

Advanced Group Accounting (RIKA)

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Self-Study Exercises Lecture Block 2: Acquisition Method

Exercise 1: Business Combinations and Goodwill

a) Goodwill without taxes:

Zeller	0%
Purchase Price	€ 75,000
- Revalued equity	$\begin{aligned} & \text{€2,000 (cash) + €3,000 (acc/re) + €5,000} \\ & \text{(inventory) + €23,000 (plant assets) =} \\ & \underline{\text{€33,000}} \\ & \\ & \text{€3,000 (current liabilities) + €7,000 (bonds) =} \\ & \text{- } \underline{\text{€10,000}} \\ & \\ & \text{= } \underline{\text{33,000} - \text{10.000}} \\ & \text{= } \underline{\text{23,000}} \end{aligned}$
= Zeller's goodwill	€52,000

Zeller	0%
Purchase Price	€ 75,000
- Revalued equity	$\begin{aligned} & 20,000 + 3,000 \text{ (revaluation)} \\ & \underline{\text{= } 23,000} \end{aligned}$
= Zeller's goodwill	€52,000

b) Goodwill with taxes, 30% tax rate

Zeller	30%
Purchase Price	€ 75,000
- Revalued equity	= <u>23,000</u>
+ Deferred tax liabilities	€3000 * 0.3 = <u>900</u>
= Zeller's goodwill	€52,900

c) Economic interpretation:

Because there is no revaluation in the tax accounts, the uncovering of hidden reserves in Zeller's PP&E creates a deferred tax liability (IFRS amount is larger than the tax amount). This follows as in future periods, the depreciation for tax purposes will be smaller than the depreciation shown in the IFRS financial statements. Because of the lower depreciation, the taxable income and, consequently, the tax burden will be higher than implied by IFRS earnings before tax. The deferred tax liability captures this future tax "disadvantage" (relative to the tax burden implied by the IFRS financial statements without deferred taxes).

When the transaction gives rise to a (higher) deferred tax liability and the purchase price remains constant, the company needs to expect greater synergies from the transaction to justify the purchase price. This follows as these higher synergies need to "make up" for the tax burden that results from the missing depreciation (for tax purposes) on the fair value adjustments.

Exercise 2: Deferred Taxes

a)

	Carrying amount at the date of acquisition	Adjustment to fair value	Fair value at the date of acquisition
Intangible assets (brand)	-	8	8
Other assets	40	6	46
Cash	20	0	20
Deferred tax liability	-	(5.6)	(5.6)
Debt	(20)	-	(20)
= Revalued equity	40	8.4	48.4

Tax Rate:

$$(8 + 6) * x = 5.6$$

$$14 * x = 5.6$$

$$x = 0.4 = 40\%$$

b) Goodwill

Purchase Price	40
Revalued Equity	48.4
= Gain on Bargain Purchase	8.4

c) Assumption: 30% tax rate

	Carrying amount at the date of acquisition	Adjustment to fair value	Fair value at the date of acquisition
Intangible assets (brand)	-	8	8
Other assets	40	6	46
Cash	20	0	20
Deferred tax liability	-	(4.2)	(4.2)
Debt	(20)	-	(20)
= Revalued equity	40	9.8	49.8

Exercise 3: Non-controlling interest

1. Determine the non-controlling interest and goodwill at the acquisition date (as the proportionate share of revalued net assets).

Analysis	<u>Proportional share of net assets</u>
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Equity	$42,000 \text{ (capital)} + 2,000 \text{ (RE)} + 20,000 \text{ (Equipment)} + 10,000 \text{ (inventory)}$ $= \underline{74,000}$
Deferred tax liabilities	$20,000 * 30\% \text{ (Equipment)} + 10,000 * 30\% \text{ (inventory)} = \underline{9,000}$
Revalued Equity	$= (74,000 - 9,000) = \underline{65,000}$
Consideration transferred	$= \underline{45,000}$
NCI	$40\% * 65,000 =$ $\underline{26,000}$
Goodwill	$(45,000 + 26,000) - 65,000 =$ $\underline{6,000}$

2. Determine the non-controlling interest and goodwill at the acquisition date (full fair value).

$$45.000 = 60\% \rightarrow 75.000 = 100\%$$

Analysis	<u>Fair Value</u>
Revalued Equity	$= \underline{65,000}$
Consideration transferred	$= \underline{45,000}$
NCI	$40\% * 75,000 =$ $\underline{30,000}$
Goodwill	$(45,000 + 30,000) - 65,000 =$ $\underline{10,000}$