Grant Thornton

Adviser alert—*Navigating the accounting for business combinations – Applying IFRS 3 in practice*

December 2011

Overview

The Grant Thornton International IFRS team has published a new guide, *Navigating the accounting for business combinations—Applying IFRS 3 in practice*. This publication is a guide to assist management with the application of IFRS 3 *Business Combinations*. IFRS 3 was revised in January 2008, as was IAS 27 *Consolidated and Separate Financial Statements;* these two standards apply to business combinations occurring on or after July 1, 2009. The revised standards made major changes to accounting for business combinations and for changes in ownership interests in subsidiaries and some related items.

As a result of the amendments, this guide aims to assist management in:

- planning and negotiating the terms of the business combinations— identifying how alternative deal strategies can affect an acquirer's reported results and financial position;
- preparing to report the effects of the transaction—by noting key information requirements, accounting policy options and areas where specialist advice might be needed; and
- applying IFRS 3—by summarizing the requirements, using extensive examples to explain their application and highlighting possible problem areas.

The guide is split into four areas as follows:

1 An overview of key changes.

2 A step-by-step summary of IFRS 3, using examples to explain key concepts and illustrate their application.

3 A summary of practical steps that an acquirer needs to perform when preparing its consolidated financial statements after a business combination.

4 A summary of disclosure requirements, including an illustrative disclosure, and a comparison of the provisions of IFRS 3 and the previous version of the standard.

Resources

Navigating the accounting for business combinations—Applying IFRS 3 in practice follows this *Adviser alert.*

Please note that this publication has not been modified from its original version.

About Grant Thornton in Canada

Grant Thornton LLP is a leading Canadian accounting and advisory firm providing audit, tax and advisory services to private and public organizations. Together with the Quebec firm Raymond Chabot Grant Thornton LLP, Grant Thornton has approximately 4,000 people in offices across Canada. Grant Thornton LLP is a Canadian member of Grant Thornton International Ltd, whose member firms operate in close to 100 countries worldwide.

We have made every effort to ensure information in this publication is accurate as of its issue date. Nevertheless, information or views expressed herein are neither official statements of position, nor should they be considered technical advice for you or your organization without consulting a professional business adviser. For more information about this topic, please contact your Grant Thornton adviser. If you do not have an adviser, please contact us. We are happy to help.

© Grant Thornton LLP. A Canadian Member of Grant Thornton International Ltd. All rights reserved.

Grant Thornton

APPLYING IFRS 3 IN PRACTICE DECEMBER 2011

Navigating the accounting for business combinations

Important Disclaimer:
This document has been developed as an information resource. It is intended as a guide only and the application of its contents to specific situations will depend on the particular circumstances involved. While every care has been taken in its presentation, personnel who use this document to assist in evaluating compliance with International Financial Reporting Standards should have sufficient training and experience to do so. No person should act specifically on the basis of the material contained herein without considering and taking professional advice. Neither Grant Thornton International Ltd, nor any of its personnel nor any of its member firms or their partners or employees, accept any responsibility for any errors it might contain, whether caused by negligence or otherwise, or any loss, howsoever caused, incurred by any person as a result of utilising or otherwise placing any reliance upon this document.

Introduction

Business combinations

Mergers and acquisitions (business combinations) can have a fundamental impact on the acquirer's operations, resources and strategies. For most companies such transactions are infrequent, and each is unique.

IFRS 3 *Business Combinations* (IFRS 3) and IAS 27 *Consolidated and Separate Financial Statements* (IAS 27), were revised in January 2008 and apply to business combinations occurring on or after 1 July 2009. The revised Standards made major changes to business combination accounting and to the accounting for changes in ownership interests in subsidiaries and some related items. The revised requirements, along with the importance of these transactions, make this a challenging area in financial reporting.

Fortunately, the member firms within Grant Thornton International Ltd (Grant Thornton International) – one of the world's leading organisations of independently owned and managed accounting and consulting firms – have gained extensive insights into business combinations and the related accounting requirements. Grant Thornton International, through its IFRS team, develops general guidance that supports its member firms' commitment to high quality, consistent application of IFRS. We are pleased to share these insights by publishing Navigating the Accounting for Business Combinations – Applying IFRS 3 in Practice (the Guide).

Important note

References in the Guide to IFRS 3 and IAS 27 relate to the January 2008 versions of these Standards. Where relevant, the Guide also discusses subsequent amendments to these Standards. The Guide does not cover the Standards on consolidation and related topics published by the IASB in May 2011, particularly IFRS 10 *Consolidated Financial Statements* (which revises IAS 27's control definition) and IFRS 13 *Fair Value Measurement* (which amends the definition of fair value and accompanying guidance). These new Standards are effective for annual periods beginning on or after 1 January 2013.

Using the guide

The aims of the Guide are to assist management in:

- planning and negotiating the terms of the business combinations – identifying how alternative deal strategies can affect an acquirer's reported results and financial position
- preparing to report the effects of the transaction – by noting key information requirements, accounting policy options and areas where specialist advice might be needed
- applying IFRS 3 – by summarising the requirements, using extensive examples to explain their application and highlighting possible problem areas.

The Guide is organised as follows:

- **Section A** provides an overview of key changes brought about by IFRS 3, the key steps in applying the acquisition method, how alternative deal structures can affect the acquirer's results and financial position, and insights on preparing to apply IFRS 3 efficiently and avoiding unwelcome surprises at year-end
- **Section B** sets out a step-by-step summary of IFRS 3, using examples to explain key concepts and illustrate their application. It also includes discussions of how an acquirer deals with situations where the accounting for the business combination is not complete at the end of the reporting period in which the business combination occurred
- **Section C** summarises practical steps that an acquirer needs to perform when preparing its consolidated financial statements after a business combination. It considers IFRS 3's provisions on the post-combination accounting for certain assets acquired and liabilities assumed in a business combination. This Section also discusses related requirements for subsequent changes in a parent's ownership interest in a subsidiary when control is maintained and when control is lost
- **Appendices** include a summary of IFRS 3's disclosure requirements, including an illustrative disclosure, and a comparison of the provisions of IFRS 3 and the previous version of the Standard.

Grant Thornton International Ltd
December 2011

Contents

Introduction 1

A. Overview 1

1 Headline changes in IFRS 3 Business Combinations 1

2 The acquisition method – at a glance 2

3 Effect of deal terms on the accounting for business combinations 3

4 Reporting business combinations and avoiding surprises 5

B. The Acquisition Method – Step by step 6

1 Identifying a business combination 7

1.1 Is the investee a 'business'? 8

1.2 Has control been obtained? 11

1.3 Is the business combination within the scope of IFRS 3? 14

1.3.1 Scope of IFRS 3 14

1.3.2 Accounting for common control business combinations outside the scope of IFRS 3 17

2 Identify the acquirer 18

2.1 Reverse acquisitions 20

3 When is the acquisition date? 21

4 Recognising and measuring assets acquired and liabilities assumed 22

4.1 Recognising assets acquired and liabilities assumed as part of the business combination 23

4.1.1 Applying IFRS 3's recognition principles 23

4.1.2 Assets and liabilities requiring specific attention 24

4.1.3 Recognising identifiable intangible assets 25

4.1.4 IFRS 3's guidance on particular intangible assets 29

4.2 How are the assets and liabilities measured? 31

4.2.1 IFRS 3's measurement principle 31

4.2.2 IFRS 3's specific guidance on fair value measurement 34

4.3 Specific recognition and measurement provisions 35

4.3.1 Assets and liabilities subject to specific guidance (exceptions) 35

4.3.2 Recognising and measuring deferred taxes 37

4.4 Classify or designate identifiable assets acquired and liabilities assumed 39

5 Recognising and measuring any NCI 40

5.1 NCI measurement options 41

5.2 Determining the fair value of NCI 41

6 Consideration transferred 42

6.1 Contractual purchase price 43

6.1.1 Contingent consideration 43

6.1.2 Transfer of acquirer's assets 45

6.1.3 Share-for-share exchanges and combinations of mutual entities 45

6.1.4 Business combinations with no consideration transferred 46

6.2 Adjustments for transactions not part of the business combination 46
6.2.1 Identifying separate transactions 47
6.2.2 Settlement of pre-existing relationships 48
6.2.3 Employee compensation arrangements 50
6.2.4 Acquisition costs 52
6.2.5 Replacement of acquiree share-based payment awards 53
6.2.6 Non-replaced share-based payment awards 56
6.2.7 Contracts to acquire shares from non-selling shareholders 57

7 Recognising and measuring goodwill or a gain from a bargain purchase 59
7.1 Business combination achieved in stages 59
7.2 Determining goodwill or a gain from a bargain purchase 61

8 Initial accounting for the business combination is incomplete at the reporting date 62
8.1 Use of provisional amounts at the reporting date 62
8.2 The measurement period and related adjustments 62

C. Accounting after the acquisition date (selected topics) 64
1 Practical implications for post-combination reporting 65
1.1 General issues 65
1.2 Post-combination reporting for specific items 66

2 Accounting for subsequent changes in ownership interest in a subsidiary 68
2.1 Changes in ownership interest that do not result in loss of control 68
2.2 Accounting for the loss of control of a subsidiary 70

Appendix A – Disclosures under IFRS 3: Understanding the requirements 74
1 General objectives of the disclosure requirements 74
2 Business combinations that require disclosures 74
3 Minimum disclosure requirements 74
3.1 Required disclosures applicable to most business combinations 75
3.2 Specific disclosures for contingent consideration, indemnification assets and contingent liabilities arising from a business combination 76
3.3 Disclosures applicable only to certain business combinations 77

4 Illustrative Disclosure 78
4.1 Significant accounting policy disclosures 78
4.2 Disclosure of the business combination transaction 79

Appendix B – Comparison of IFRS 3 and the previous version of the Standard 82

A. Overview

This section provides a high-level overview of the accounting for business combinations:
- major changes in the accounting requirements of IFRS 3 *Business Combinations*
- the key steps in accounting for a business combination.

It also highlights some practical application issues:
- the accounting effects of the terms and structures of purchase agreements
- planning considerations to avoid accounting surprises.

