FA Module 17: Business combinations (overview)

(The attached PDF file has better formatting.)

Reading: chapter 15 §6 business combinations, *excluding* sub-sections

- 6.1 (pooling of interests and purchase methods),
- 6.2.2 (recognition and measurement of contingent liabilities),
- 6.7 (additional issues in business combinations that impair comparability) (all subsections are excluded)

The pooling of interests has not been used for many years. The textbook discusses it because it still affects the financial statements of some firms.

Contingent liabilities are relevant in some scenarios but are not important for most financial accounting.

Business combinations where the investor has control over the investee (often measured at 50% or more of the voting shares) require consolidated financial statements, with the fair values of the investee's assets and liabilities added to the book values of the investor's assets and liabilities.

The excess of the purchase price over the fair values of the investee's identifiable assets and liabilities is recognized as goodwill on the investor's balance sheet. The textbook gives two goodwill methods (partial and full goodwill), with their effects on shareholders' equity and financial ratios.

The portion of the investee not purchased by the investor is non-controlling (minority) interest, which differs for the full goodwill method vs the partial goodwill method.

The textbook explains the differences between mergers, acquisitions, consolidations, and special purpose entities (called variable interest entities by IFRS). Special purpose entities are used by many firms for leased assets, securitization of assets, and structured securities. Some large insurers and reinsurers use special purpose entities to issue catastrophe bonds.

Final exam problems give book values and fair values of the investor's and the investee's assets and liabilities for a less than 100% consolidation and derive

- the consolidated financial statements
- the goodwill asset (partial and full)
- the non-controlling (minority) interest

Upstream sales and downstream sales apply to consolidation just as they apply to the equity method.

The GAAP procedure for goodwill impairment has been rescinded by the FASB; only the IFRS procedure is tested on the final exam for this course.