Determining the acquirer in such cases shall include a consideration of, amongst other things, which of the combining entities initiated the combination and whether the assets or revenues of one of the combining entities significantly exceed those of the others.

2. Cost of a business combination

The acquirer shall measure the cost of a business combination as the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree; plus any costs directly attributable to the business combination.

CBC=LI+DC, where:

CBC - cost of a business combination;

LI - liabilities incurred or assumed, and equity instruments issued by

the acquirer, in exchange for control of the acquiree;

DC - costs directly attributable to the business combination.

The acquisition date is the date on which the acquirer effectively obtains control of the acquiree. When this is achieved through a single exchange transaction, the date of exchange coincides with the acquisition date. However, a business combination may involve more than one exchange transaction, for example when it is achieved in stages by successive share purchases.

When this occurs:

a) the cost of the combination is the aggregate cost of the individual transactions; and

b) the date of exchange is the date of each exchange transaction, whereas the acquisition date is the date on which the acquirer obtains control of the acquiree.

Assets given and liabilities incurred or assumed by the acquirer in exchange for control of the acquiree are required to be measured at their fair values at the date of exchange. Therefore, when settlement of all or any part of the cost of a business combination is deferred, the fair value of that deferred component shall be determined by discounting the amounts payable to their present value at the date of exchange, taking into account any premium or discount likely to be incurred in settlement.

The published price at the date of exchange of a quoted equity instrument provides the best evidence of the instrument's fair value and shall be used, except in rare circumstances. Other evidence and valuation methods shall be considered only in the rare circumstances when the acquirer can demonstrate that the published price at the date of exchange is an unreliable indicator of fair value, and that the other evidence and valuation methods provide a more reliable measure of the equity instrument's fair value. The published price at the date of exchange is an unreliable indicator only when it has been affected by the thinness of the market. If the published price at the date of exchange is an unreliable indicator or if a published price does not exist for equity instruments issued by the acquirer, the fair value of those instruments could, for example, be estimated by reference to their proportional interest in the fair value of the acquirer or by reference to the proportional interest in the fair value of the acquiree obtained, whichever is the more clearly evident. The fair value at

the date of exchange of monetary assets given to equity holders of the acquiree as an alternative to equity instruments may also provide evidence of the total fair value given by the acquirer in exchange for control of the acquiree. In any event, all aspects of the combination, including significant factors influencing the negotiations, shall be considered.

The cost of a business combination includes liabilities incurred or assumed by the acquirer in exchange for control of the acquiree. Future losses or other costs expected to be incurred as a result of a combination are not liabilities incurred or assumed by the acquirer in exchange for control of the acquiree, and are not, therefore, included as part of the cost of the combination.

The cost of a business combination includes any costs directly attributable to the combination, such as professional fees paid to accountants, legal advisers, valuers and other consultants to effect the combination. General administrative costs, including the costs of maintaining an acquisitions department, and other costs that cannot be directly attributed to the particular combination being accounted for are not included in the cost of the combination: they are recognised as an expense when incurred.

The costs of arranging and issuing financial liabilities are an integral part of the liability issue transaction, even when the liabilities are issued to effect a business combination, rather than costs directly attributable to the combination. Therefore, entities shall not include such costs in the cost of a business combination. In accordance with IAS 39, such costs shall be included in the initial measurement of the liability.

Similarly, the costs of issuing equity instruments are an integral part of the equity issue transaction, even when the equity instruments are issued to effect a business combination, rather than costs directly attributable to the combination. Therefore, entities shall not include such costs in the cost of a business combination. In accordance with IAS 32 *Financial instruments: presentation*, such costs reduce the proceeds from the equity issue.

3. Allocating the cost of a business combination to the assets acquired and liabilities and contingent liabilities assumed

The acquirer shall, at the acquisition date, allocate the cost of a business combination by recognising the acquiree's identifiable assets,

liabilities and contingent liabilities that satisfy the recognition criteria at their fair values at that date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Non-current assets held for sale and discontinued operations*, which shall be recognised at fair value less costs to sell. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities so recognised shall be accounted.

The acquirer shall recognise separately the acquiree's identifiable assets, liabilities and contingent liabilities at the acquisition date only if they satisfy the following criteria at that date:

a) in the case of an asset other than an *intangible asset*, it is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be measured reliably;

b) in the case of a liability other than a contingent liability, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and its fair value can be measured reliably;

c) in the case of an intangible asset or a contingent liability, its fair value can be measured reliably.

The acquirer's income statement shall incorporate the acquiree's profits and losses after the acquisition date by including the acquiree's income and expenses based on the cost of the business combination to the acquirer.

Application of the purchase method starts from the acquisition date, which is the date on which the acquirer effectively obtains control of the acquiree. Because control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities, it is not necessary for a transaction to be closed or finalised at law before the acquirer obtains control. All pertinent facts and circumstances surrounding a business combination shall be considered in assessing when the acquirer has obtained control.

Because the acquirer recognises the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria at their fair values at the acquisition date, any minority interest in the acquiree is stated at the minority's proportion of the net fair value of those items.

CONCLUSION

If an entity obtains control of one or more other entities that are not businesses, the bringing together of those entities is not a business combination. When an entity acquires a group of assets or net assets that does not constitute a business, it shall allocate the cost of the group between the individual identifiable assets and liabilities in the group based on their relative fair values at the acquisition date.

An acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of business combinations that were effected:

a) during the period;

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

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