1 Headline changes in IFRS 3 Business Combinations

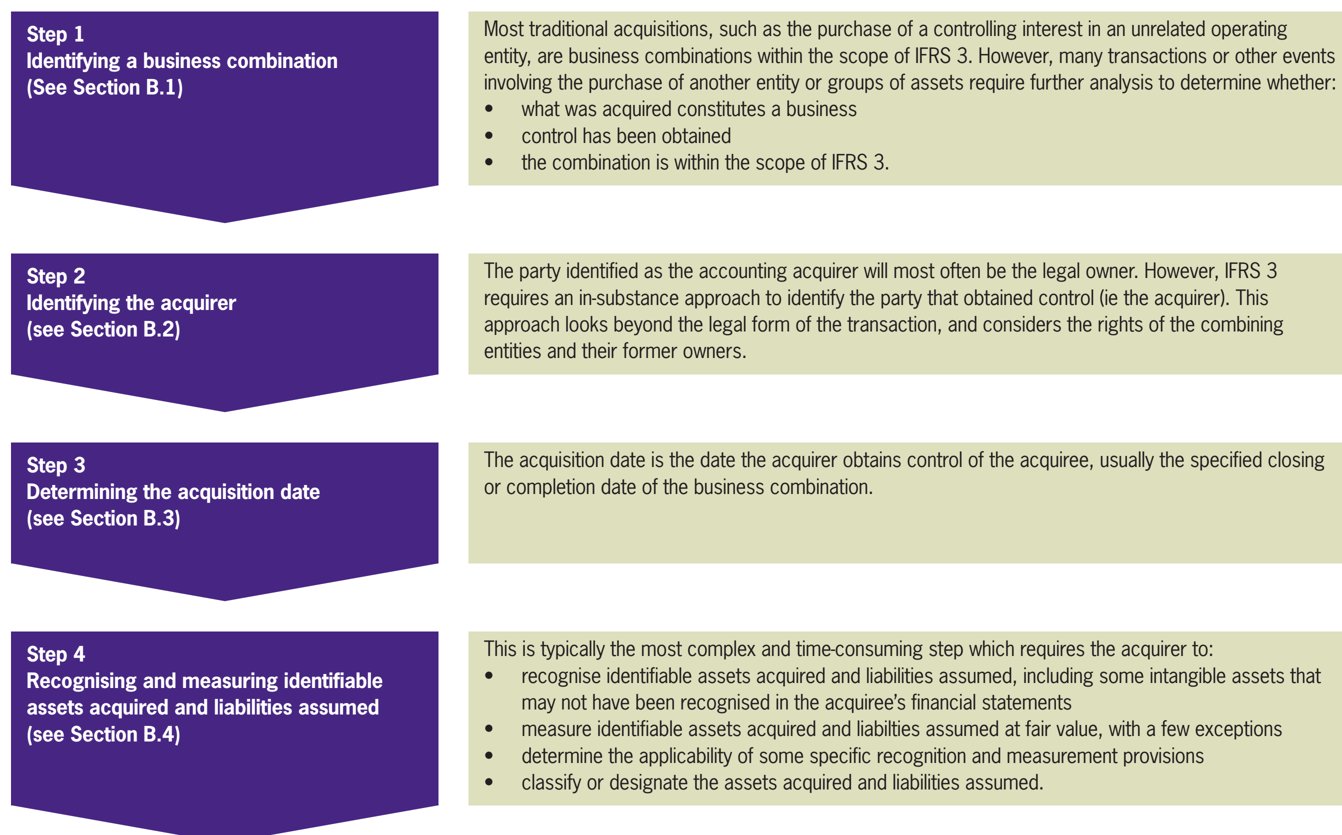
IFRS 3 (as revised in 2008) introduced significant changes in the accounting for business combinations. The key changes are summarised below.

IFRS 3 (as revised in 2008)	Previous requirements
Acquisition costs • recognised as an immediate expense	• included in the cost of the business combination and in the determination of goodwill
Price paid for the acquiree • now referred to as consideration transferred and comprises only amounts transferred in exchange for the assets and liabilties of the acquiree • excludes acquisition costs (see above) but includes contingent consideration (see below) • payments relating to transactions that are not part of the business combination exchange are accounted for separately	• referred to as the purchase price or the cost of the business combination • the aggregate of the: – fair values of assets given, liabilities incurred or assumed and equity instruments issued – costs directly attributable to the business combination
Contingent consideration • recognised and measured at fair value on acquisition date, irrespective of the probablity of an outlow of resources • subsequent changes in contingent consideration classified as a liability usually affect post-combination earnings	• recognised on the acquisition date when outflow of resources is probable and reliably measurable • when recognition criteria are met after the acquisition date, treated as an adjustment to the cost of the combination with a corresponding effect on goodwill
A choice in measuring non-controlling interests (NCI) • acquirer has an option to measure NCI that are present ownership interests either at fair value or at the NCI's proportionate interest in recognised net assets. Other types of NCI are measured at fair value	• all types of NCI are measured at the proportionate interest in recognised net assets

IFRS 3 (as revised in 2008)	Previous requirements
Goodwill formula • goodwill is measured as the excess of: • the sum of: – the fair value of consideration transferred in exchange for the acquiree – any recognised amount of NCI – the fair value of any previously held equity interest (see below) over • the recognised amount of the acquiree's identifiable net assets	• goodwill is measured as the excess of – the cost of the combination over – the acquirer's share of the acquiree's net assets
Calculation of goodwill in business combinations achieved in stages • goodwill is determined on the date the acquirer obtains control • any previously held investment is remeasured to its acquisition date fair value and is included in the goodwill calculation (see above). Any resulting gain or loss from the remeasurement is recognised in earnings	• goodwill is measured at each stage of the combination, using the original cost of each investment and the proportionate fair value of the acquiree's net assets at each stage

2 The acquisition method – at a glance

IFRS 3 establishes the accounting and reporting requirements (known as 'the acquisition method[1]') for the acquirer in a business combination. The key steps in applying the acquisition method are summarised below:



(continued on next page)

1 IFRS 3.5 identifies the steps in applying the acquisition method as 1) identifying the acquirer; 2) determining the acquisition date; 3) recognising and measuring the identifiable assets acquired, the liabilities assumed and any NCI in the acquiree; and 4) recognising and measuring goodwill or a gain from a bargain purchase.

Step	Description
Step 5 **Recognising and measuring any non-controlling interest (NCI)** **(see Section B.5)**	The acquirer has a choice to measure present ownership-type NCI at either fair value or the proportionate interest in the acquiree's recognised identifiable net assets. When making the choice, a number of factors should be considered. The measurement of NCI affects the amount of goodwill and can impact post-combination reported results.
Step 6 **Determining consideration transferred** **(see Section B.6)**	Consideration transferred can include cash and other assets transferred, liabilities incurred and equity interests issued by the acquirer. Some consideration may be deferred or be contingent on future events. In addition, consideration transferred in exchange for the acquired business may be different from the contractual purchase price if the overall transaction includes elements that are not part of the business combination exchange. For example, the following must be accounted for separately from the buisness combination: • acquisition-related costs • the effective settlement of a pre-existing relationship between the acquirer and acquiree • contingent payments that are compensation for future services
Step 7 **Recognising and measuring goodwill or a gain from a bargain purchase** **(see Section B.7)**	Goodwill or gain from a bargain purchase is measured as a residual amount using a formula

Section B discusses the acquisition method in more detail.

3 Effect of deal terms on the accounting for business combinations

The terms and structures of purchase agreements vary extensively and will significantly impact the accounting for the business combination. Although accounting considerations should not dictate the way deals are structured, it is important that management is aware of these interactions. Presented below is a selection of some common deal terms or structures and their related effects on the accounting for the business combination.

Deal terms or structure	Effects on the accounting for the business combination	Further information
Structure of the purchase price: The purchase price may include: • contingent consideration arrangements, such as variations to the ultimate price depending on the future performance of the acquired business	• recognition on the acquisition date at fair value has an immediate effect on the balance sheet (ie directly impacts goodwill and reported amounts of liability or equity) • subsequent changes in the fair value of any contingent consideration liability will usually affect post-combination earnings	Section B.6.1.1
• contingent payment arrangements with selling employee-shareholders who remain employees of the acquired business (eg earn-out agreements)	• accounted for based on their substance and may need to be treated (wholly or partly) as compensation for future services rather than payment for the business acquired • compensation payments are recognised as remuneration expense in the period when services are rendered	Section B.6.2.3
• transfer of acquirer's assets	• the assets are remeasured at fair value on the acquisition date and form part of consideration transferred • any remeasurement gain or loss is recognised immediately in earnings	Section B.6.1.2

Deal terms or structure	Effects on the accounting for the business combination	Further information
Arrangements for the payment of acquisition costs • the parties may arrange that transaction costs are paid by the vendor which may or may not be reimbursed by the acquirer	• reimbursement of acquisition costs is recognised as an immediate expense • if costs paid by the vendor are not reimbursed directly by the acquirer, a portion of the contractual price is treated as in-substance reimbursement and excluded from consideration transferred	Section B.6.2.4
Pre-existing relationship between the acquirer and the acquiree The parties may have an existing: • contractual arrangement (eg supplier and customer relationship) • non-contractual relationship (eg litigation)	• the business combination is treated as an effective settlement of the pre-existing relationship, which is in turn accounted for as a separate transaction • any gain or loss arising from such settlement is recognised immediately in earnings • the amount deemed to relate to the settlement is excluded from consideration transferred	Section B.6.2.2
Replacement or continuation of an acquiree's share-based payment awards The acquirer may: • replace the acquiree's share-based payment awards	• consideration transferred includes the value of the replacement awards attributable to pre-combination service • amount relating to post-combination service is recognised as compensation expense over the vesting period	Section B.6.2.5
• continue the acquiree's share based payment awards without changes	• the value of any vested awards is recognised as part of NCI with a consequent effect on goodwill • NCI is increased by the value of unvested awards attributable to pre-combination service • amount relating to post-combination service is recognised as compensation expense over the vesting period	Section B.6.2.6
Contracts to acquire shares from non-selling shareholders at a later date • these contracts may be negotiated at or around the same time as the business combination	• a contract that in substance represents the purchase of the underlying acquiree shares is accounted for as part of the business combination, as a deferred or contingent consideration arrangement. Contracts that are in substance arrangements to purchase NCI shares at a future date are accounted for separately.	Section B.6.2.7

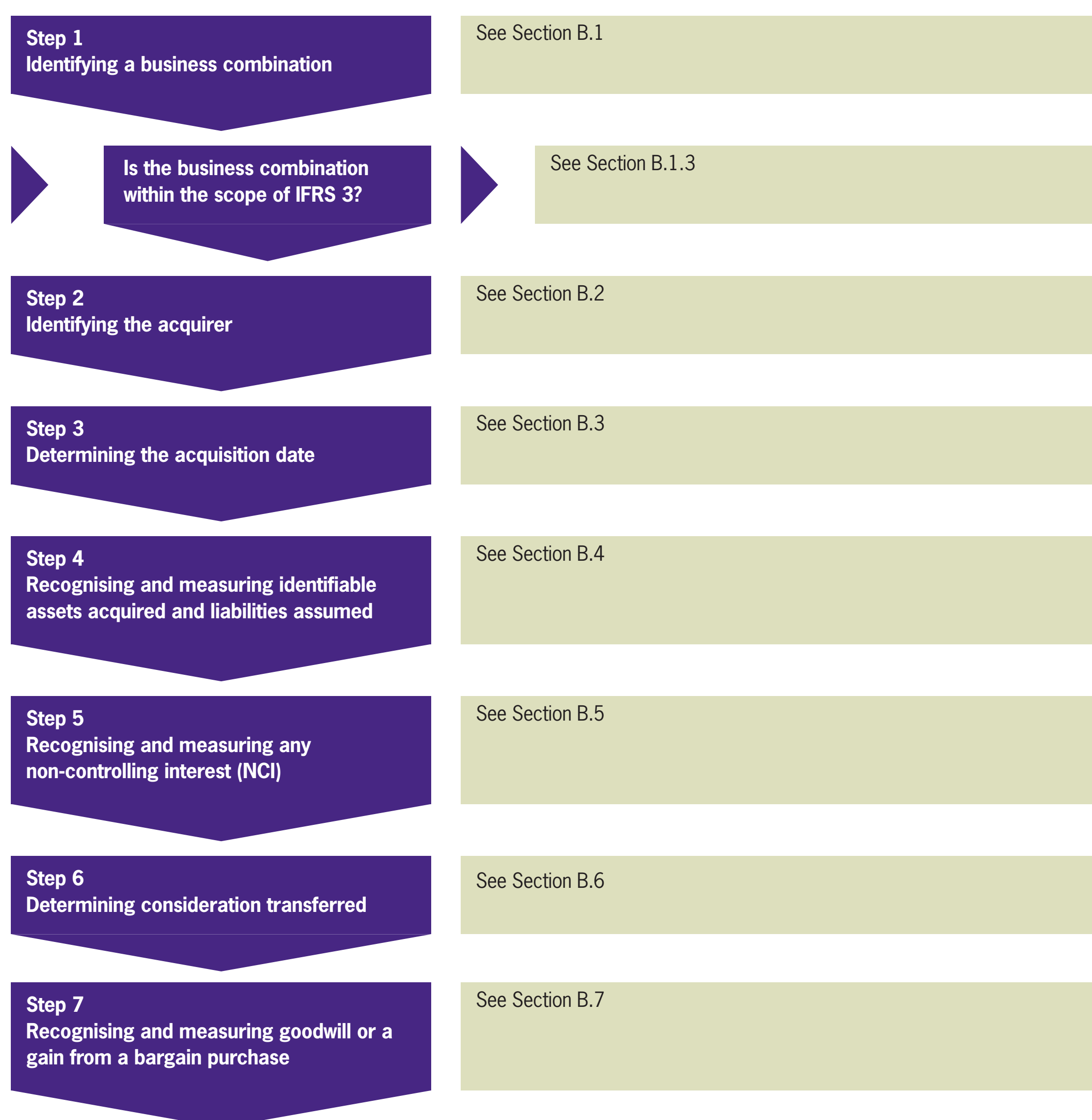
4 Reporting business combinations and avoiding surprises

Reporting a business combination is a significant exercise, often requiring considerable time and effort. Presented below are selected planning considerations and suggestions on how they can be implemented.

Matters to consider (planning considerations)	Implementation hints	Further information
During the deal negotiation: • understand the accounting effects of deal terms and structure • identify related transactions or other elements that may require separate accounting	• involve finance/accounting personnel in the early stages of the negotiation to assist in evaluating the accounting effects of the deal terms	Section A.3
Applying the acquisition method: • identifying intangible assets: these assets are more challenging to identify as they are often not recognised in the acquiree's financial statements	• consider various sources of information that may provide valuable inputs in detecting intangible assets: – the acquiree's operations – results of due diligence – acquiree's website and other investor-related communication	Section B.4.1.3
• valuation process: fair values of certain items may not be readily available and may require complex estimates	• implement a robust process in developing fair value estimates • assistance from valuation experts may be required if the acquirer does not have the relevant expertise and experience in valuation	Section B.4.2
• determining consideration transferred: need to consider the effects of transactions that are not part of the business combination under IFRS 3	• consider the commercial reasons for each material element of the transaction, who initiated it and its timing	Section B.6.2
• making an accounting policy choice in certain areas, for example: – measurement of NCI – classification and designation of assets acquired and liabilities assumed	• assess the implications of the choices available, including the immediate effect on the acquisition date; the relative ease of applying a particular choice; the subsequent accounting requirements; and the related impact on post-combination earnings	Sections B.5.1 and B.4.4
Determining the need for outside experts • some entities enter into frequent business combination transactions but for others, these are one-time events. The entity may then not have the adequate resources to apply IFRS 3's requirements	• assess the skills and relevant experience of the finance team to determine whether external consultants are required • this decision should be made early in the process to ensure the quality of financial information and avoid unnecessary delays	
Timely completion of the accounting for the business combination • the accounting for a business combination, including all the required disclosures, should be completed within the measurement period (not to exceed 12 months after the acquisition date). Depending on the complexity of the business combination, this time frame may be challenging	• plan early • identify all the relevant requirements, gather required information and assess the needed resources • engage external consultants as necessary and agree on scope of work, due dates and deliverables • implement a project plan and monitor progress of activities regularly	Section B.8

B. The acquisition method – step by step

Accounting for a business combination under IFRS 3's acquisition method can be broken down into a step-by-step process. This Section provides a roadmap through these steps, using examples to illustrate key requirements. The following flowchart summarises the roadmap and cross refers to the relevant guidance for each step.



This Section also covers IFRS 3's guidance on situations where the initial accounting for the business combination is incomplete at the reporting date (see Section B.8).

1 Identifying a business combination

Step 1
Identifying a business combination

IFRS 3 refers to a 'business combination' rather than more commonly used phrases such as takeover, acquisition or merger. A business combination is defined as a transaction or other event in which an acquirer (an investor entity) obtains control of one or more businesses.

An entity's purchase of a controlling interest in another unrelated operating entity will usually be a business combination (see Example B.1 below). However, a business combination may be structured, and an entity may obtain control of that structure, in a variety of ways. Therefore, identifying a business combination transaction requires the determination of whether:

- what is acquired constitutes a 'business' – see Section B.1.1
- control has been obtained – see Section B.1.2.

Business combination accounting does not apply to the acquisition of an asset or asset group that does not constitute a business. The accounting for an asset purchase differs from business combination accounting in several key respects, some of which are summarised below:

Accounting topic	Business combination	Asset purchase
Recognition of identifiable assets and liabilities	• measured at fair value	• total cost is allocated to individual items based on relative fair values
Goodwill or gain on bargain purchase	• recognised as an asset (goodwill) or as income (gain on bargain purchase)	• not recognised
Transaction costs	• expensed when incurred	• typically capitalised
Deferred tax on initial temporary differences	• recognised as assets and liabilities	• not recognised unless specific circumstances apply

Alternatively, if an entity acquires an interest in a business entity but does not obtain control, it applies IAS 28 *Investments in Associates* (IAS 28), IAS 31 *Joint Ventures* (IAS 31)[2] or IFRS 9/IAS 39 *Financial Instruments*, depending on the level of influence the investor can exert over the investee's financial and operating policies.

2 In May 2011, the IASB published IFRS 11 *Joint Arrangements* which supersedes IAS 31. It aligns more closely the accounting by the investors with their rights and obligations relating to the joint arrangement and classifies such arrangements as either joint ventures or joint operations. In addition, IAS 31's option of using proportionate consolidation for joint ventures has been eliminated. IFRS 11 instead requires that an investor with joint control applies IAS 28's equity accounting method to arrangements classified as joint ventures, and recognises its share of assets, liabilities, income and expense for joint operations. IAS 28's scope has been amended accordingly. IFRS 11 is effective for annual periods beginning on or after 1 January 2013. Early application is permitted but only if IFRS 10 *Consolidated Financial Statements*, IFRS 12 *Disclosure of Interests in Other Entities*, IAS 27 (Revised) *Separate Financial Statements* and and IAS 28 (Revised) *Investments in Associates and Joint Ventures* are also adopted at the same time.

Example B.1 – Straightforward business combination

Company T is a clothing manufacturer and has traded for a number of years. The company produces a wide range of clothing and employs a workforce of designers, machine operators, quality checkers, and other operational, marketing and administrative staff. It owns and operates a factory, warehouse and machinery and holds raw material inventory and finished products.

On 1 January 2011, Company A pays CU[3]2,000 to acquire 100% of the ordinary voting shares of Company T. No other type of shares has been issued by Company T. On the same day, the three main executive directors of Company A take on the same roles in Company T.

Analysis:

In this case, it is clear that Company T is a business. It operates a trade with a variety of assets that are used by its employees in a number of related activities. These assets and activities are necessarily integrated in order to create and sell the company's products. Company A obtains control on 1 January 2011 by acquiring 100% of the voting rights.

1.1 Is the investee a 'business'?

This may seem an obvious or intuitive question. It is however one of the most commonly asked application questions in practice, in part because of the significant differences between accounting for an asset purchase and accounting for a business combination discussed above. IFRS 3 includes both a definition of a business and quite detailed supporting guidance (at IFRS 3.B7-B12).

IFRS 3 Definition of a business

"an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants"

IFRS 3 goes on to explain that a business consists of inputs and processes applied to those inputs that have the ability to create outputs. Determining whether an investee comprises a business or an asset group is often straightforward, but not always. The supporting guidance in IFRS 3.B7-B12 clarifies that:

- the assessment of whether the integrated set of activities and assets are capable of being managed as a business is a matter of principle and normal market practice
- it is not relevant whether the seller previously operated the set as a business or whether the acquirer intends to operate the set as a business
- similarly, a set can still be considered a business when it does not contain all the assets and activities that the seller used in operating that business, so long as market participants are capable of acquiring or otherwise providing the missing elements (for example by integrating the business with their own operations).

3 In this publication, monetary amounts are denominated in currency units (CU).

The application of the definition in less clear situations is illustrated in the following examples.

Common situations requiring analysis	Relevant example
• the company acquired is in the development stage and is not yet producing saleable outputs	• Example B.2: Investment in a development stage entity
• the company acquired holds only a single asset with a few employees providing ancillary services	• Example B.3: Acquisition of an entity holding investment properties
• the integrated set of activities and assets transferred does not include all the activities or assets that the seller used in operating the business	• Example B.4: Seller retains some activities and assets
• the legal entity acquired is a 'shell' or 'off-the-shelf' company	• Example B.5: Acquisition of a shell company

Example B.2 – Investment in a development stage entity

Company D is a development stage entity that has not started revenue-generating operations. The workforce consists mainly of research engineers who are developing a new technology that has a pending patent application. Negotiations to license this technology to a number of customers are at an advanced stage. Company D requires additional funding to complete development work and commence planned commercial production.

The value of the identifiable net assets in Company D is CU750. Company A pays CU600 in exchange for 60% of the equity of Company D (a controlling interest).

Analysis:

Although Company D is not yet earning revenues (an example of 'outputs') there are a number of indicators that it has a sufficiently integrated set of activities and assets that are capable of being managed to produce a return for investors. In particular, Company D:

- employs specialist engineers developing the know-how and design specifications of the technology
- is pursuing a viable plan to complete the development work and commence production
- has identified and will be able to access customers willing to buy the outputs (IFRS 3.B10).

In addition, Company A has paid a premium (or goodwill) for its 60% interest. In the absence of evidence to the contrary, Company D is presumed to be a business (IFRS 3.B12).

Example B.3 – Acquisition of an entity holding investment properties

Scenario 1:

Company A acquires 100% of the equity and voting rights of Company P, a subsidiary of a property investment group. Company P owns three investment properties. The properties are single-tenant industrial warehouses subject to long-term leases. The leases oblige Company P to provide basic maintenance and security services, which have been outsourced to third party contractors. The administration of Company P's leases was carried out by an employee of its former parent company on a part-time basis but this individual does not transfer to the new owner.

Analysis

In most cases, an asset or group of assets and liabilities that are capable of generating revenues, combined with all or many of the activities necessary to earn those revenues, would constitute a business. However, investment property is a specific case in which earning a return for investors is a defining characteristic of the asset. In our view, revenue generation and activities that are specific and ancillary to an investment property and its tenancy agreements should therefore be given a lower 'weighting' in assessing whether the acquiree is a business. In our view the purchase of investment property with tenants and services that are purely ancillary to the property and its tenancy agreements should generally be accounted for as an asset purchase.

Example B.3 (continued)

Scenario 2:

Company A acquires 100% of the equity and voting rights of Company Q, which owns three investment properties. The properties are multi-tenant residential condominiums subject to short-term rental agreements that oblige Company Q to provide substantial maintenance and security services, which are outsourced with specialist providers. Company Q has five employees who deal directly with the tenants and with the outsourced contractors to resolve any non-routine security or maintenance requirements. These employees are involved in a variety of lease management tasks (eg identification and selection of tenants; lease negotiation and rent reviews) and marketing activities to maximise the quality of tenants and the rental income.

Analysis

In this example, Company Q consists of a group of revenue-generating assets, together with employees and activities that clearly go beyond activities ancillary to the properties and their tenancy agreements. The assets and activities are clearly integrated so Company Q is considered a business.

Example B.4 – Seller retains some activities and assets

Company S is a manufacturer of a wide range of products. The company's payroll and accounting system is managed as a separate cost centre, supporting all the operating segments and the head office functions. Company A agrees to acquire the trade, assets, liabilities and workforce of the operating segments of Company S but does not acquire the payroll and accounting cost centre or any head office functions. Company A is a competitor of Company S.

Analysis

In this example, the activities and assets within the operating segments are capable of being managed as a business and so Company A accounts for the acquisition as a business combination. The payroll and accounting cost centre and administrative head office functions are typically not used to create outputs and so are generally not considered an essential element in the assessment of whether an integrated set of activities and assets is a business.

Example B.5 – Acquisition of a shell company

Company A is a property development company with a number of subsidiary companies, each of which holds a single development. After completion of the development, Company A sells its equity investment because the applicable tax rate is lower than that applicable to the sale of the underlying property. Company A is planning to start the development of a large new retail complex. Rather than incorporating a new company, Company A acquires the entire share capital of a 'shell' company.

Analysis

The shell company does not contain an integrated set of activities and assets and so does not constitute a business. Consequently, Company A should account for the purchase of the shell company in the same way as the incorporation of a new subsidiary. In the consolidated financial statements, any costs incurred will be accounted for in accordance with their nature and applicable IFRSs. No goodwill is recognised.

1.2 Has control been obtained?

A business combination involves an entity obtaining control over one or more businesses. The determination of whether an entity has obtained control is based on guidance in both IFRS 3 and in IAS 27 *Consolidated and Separate Financial Statements* (IAS 27)[4].

For a simple entity controlled by voting rights, control is normally obtained through ownership of a majority of the shares that confer voting rights (or additional voting rights resulting in majority ownership if some are already owned). In transactions where an acquired business is not a separate legal entity (a trade and assets deal), control typically arises through ownership of those assets.

In such cases, the control assessment is straightforward. However, control can also be obtained through various other transactions and arrangements – some of which require careful analysis and judgement. The definition of control and relevant guidance should then be considered. As well as assessing whether control is obtained, this guidance is also relevant in addressing the related questions of when control transfers and which entity obtains control.

Definition of control (IFRS 3 and IAS 27.4)

"control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities"

Control involves both the ability to make decisions and the exposure to the results of those decisions (benefits and risks). IAS 27 explains that control is generally presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity. Other supporting guidance is set out in IFRS 3 paragraphs B14-B18 and IAS 27 paragraphs 13-15 and IG1-IG8. In comparatively rare cases in which an entity obtains an interest in a special purpose entity that comprises a business, the guidance in SIC 12 *Consolidation – Special Purpose Entities* (SIC 12) should be applied.

In particular, control might be obtained:

- without holding or acquiring a majority of the investee's voting rights
- without the investor actually being party to a transaction or paying consideration.

4 Note: In May 2011, the IASB published IFRS 10 *Consolidated Financial Statements* which supersedes IAS 27 and SIC 12. IFRS 10 introduces a new, principle-based definition of control together with guidance on how it is to be applied. IFRS 10's requirements will apply to all types of potential subsidiaries. Control obtained through majority ownership of voting rights will rarely be affected. However, IFRS 10's guidance on borderline or more complex situations may change the results of the control assessment. For example, IFRS 10 includes new and clarified guidance on potential voting rights and explicit guidance on control with large minority holdings and delegated power (ie principal and agency relationships). IFRS 10 will therefore affect assessments of whether and when control over a business is obtained in particular circumstances.

IFRS 10 is effective for annual periods beginning on or after 1 January 2013. Early application is permitted but only if IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IAS 27 (Revised) *Separate Financial Statements* and IAS 28 (Revised) *Investments in Associates and Joint Ventures* are also adopted at the same time.

The following tables and examples provide non-exhaustive illustrations of how control can be obtained in these broader circumstances.

Situations where control can be obtained without majority of voting rights	Relevant example
• an investor obtains the power to appoint or remove the majority of the board of directors or other body that determines an investee's financial and operating policies	• Example B.6: Control obtained through the investor's power to appoint or remove the board of directors and cast majority votes
• an investor obtains direct powers to determine an investee's financial and operating policies through contractual agreement or statute	
• the investor holds currently-exercisable options or other instruments that contain potential voting rights that, if exercised, would give majority voting rights	• Example B.7: Potential voting rights
• the interest acquired by the investor is the most significant interest and there is no realistic possibility that other non-majority shareholders are (or may become) organised in such a way to block the acquirer's exercise of power (sometimes called 'de facto control')	

Example B.6 – Control obtained through the investor's power to appoint or remove the board of directors and cast majority votes

Company X, a clothing retailer acquires 40% of the voting shares in Company Z, a major supplier. Company Z needs to expand its production capacity to meet Company X's demands but currently has limited access to financing. Company X agrees to provide a long-term loan to fund expansion. As part of the agreement, Company Z's other shareholders agree that Company X will be able to appoint or remove three of the five directors of Company Z. The directors are empowered to determine Company Z's financial and operating policies by simple majority vote.

Analysis

Company X's ability to appoint or remove the majority of the board of directors of Company Z gives it the power to determine Company Z's financial and operating policies. Its ownership of 40% of the equity gives Company X access to benefits from Company Z's activities. Accordingly, Company X has obtained control.

Example B.7 – Potential voting rights

Company A, a manufacturer of consumer products, acquires 450 of the equity shares of Company D (a manufacturer of complementary products) out of 1,000 shares in issue. As part of the same agreement, Company A purchases an option to acquire an additional 200 shares. The option is exercisable at any time in the next 12 months. The exercise price includes a small premium to the market price at the transaction date.

After the above transaction, the shareholdings of Company D's two other original shareholders are 250 and 300. Each of these shareholders also has currently exercisable options to acquire 25 additional shares.

Example B.7 – Potential voting rights (continued)

Analysis

In assessing whether it has obtained control over Company D, Company A should consider not only the 450 shares it owns but also its option to acquire another 200 shares (a so-called potential voting right). In this assessment, the specific terms and conditions of the option agreement and other factors are considered:

- the options are currently exercisable and there are no other required conditions before such options can be exercised
- if exercised, these options would increase Company A's ownership to a controlling interest of over 50% before considering other shareholders' potential voting rights (650 shares out of a total of 1,200 shares)
- although other shareholders also have potential voting rights, if all options are exercised Company A will still own a majority (650 shares out of 1,250 shares)
- the premium included in the exercise price makes the options out-of-the-money. However, the fact that the premium is small and the options could confer majority ownership indicates that the potential voting rights have economic substance.

By considering all the above factors, Company A concludes that with the acquisition of the 450 shares together with the potential voting rights, it has obtained control of Company D.

Situations where control can be obtained without the investor being party to any transaction or paying any consideration	Relevant example
• an investee repurchases its own shares held by other investors resulting in an existing shareholder becoming the majority shareholder • an investor becomes a majority shareholder as a result of taking dividends in shares when other shareholders have elected to receive cash • cancellation or expiry of veto or similar voting rights of other shareholders that prevented the investor from exercising control	• Example B.8: Investee's repurchase of its own shares

Example B.8 – Investee's repurchase of its own shares

Company Z has an existing 40% ownership interest in Company X, a company in the technology industry. Two private equity firms, Firm A and Firm B, own 30% each of the remaining equity of Company X. During the year, Firm A announced that it will concentrate its investments in the real estate sector and is planning to divest its investments in other sectors, including its investment in Company X. Since Company X is cash rich and has sufficient capital, it repurchased the shares held by Firm A.

Analysis

In this situation, Company Z was not a party to the transaction between Company X and Firm A and Company Z did not pay any consideration. However, the repurchase by Company X of its shares is an economic event that changed Company Z's ownership interest in Company X from 40% to 57%. As a result, Company Z obtained control of Company X and accordingly should account for the event as a business combination.

1.3 Is the business combination within the scope of IFRS 3?

1.3.1 Scope of IFRS 3

IFRS 3 applies to all business combinations with the following two exceptions[5].

- the formation of a joint venture
- a combination of entities or businesses under common control (referred to as common control combinations).

In these cases, IFRS 3's acquisition method need not be applied. Instead, management should develop an accounting policy using the general principles of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (IAS 8) – see Section B.1.3.2.

Of the two scoped-out transactions, common control combinations are the most frequent. Broadly, these are transactions in which an entity obtains control of a business (hence a business combination) but both combining parties are ultimately controlled by the same party or parties both before and after the combination. These combinations often occur as a result of a group reorganisation in which the direct ownership of subsidiaries changes but the ultimate parent remains the same. However, such combinations can also occur in other ways and careful analysis and judgement are sometimes required to assess whether some combinations are covered by the definition (and the scope exclusion). In particular:

- an assessment is required as to whether common control is 'transitory' (if so, the combination is not a common control combination and IFRS 3 applies). The term transitory is not explained in IFRS 3. In our view it is intended to ensure that IFRS 3 is applied when a transaction that will lead to a substantive change in control is structured such that, for a brief period before and after the combination, the entity to be acquired/sold is under common control. However, common control should not be considered transitory simply because a combination is carried out in contemplation of an initial public offering or sale of combined entities
- when a group of two or more individuals has control before and after the transaction, an assessment is needed as to whether they exercise control collectively as a result of a contractual agreement.

Examples of common control combinations

- combinations between subsidiaries of the same parent
- the acquisition of a business from an entity in the same group
- bringing together entities under common control into a legally-defined group
- some transactions involving the insertion of a new parent company at the top of a group.

---

5 IFRS 3 does now apply to the following transactions which were outside the scope of the previous version of the Standard:

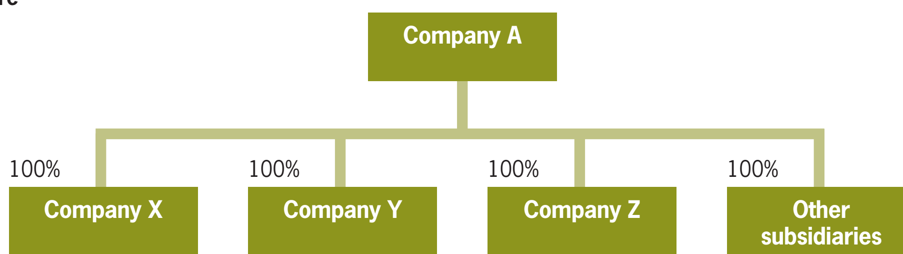
- business combinations involving two or more mutual entities
- businesses brought together to form a reporting entity by contract alone (for example bringing together two businesses in a stapling arrangement or by forming a dual-listed corporation).

The following examples illustrate some aspects of the analysis:

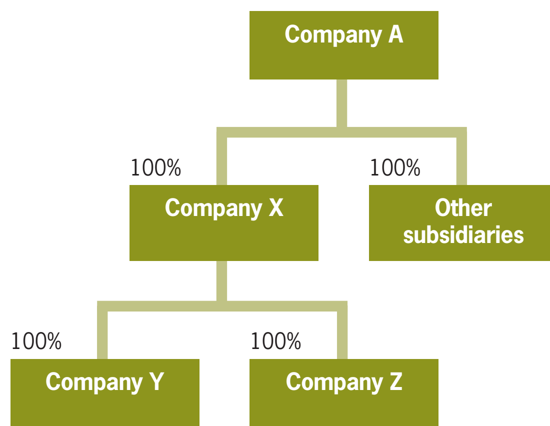
Example B.9 – Group reorganisation

Company A, the ultimate parent of a large number of subsidiaries, reorganises the retail segment of its business to consolidate all of its retail businesses in a single entity. Under the reorganisation, Company X (a subsidiary and the biggest retail company in the group) acquires Company A's shareholdings in its two operating subsidiaries, Companies Y and Z by issuing its own shares to Company A. After the transaction, Company X will directly control the operating and financial policies of Companies Y and Z.

Before



After

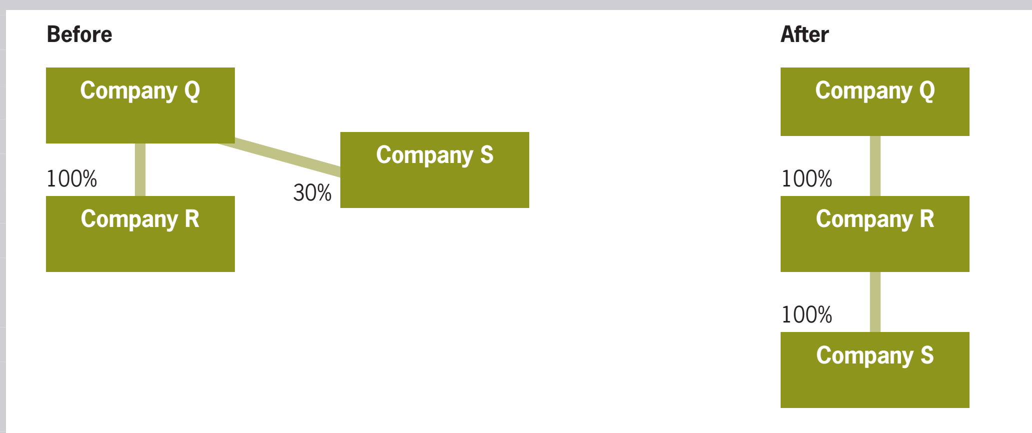


Analysis:

In this situation, Company X pays consideration to Company A to obtain control of Companies Y and Z. The transaction meets the definition of a business combination. Prior to the reorganisation, each of the parties are controlled by Company A. After the reorganisation, although Companies Y and Z are now owned by Company X, all three companies are still ultimately owned and controlled by Company A. From the perspective of Company A, there has been no change as a result of the reorganisation. This transaction therefore meets the definition of a common control combination and is outside IFRS 3's scope.

Example B.10 – Acquisition of a related entity

Company Q has a wholly-owned subsidiary, Company R, and a 30% owned associate, Company S. During the year, Company R acquired Company Q's shares in Company S by issuing its own shares and purchased the remaining shares of Company S held by other shareholders for cash. After these transactions, Company S became a wholly-owned subsidiary of Company R.

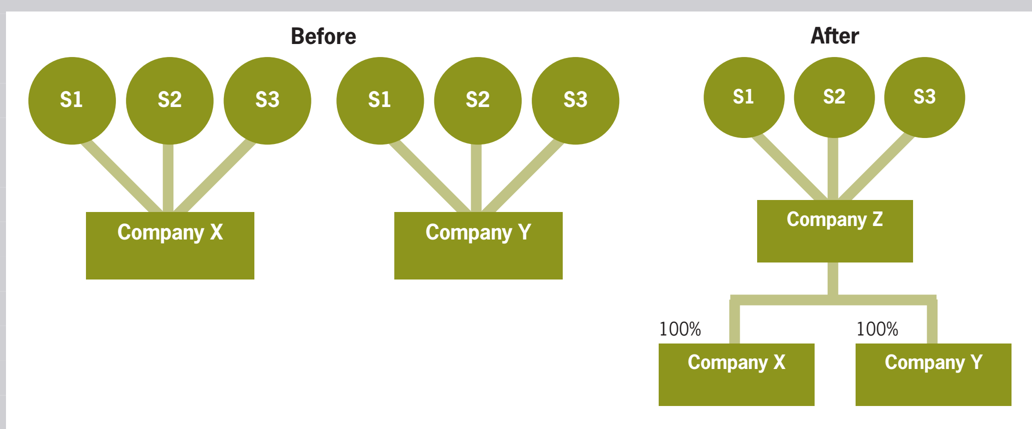


Analysis:

In this situation, Company R paid consideration to Company Q and the other shareholders of Company S to obtain control of Company S. The transaction meets the definition of a business combination. Although Company S is a related party, Company Q did not control Company S before the transaction. Company R's acquisition of Company S changed the nature of the investment from an associate to a subsidiary. This transaction does not meet the criteria of a common control combination and is a business combination within the scope of IFRS 3. Company Q and Company R (if it prepares consolidated financial statements) will apply the acquisition method in their consolidated financial statements.

Example B.11 – A new parent created by shareholders

Company X and Company Y are each owned by three unrelated shareholders (ie each shareholder owns one third of each company). The three individuals have an established pattern of voting together but there is no contractual agreement in place that creates control or joint control for any of the shareholders. As part of the reorganisation, the shareholders incorporated a new entity, Company Z. Company Z issued shares to each of the shareholders in exchange for 100% of the equity of Company X and Company Y. Subsequent to the share exchange, the three shareholders now each own one third of Company Z.



Example B.11 – A new parent created by shareholders (continued)

Analysis:
In this situation, the shareholders are identical before and after the transaction. However, there is no contractual agreement that gives an individual shareholder or combination of shareholders the power to control any of the entities. Although there are common shareholders, there is no common control before and after the transaction. Thus, the transaction is not considered a common control combination (IFRS 3.B2). Consequently, this transaction is within the scope of IFRS 3 and the acquisition method of accounting applies.

1.3.2 Accounting for common control business combinations outside the scope of IFRS 3

If a business combination is outside the scope of IFRS 3, management must develop an accounting policy that will provide relevant and reliable information in accordance with IAS 8. Some entities decide to apply IFRS 3 by analogy, which we regard as acceptable. In practice, however, companies more often select accounting policies that can be broadly categorised as predecessor value methods. Such methods include the pooling of interests method and merger accounting. The key characteristic of these methods is that the balance sheets of the combining entities are brought together using the IFRS-based book values of the entities' assets and liabilities, without applying a fair value exercise. Within that broad description, the detailed application differs from one entity to another. This is also an area in which some jurisdictional regulators have issued interpretive guidance on what they regard as acceptable.

Predecessor value methods and the acquisition method are based on different principles and produce significantly different accounting results. The table below provides a high level summary of some key differences.

Accounting topic	Accounting using a predecessor value method	Accounting under acquisition method
Characteristic of transaction	• no change in ultimate control	• an entity obtains control of a business
Recognition of identifiable assets and liabilities	• measured at book values, usually as reported by the ultimate controlling party • intangible assets and contingent liabilities are normally recognised only to the extent they were previously recognised	• measured at fair value, with a few exceptions • an intangible asset (if it meets the IAS 38 *Intangible Assets* criteria) is recognised even if not previously recognised by the acquiree • a contingent liability is recognised if it is a present obligation and fair value can be measured reliably
Goodwill or gain on a bargain purchase	• not recognised. Any difference between the cost of investment and the net assets is usually presented as a separate reserve in equity	• recognised as an asset or as an immediate gain
Non-controlling interests (NCI)	• recognised at proportionate interest	• recognised at fair value or proportionate interest
Comparative information	• comparative periods are often restated as if the combination occurred at the beginning of the earliest comparative period (although practice differs)	• no restatement of comparative period

2 Identify the acquirer

Step 2
Identifying the acquirer

The acquisition method is applied from the point of view of the acquirer – the entity that obtains control over an acquiree. An acquirer must therefore be identified for each business combination. A critical point to note is that the acquirer for IFRS 3 purposes (the accounting acquirer) is not always the legal acquirer (the entity that becomes the legal parent, typically through ownership of majority voting power in the other combining entity). IFRS 3 takes an in-substance approach to identifying the acquirer rather than relying solely on the legal form of the transaction. This in-substance approach looks beyond the rights of the combining entities themselves. It also considers the relative rights of the combining entities' owners before and after the transaction. Combinations in which the accounting acquirer is the legal acquiree are referred to as reverse acquisitions and give rise to some specific accounting issues (see Section B.2.1).

In most business combinations identifying the acquirer is straightforward and is consistent with legal ownership. However, the identification can be more complex for business combinations in which, for example:

- businesses are brought together by contract alone such that neither entity has legal ownership of the other
- a combination is effected by legal merger of two or more entities or through acquisition by a newly created parent entity
- a smaller entity arranges to be acquired by a larger one.

In these and other cases, a more detailed analysis of the definition of control and its supporting guidance (as discussed in Section B.1.2) is required. When the outcome of this analysis remains uncertain, IFRS 3 offers additional indicators which are summarised below:

Factors to consider	Who is usually the acquirer? (IFRS 3.B14 – B18)
Consideration settled by transferring cash, other assets or incurring liabilities	• the entity that transfers cash or other assets or incurs the liabilities
Combination effected primarily by exchanging equity interests	• the entity that issues the equity interests
Relative voting rights in the combined entity	• the entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity
Existence of a single large minority interest	• the entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity, if no other owner or organised group of owners has a significant voting interest
Composition of the governing body of the combined entity	• the entity whose owners have the ability to elect or appoint or remove a majority of the members of the governing body of the combined entity
Senior management of the combined entity	• the entity whose (former) management dominates the combined management
Terms of the exchange of equity interest	• the entity that pays a premium over the pre-combination fair value of the equity interest of the other combining entity or entities

Factors to consider	Who is usually the acquirer? (IFRS 3.B14 – B18)
Relative size	• the entity whose size is significantly greater than that of the other combining entity or entities
More than two entities involved	• the entity that initiated the combination
A new entity is formed to effect a new business combination	• if the new entity is formed to issue equity instruments, one of the existing combining entities is the acquirer • if the new entity transfers cash or other assets or incurs liabilities, the new entity may be the acquirer

In practice, the most common situation where the process of identifying the acquirer requires a more in-depth analysis is when a new entity is formed to effect a business combination. Examples of how the IFRS 3 guidance is applied to these situations are presented below.

Example B.12 – New parent pays cash to effect a business combination

Company W decided to spin-off two of its existing businesses (currently housed in two separate entities, Company X and Company Y). To facilitate the spin-off, Company W incorporates a new entity (Company Z) with nominal equity and appoints independent directors to the board of Company Z. Company Z signs an agreement to purchase Companies X and Y in cash, conditional on obtaining sufficient funding. To fund these acquisitions, Company Z issues a prospectus offering to issue shares for cash.

At the conclusion of the transaction, Company Z is owned 99% by the new investors with Company W retaining only a 1% non-controlling interest.

Analysis:

In this situation, a set of new investors paid cash to obtain control of Company Z in an arm's length transaction. Company Z is then used to effect the acquisition of 100% ownership of Companies X and Y by paying cash. Company W relinquishes its control of Companies Y and Z to the new owners of Company Z.

Although Company Z is a newly formed entity, Company Z is identified as the acquirer not only because it paid cash but also because the new owners of Company Z have obtained control of Companies X and Y from Company W.

Example B.13 – New entity is created to acquire a business by issuing shares

Company A, a company with its own retail division, plans to expand its operations by acquiring the retail operations of another retailer, Company B. Company B's retail operations are smaller and less valuable than Company A's. Company A facilitated the acquisition through the following transactions:

- Company A formed a new entity, Company C, and transferred its retail operations to Company C in exchange for Company C shares
- Company C acquired Company B's retail operations also by issuing shares.

After the acquisition, Company A holds the majority of the equity shares of Company C and has the right to appoint 4 of the 6 directors of Company C. The remaining 2 directors are appointed by Company B. Company C will prepare its own IFRS financial statements.

Analysis:

Based on the legal form of the transactions, it appears that Company C acquired two retail businesses (the retail division of Company A and the retail operations of Company B). However, in substance, Company C is an extension of Company A and was created to hold Company A's retail division. Company A retains control of its existing retail division and obtains control over the retail operations of Company B. In Company C's financial statements, these two transactions will be accounted for separately:

- the transfer of Company A's retail division to Company C is a common control combination and is outside the scope of IFRS 3. Being a continuation of Company A's retail division, Company C will then have an accounting policy choice on how to account for this transaction (usually by applying a predecessor value method as discussed in Section B.1.3.2)
- Company C's acquisition of Company B's retail operations is accounted for using the acquisition method under IFRS 3. Company B has exchanged control of its retail operation for a non-controlling interest in the combined entity, Company C. Therefore, Company C is identified as the acquirer.

2.1 Reverse acquisitions

Reverse acquisitions are business combinations in which the accounting acquirer is the legal acquiree (and, accordingly, the legal acquirer is the accounting acquiree).

One situation in which reverse acquisitions often arise is when a private operating entity wants a fast-track to a public listing. To accomplish this, the private entity arranges for its equity interests to be acquired by a smaller, publicly-listed entity. The listed entity effects the acquisition by issuing shares to the owners of the private operating entity. After the exchange, the former shareholders of the private entity hold the majority of the voting rights of the combined entity. In this case, although the publicly-listed entity issued shares to acquire the private entity, the listed entity will be identified as the accounting acquiree and the private entity as the accounting acquirer.

Reverse acquisitions are within the scope of IFRS 3 provided the accounting acquiree (in this example, the listed entity) is a business (see Section B.1.1). When the accounting acquiree is a business, the recognition and measurement principles in IFRS 3 apply, including the requirement to recognise goodwill. In applying these principles:

- the consolidated financial statements of the legal parent (accounting acquiree) are presented as a continuation of the financial statements of the legal subsidiary (accounting acquirer), except for the capital structure
- the assets and liabilities reported in these statements are therefore based on the pre-combination book values of the legal subsidiary. IFRS 3's recognition and measurement principles are applied to the identifiable assets and liabilities of the legal parent
- the fair value of a 'deemed' consideration transferred must be calculated based on the number of shares that the accounting acquirer would have had to issue to give the owners of the legal acquirer the same proportionate ownership that they obtain in the reverse acquisition.

IFRS 3 includes specific guidance on the accounting for reverse acquisitions (IFRS 3.B19-B27) and some useful examples (IFRS 3's Illustrative Examples IE1-IE15).

3 When is the acquisition date?

Step 3
Determining the acquisition date

IFRS 3 defines the acquisition date as the date the acquirer obtains control of the acquiree. In a combination effected by a sale and purchase agreement, this is generally the specified closing or completion date (the date when the consideration is transferred and acquiree shares or underlying net assets are acquired).

The acquisition date is critical because it determines when the acquirer recognises and measures the consideration, the assets acquired and liabilities assumed. The acquiree's results are consolidated from this date. The acquisition date materially impacts the overall acquisition accounting, including post-combination earnings.

The acquisition date is often readily apparent from the structure of the business combinations and the terms of the sale and purchase agreement (if applicable) but this is not always the case. Complications can arise because of the many ways – both contractual and non-contractual – that business combinations can be effected. The period between the start of negotiations and final settlement of all aspects of a combination can be protracted. Applicable corporate laws, shareholder approval requirements, competition rules and stock market regulations also vary and may affect the analysis.

Because each transaction is different, there are few (if any) 'rules of thumb' to assist in identifying the acquisition date. Instead, the definition of control (see Section B.1.2) should be applied to the specific facts and circumstances of each situation. Judgement may be required.

Examples of arrangements that may require further analysis include acquisitions:

- for which the agreement specifies an effective date that is not the closing date
- that are completed subject to regulatory and/or shareholder approval
- that are completed subject to other conditions
- made by public offer
- for which there is no sale and purchase agreement and hence no specified closing date (for example a business combination that occurs through an investee share buy-back).

The following illustrates some aspects of analysis required in two of the above situations:

Situations requiring analysis	Considerations
The purchase agreement specifies that control is transferred on an effective date different from the closing date	• this requires the determination of whether the effective date provision actually changes the acquisition date. In practice, many of these types of provisions are simply mechanisms to adjust the price but may not affect the date when control is obtained
No closing date specified	• for example, when an investee repurchases own shares held by other investors resulting in an existing shareholder becoming a majority shareholder. In this case, the starting point is to identify the date when the shareholder's proportionate voting rights amounted to a controlling interest

4 Recognising and measuring assets acquired and liabilities assumed

Step 4
Recognising and measuring identifiable assets acquired and liabilities assumed

The acquisition method requires the acquirer to recognise and measure assets acquired and liabilities assumed. These assets and liabilities are however not the same amounts (or even the same items) shown in the acquiree's financial statements. Instead, IFRS 3's recognition and measurement principles are applied to determine which assets and liabilities are recognised and how they are measured. Most, but not quite all, of these assets and liabilities are measured at fair value at the acquisition date – the so called 'fair value exercise'. (The term 'purchase price allocation' is still sometimes used to describe this process although it does not strictly fit the IFRS 3 accounting model.)

This is typically the most complex and time-consuming step in accounting for a business combination. Many companies engage outside specialists to provide assistance. In most cases this process requires careful analysis, extensive use of estimates and management judgement in a number of areas.

In an acknowledgement of these challenges, IFRS 3 allows a 'measurement period' of up to twelve months for the acquirer to complete the initial accounting for the business combination (refer to Section B.8 for further information).

This Section discusses the key activities that an acquirer needs to undertake in this step and provides examples to illustrate IFRS 3's requirements, as follows:

Recognise identifiable assets acquired and liabilities assumed	See Section B.4.1
Measure identifiable assets acquired and liabilities assumed	See Section B.4.2
Determine applicability of specific recognition and measurement provisions	See Section B.4.3
Classify or designate identifiable assets acquired and liabilities assumed	See Section B.4.4

4.1 Recognising assets acquired and liabilities assumed as part of the business combination

4.1.1 Applying IFRS 3's recognition principles

Assets acquired and liabilities assumed in the business combination are recognised (separately from goodwill) if, and only if, they meet IFRS 3's recognition principles on the acquisition date. These assets and liabilities may not be the same as those recognised in the acquiree's own financial statements.

IFRS 3's recognition principles (IFRS 3.11-12)

Assets acquired and liabilities assumed are recognised if they:
- meet the definition of an asset or liability in the *Conceptual Framework for Financial Reporting*

Asset	Liability
• a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity	• a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits

and
- are part of what is exchanged in the business combination (rather than in a separate transaction or arrangement – see Section B.6.2).

In practice, most of the assets and liabilities to be recognised will fall within familiar IFRS categories, such as:
- cash and cash equivalents
- inventories
- financial assets and liabilities, including trade receivables and payables
- prepayments and other assets
- property, plant and equipment
- intangible assets (see Section B.4.1.3)
- income tax payable or receivable
- accruals and provisions.

It can also be helpful to divide the identification process into two steps:
- determine the population of 'potential' assets and liabilities from sources such as the acquiree's historical financial statements, internal management reports and underlying accounting records, due diligence reports and the purchase agreement itself
- evaluate these potential assets and liabilities against IFRS 3's criteria. This determination can be straightforward or may require a detailed analysis depending on the nature of each item. Section B.4.1.2 sets out some assets and liabilities for which more detailed analysis is often needed.

The acquirer recognises only assets and liabilities of the acquiree that were exchanged in the business combination. Similarly, the 'consideration transferred' comprises only amounts transferred in exchange for the acquiree (IFRS 3.51). Some transactions and arrangements that might be entered into in conjunction with a business combination, or viewed as consequences of it from a commercial perspective, must be accounted for separately.

See Section B.6.2 for more information on how to determine what is part of a business combination.

4.1.2 Assets and liabilities requiring specific attention

The assets and liabilities to be recognised are unique to each business combination and differ extensively. However, specific considerations apply to some types of assets and liabilities because of one or more of the following factors:

- IFRS 3 includes specific guidance that is, in some cases, an exception to the general recognition principle discussed above
- these items often differ from the assets and liabilities recognised in the acquiree's own financial statements (if applicable).

The following table summarises examples of the types of assets and liabilities that will often require specific attention, with cross-references to relevant guidance where applicable.

Items requiring analysis	Specific guidance or considerations
Items with specific guidance in IFRS 3 Restructuring obligation	• recognised only if the acquiree has an obligation at the acquisition date to incur the restructuring costs. Costs that the acquirer expects to incur as a result of its own post-combination decisions are not liabilities at the acquisition date and will be recognised in post-combination earnings (IFRS 3.11)
Intangible assets	• determining the intangible assets to be recognised can be challenging and often requires judgement (see Section B.4.1.3)
Contingent liabilities	• recognised if a present obligation exists and fair value can be measured reliably (see Section B.4.3.1)
Deferred taxes	• the acquirer does not recognise the acquiree's historical deferred tax balances but determines new amounts based on the assets and liabilities recognised in the acquisition accounting and the requirements of IAS 12 *Income Taxes* (IAS 12) (see Section B.4.3.2)
Operating leases	• if the acquiree is the lessee, an asset or liability is recognised for operating leases on favourable or unfavourable terms and in some other circumstances (see Section B.4.1.4)
Employee benefit obligations	• the acquirer applies the specific requirements of IAS 19 *Employee Benefits* (IAS 19) to determine the assets or liabilities to be recognised for any assumed post-employment benefit plans and other post-retirement benefit plans (see Section B.4.3.1)
Indemnification assets	• if the acquiree's former owners contractually indemnify the acquirer for a particular uncertainty, an indemnification asset is recognised on a basis that matches the indemnified item (see Section B.4.3.1)
Reacquired rights	• if the acquirer previously granted a right to the acquiree to use the acquirer's intellectual property or other asset (such as a trade name or licensed technology), a separate 'reacquired right' intangible asset is recognised even if the underlying asset was not previously capitalised (see Section B.4.1.4)

Items requiring analysis	Specific guidance or considerations
Other items Acquiree's previous goodwill	• the acquirer does not recognise goodwill recognised by the acquiree from a past business combination. Instead, a new goodwill amount is calculated on the acquisition date (see Section B.7)
Liability and equity accounts	• financial instruments issued by the acquiree to third parties need to be classified as liabilities, equity instruments or compound instruments based on IAS 32 *Financial Instruments: Presentation* (IAS 32) and conditions at the acquisition date. The change of ownership sometimes changes the classification and/or triggers specific clauses in contractual agreements. • equity 'reserves' such as retained earnings and revaluation reserve are not assets or liabilities • equity instruments held by non-controlling parties affect goodwill and may require more analysis (see Section B.5)
Deferred revenue	• deferred (unearned) and accrued revenue balances that arise from application of the acquiree's revenue recognition policies should be analysed to determine if an underlying asset or liability exists at the acquisition date and, if so, how it should be recognised in the combination.

4.1.3 Recognising identifiable intangible assets

It is important to identify intangible assets separately because, in most cases, their lives will be finite and amortisation under IAS 38 *Intangible Assets* (IAS 38) will be required. Separate recognition therefore affects post-combination earnings. Partly for this reason, IFRS 3's approach places a strong emphasis on separate recognition rather than subsuming intangibles within goodwill.

However, identifying intangible assets is inherently more difficult and subjective than identifying physical assets such as inventory and property. In addition, many intangibles recognised in a business combination may not have been recognised in the acquiree's own financial statements.

Specific recognition requirements

Intangible assets acquired in a business combination are recognised separately from goodwill if they:

- meet IFRS 3's general recognition principles (see Section B.4.1.1) and
- are identifiable (IFRS 3.B31 – B34).

Identifiable has a specific meaning in this context and is based on IAS 38. An acquired intangible asset is identifiable if it meets either of the following criteria:

Criterion	Meaning
Contractual-legal **(IFRS 3.B32)**	• arising from contractual or legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations
Separable **(IFRS 3.B33)**	• capable of being separated or divided from the acquiree and sold, transferred, licensed, rented or exchanged either individually or together with a related contract, identifiable asset or liability

Applying the specific recognition requirements

The intangible assets acquired will depend on the nature of the business, its industry and other specific facts and circumstances of the combination. It is useful to divide the identification process into two steps:

- identify the population of 'potential' intangibles
- assess each against IFRS 3's specific criteria.

Potential intangible assets

Potential intangible assets arising from contractual or legal rights, such as trademarks and licences, may be detected based on analysis of applicable contracts or agreements.

Non-contractual intangibles, such as customer relationships and in-process research, can require more analysis. Possible indicators and information sources include:

Source of information	Possible indicators
Acquiree's financial statements and other internal reports	• some intangible assets will have been recognised in the acquiree's financial statements. Other financial statement information may also provide indirect indicators, for example: – significant marketing costs may be an indicator of the relative importance of brands, trademarks and related intangible assets – significant expenditures on research and development may indicate the existence of technology-based intangible assets – significant expenditures related to customer care may point to customer relationship assets
Purchase agreement and accompanying documents	• may include references to certain trademarks, patents or other intangible assets that are established by contract or legal rights • may include non-compete provisions that sometimes give rise to a potential intangible asset
Due diligence reports	• may include information that assists in understanding the acquired business, resources and how revenues are generated
Website materials, press releases and investor relation communications	• the website may contain discussions of the unique characteristics of the business which may translate into a potential intangible asset • press releases and investor relation communications of both the acquiree and the acquirer may include discussions of potential intangible assets
Industry practice	• results of similar business combinations may provide indicators of the types of intangible assets that are typically recognised in such situations

Determining whether a potential intangible asset is identifiable

Each potential intangible asset is assessed to determine if it is 'identifiable'. As noted, intangible assets arising from contracts or agreements will always meet this test.

For other potential intangible assets an assessment of 'separability' is required. This is based on whether the item can be sold or otherwise transferred, without selling the entire business. The following table provides some examples.

Considerations in assessing separability	Relevant example
• it is a hypothetical assessment and is not dependent on any intention to sell (although a sale plan, if one exists, demonstrates separability) • actual exchange transactions for the type of potential intangible assets being analysed or a similar type indicate separability, even if those transactions are infrequent and regardless of whether the acquirer is involved in them (IFRS 3.B33)	• Example B.14: Database used in a supporting activity
• in order to be separable, the potential intangible asset need not be saleable on its own. It could be transferred in combination with a related contract, identifiable asset or liability (IFRS 3.B34). However, if separation is only possible as part of a larger transaction, judgement is required to determine whether the potential sale is of the entire business or only part of it • the terms of the purchase agreement or related agreements may prohibit the transfer of certain intangible assets (for example, confidentiality agreements prohibiting transfer of customer information) • the legal and regulatory environment may prevent the transfer of intangible assets without underlying contractual or legal rights	• Example B.15: Complementary intangible assets • Example B.14: Database used in a supporting activity

Example B.14 – Database used in a supporting activity

Company Q acquired Company R, a retailer. Company R owns a database, used in managing its loyalty scheme, which captures information on customer demographics, preferences, relationship history and past buying patterns. The database can either be sold or licensed. However, Company R has no intention to do so because it will negatively impact its operations.

Analysis:

In this situation, the database does not arise from a contractual or legal right. Thus, an assessment of its separability is required. The database and content were generated from one of Company R's supporting activities (ie management of the loyalty scheme) and could be transferred independently of the rest of the business. The actual intention not to transfer the database does not affect the assessment.The separability criterion is met and the database is recognised as an intangible asset in the business combination.

Example B.15 – Complementary intangible assets

Company X acquired the food manufacturing division of Company Y, which includes a registered trademark for a certain product and an associated secret recipe for the product. Access to the secret recipe is required to enable the product to be manufactured and reasonable steps are taken to maintain its secrecy. The recipe is not protected by legal rights.

Analysis:

The trademark is recognised as a separate intangible asset – as this is based on a legal right.

The secret recipe is not covered by the trademark registration and is not otherwise protected by legal rights. Its separability is therefore assessed. It is probably not feasible to transfer the recipe without the trademark, or vice versa. It is however likely to be feasible to transfer the recipe and trademark together without transferring the entire business. If so, the secret recipe meets the separability criterion and is recognised as a separate intangible asset. However, the recipe may be grouped with the trademark for presentation and measurement purposes if their useful lives are similar (IFRS 3.IE21).

Paragraphs B32-B34 of IFRS 3 provide other examples of intangible assets that meet either the separability or the contractual-legal criterion. In addition, IFRS 3's Illustrative Examples IE18 to IE44 provide a list of the common types of identifiable intangible assets (see below) that may be acquired in a business combination. This list is not exhaustive.

Marketing-related intangible assets

- trademarks, trade names, service marks, collective marks and certification marks
- internet domain names
- trade dress (unique colour, shape or package design)
- non-compete agreements

Customer-related intangible assets

- customer lists[‡]
- order or production backlog
- customer contracts and the related customer relationships
- non-contractual customer relationships[‡]

Contract-based intangible assets

- advertising, construction, management, service or supply contracts
- licensing, royalty and standstill agreements
- lease agreements (see Section B.4.1.4)
- construction permits
- franchise agreements
- operating and broadcasting rights
- use rights such as drilling, water, air, mineral, timber-cutting and route authorities
- servicing contracts such as mortgage servicing contracts
- employment contracts that are beneficial contracts from the perspective of the employer because the pricing of those contracts is below the current market value

Artistic-related intangible assets

- plays, operas and ballets
- books, magazines, newspapers and other literary works
- musical works such as compositions, song lyrics and advertising jingles
- pictures and photographs
- video and audio visual material, including films, music videos and television programmes

Technology-based intangible assets

- patented technology
- computer software and mask works
- unpatented technology[‡]
- databases[‡]
- trade secrets such as secret formulas, processes or recipes

[‡] these items are usually considered as identifiable intangible assets because they meet the separability criterion. All other items usually satisfy the contractual-legal criterion.

In many business combinations, the acquirer will detect other items or resources that are valuable to the acquired business. However, not all of them meet IFRS 3's recognition criteria, for example:

Item or resources	Rationale why not recognised as an intangible asset
Assembled workforce	• an assembled workforce is not considered identifiable (IFRS 3.B37). IAS 38 also points out that there is usually insufficient control over the economic benefits that may result from the assembled workforce (IAS 38.15)
Potential contracts	• potential contracts are not assets at the acquisition date
Synergies	• synergies are usually not identifiable as they do not depend on contractual or other legal rights and they are usually not capable of being separated from the acquired entity
Market share, market potential, monopoly situations or similar 'strategic values'	• a robust position in the market may enhance the value of identifiable marketing-related or technology-driven intangible assets. However, the acquiree's market share or market condition is not a controllable future economic benefit
High credit rating or going concern	• value is sometimes attributed to a high credit rating or other indicators of the sustained ability of the acquiree to operate as a going concern. However, these values are not controllable future economic benefits

4.1.4 IFRS 3's guidance on particular intangible assets

Intangible assets related to operating lease agreements

In many business combinations, the acquiree is party to an operating lease agreement either as lessee or lessor. However, its own financial statements will rarely include lease-related intangible assets or liabilities. The acquisition method may require the acquirer to recognise additional items if the acquiree is the lessee. IFRS 3 provides the following guidance:

Lessee or Lessor	IFRS 3 guidance
Acquiree is the lessee (IFRS 3.B28-B30)	• an asset or liability is only recognised when: – the terms of the operating lease are either favourable or unfavourable compared to market terms; or – there is evidence of market participants' willingness to pay a price for the lease even if it is at market terms
Acquiree is the lessor (IFRS 3.B42)	• no separate asset or liability is recognised on acquisition even if the lease terms are either favourable or unfavourable when compared with market terms (but the lease terms are taken into account when measuring the fair value of the lessor's underlying asset)

As a consequence, amounts in the acquiree's own financial statements such as unamortised lease incentives or deferred rent related to straight-lining of lease income or expense under IAS 17 *Leases* (IAS 17)/SIC 15 *Operating Leases – Incentives* may not qualify as separate assets or liabilities in the business combination. The post-combination financial statements will include operating lease income or expense on a straight-line basis based on the remaining terms of the assumed lease agreement, plus amortisation of any amounts recognised in accordance with the guidance for lessees.

The following examples illustrate how IFRS 3's provisions are applied to operating lease agreements.

Example B.16 – Acquiree is a lessee in an operating lease

As part of the business combination, Company A acquires a business that includes an operating lease of retail space for which the acquiree is a lessee. The annual rent for the remainder of the lease is CU2,000. On the acquisition date, the current annual market rent for the retail space is CU2,500. An analysis of the retail space disclosed that because of its prime location, unique characteristics and the scarcity of similar locations, other retail operators are willing to pay a premium to obtain such a lease contract.

Analysis:
The assumed lease includes below-market rents. Company A therefore recognises a separate intangible asset related to the favourable terms of the lease as part of the business combination. Company A also recognises a separate intangible asset for the premium that other market participants are willing to pay.

Example B.17 – Deferred rent recognised by the acquiree

Company X acquired Company Y, a lessee in a 5 year operating lease of retail space. On the acquisition date, the lease has 3 years to run. Company X's analysis indicates that: (i) the lease is 'at-market'; and (ii) other market participants would not be willing to pay a premium for it.

The annual rentals are:

Year 1: CU1,000
Year 2: CU1,100
Year 3: CU1,200
Year 4: CU1,300
Year 5: CU1,400

Company Y's financial statements include an annual rent expense of CU1,200 (determined on a straight-line basis) and a deferred rent liability of CU300 at the acquisition date.

Analysis:
The deferred rent of CU300 does not represent an assumed liability on the acquisition date and is not recognised in the business combination. However, in its post-combination financial statements, Company X will recalculate the straight-line rent expense to be recognised in earnings based on the rentals over the remaining lease term (CU1,300 annually).

Example B.18 – Acquiree is a lessor in an operating lease

Company Q acquired Company R, an owner of an office building (an investment property) which is being leased to various third parties. The terms of the operating leases differ with some leases being above current market rate while others are below.

Analysis:
In this situation, Company Q does not recognise any separate intangible asset or liability related to the lease agreements in the business combination, although some have terms that are favourable or unfavourable to market. However, the terms of these leases are considered by Company Q in determining the fair value of the building.

Also, Company Q may attribute value to Company R's existing customer (tenant) relationships and may recognise one or more intangible assets.

Reacquired rights

In a business combination, the acquirer may reacquire a right it had previously granted the acquiree to use the acquirer's asset. Such a reacquired right is an identifiable asset recognised separately, irrespective of whether the underlying asset was previously capitalised in the acquirer's financial statements. For example the acquirer may have previously granted the acquiree the right to use its trade name or a licence to use its technology. The business combination then results in the acquirer reacquiring this right, even if it continues in legal existence and will be used in the acquiree's business in the future.

IFRS 3 guidance on recognition of reacquired rights in a business combination

- an acquirer should recognise an intangible asset if it reacquires a right it had previously granted to the acquiree to use the acquirer's recognised or unrecognised assets (IFRS 3.B35). Specific rules on measurement of reacquired rights apply – see Section B.4.3.1
- if the terms of the contract that gives rise to the reacquired right are either favourable or unfavourable compared to current market terms, the acquirer recognises a gain or loss on the acquisition date, separately from the business combination for the effective settlement of the pre-existing relationship (IFRS 3.B36). See Section 6.2.2 for more information.

Example B.19 – Reacquired rights

Company A is in the fast-food industry and has granted Company B an exclusive 5-year licence to operate franchised restaurants in a certain country. Company B paid a fixed fee for this licence.

A year later, Company A acquires Company B. On the acquisition date, Company A determines that the licence agreement reflects current market terms.

Analysis:

With the business combination, Company A now controls Company B and effectively reacquires control of the rights conveyed by the licence. Company A recognises a separate intangible asset for this reacquired right as part of the business combination.

4.2 How are the assets and liabilities measured?

4.2.1 IFRS 3's measurement principle

The assets acquired and liabilities assumed in a business combination are measured at their acquisition-date fair values (IFRS 3.18). However, there are a few exceptions to this measurement principle (see Section B.4.3).

If an asset or liability has a quoted price in an active market (for example, listed shares), this price is used as fair value. However, few assets and even fewer liabilities have such quoted prices. Fair value then needs to be estimated using a valuation technique.

This Section sets out the definition and underlying principles of fair value, and gives a very brief overview of valuation techniques. However, estimating fair values can be a complex exercise requiring considerable management judgement. Many acquirers engage professional valuation specialists to assist in this stage of the process.

IFRS 3's definition of fair value

"the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in arm's length transaction"

The definition uses certain terms that have a specific meaning in this context.

Key terms	The meaning of the key terms used in the definition
Knowledgeable	• both the buyer and seller are reasonably informed about the nature and characteristic of the asset or liability, its actual and potential uses and market conditions at the acquisition date
Willing	• the seller or buyer is motivated to sell or buy the asset or liability at market terms for the best price. A willing buyer would not pay a higher price than what the market requires. A willing seller is motivated but is not compelled to sell (ie this is not a distressed sale)
Arm's length	• the transaction is presumed to be between unrelated parties, each acting independently

Note: In May 2011, the IASB published IFRS 13 *Fair Value Measurement* (IFRS 13), which provides a single source of guidance for all fair value measurements and revises the definition of fair value. It does not affect which items are required to be 'fair-valued' but specifies how an entity should measure fair value and disclose fair value information. Consequently, it will supersede the guidance included in individual IFRSs on fair value measurement (including IFRS 3's guidance). IFRS 13 is to be applied for annual periods beginning on or after 1 January 2013. Earlier application is permitted. IFRS 13's provisions will affect some fair value estimates and should be referred to in accounting for business combinations in periods beginning on or after its date of application.

Fair value estimates have a pervasive effect on business combination accounting. Aside from measuring assets acquired and liabilities assumed, the acquisition method uses fair value to measure:

- consideration transferred (see Section B.6)
- any previously held interest in the acquiree (see Section B.7.1)
- any present ownership interests in the acquiree retained by non-selling shareholders, referred to in IFRS 3 as non-controlling interests (NCI) (if the acquirer chooses the fair value model – see Section B.5.1).

IFRS 3 defines fair value but does not provide detailed guidance on the valuation methodology. IFRS 3 does however include limited guidance on some specific situations (see Section B.4.2.2).

In practice, a number of valuation models and techniques are used to determine fair values. Management judgement is required to select the most appropriate valuation technique and to determine relevant inputs and assumptions. Valuation models and techniques can be grouped into three broad approaches:

Approach	Description and where these approaches are commonly used
Market approach	• estimates fair value from the transaction price and other relevant information in recent market transactions involving identical or similar assets or liabilities • commonly used to value financial assets and liabilities and real estate property
Income approach	• estimates fair value based on an asset's expected future cash inflows, discounted or capitalised at an appropriate rate • commonly used to value working capital type assets and liabilities, intangible assets, liabilities and equity instruments
Cost approach	• estimates fair value based on the amount necessary to replace an asset, assuming that a market participant will not pay more for an asset than its replacement cost • commonly used to value certain tangible assets (eg specialised machinery) and intangible assets (eg software assets to be used internally)

The complexity of the valuation process depends on the asset or liability in question. Some valuations require specialist expertise and management may need to engage a valuation professional. Whether or not a valuation professional is engaged, management's involvement in the process and in developing assumptions should be commensurate with its overall responsibility for the financial statements.

Whichever technique is used, the resulting valuation should be consistent with the definition and underlying concepts of fair value. The acquirer should ensure that the valuation:

- has an objective to estimate the price that would be paid or received in a hypothetical sale or transfer to other market participants (ie potential buyers and sellers)
- uses techniques and assumptions that are consistent with how other market participants would determine fair value
- does not take account of factors that are specific to the actual acquirer, such as the acquirer's intended use of an asset or synergies that would not be available to other market participants
- reflects conditions at the acquisition date
- utilises observable market inputs when available
- incorporates IFRS 3's specific guidance, as applicable.

4.2.2 IFRS 3's specific guidance on fair value measurement

IFRS 3 provides guidance on the determination of fair value in specific situations, as follows:

Assets	Specific IFRS 3 guidance on fair value measurement
Assets with uncertain cash flows (valuation allowances) (IFRS 3.B41)	• the acquisition-date fair value of assets such as receivables and loans should reflect the effects of uncertainty about future cash flows. A separate valuation allowance should not be recognised
Assets subject to operating leases – acquiree is the lessor (IFRS 3.B42)	• the acquisition-date fair value of an acquired asset (eg building or patent) subject to an operating lease should take into account the terms of the lease (eg whether it is favourable or unfavourable compared to market terms)
Assets that the acquirer intends not to use or to use in a way that is different from the way other market participants would use them (IFRS 3.B43)	• fair value should be determined in accordance with the asset's expected use by other market participants and should not be affected by the acquirer's intended use of the asset

The following examples illustrate some of the concepts of fair value:

Example B.20 – Fair value and buyer intentions

Company A acquires a competitor, Company B. The identifiable assets of Company B include its trade name. Company A plans to discontinue any marketing support to the acquired trade name and migrate Company B's customers to its own products. Company A intends to retain the trade name to prevent competitor access. Two valuations of the acquired trade name were determined: 1) estimated market value derived from other recent market transactions and 2) a lower value-in-use calculation based on the plan to discontinue its use.

Analysis:

In this situation, the fair value of the acquired trade name is based on the price that could be realised in an orderly, arm's length transaction with other market participants. The higher valuation based on evidence of the estimated market value should be used and the acquirer's plan to discontinue the use of the trade name should not affect the valuation.

Matters to consider after the acquisition date:

This type of asset is commonly referred to as a defensive intangible asset. The value of a defensive intangible asset is expected to diminish over a period of time resulting mainly from the lack of marketing support and exposure. For this reason, the immediate impairment of the asset may not be appropriate. Determining the useful life of the asset, however, can be difficult. Since there is no intention to use the trade name, the useful life may then be viewed as the period of time for which holding the trade name will be effective in discouraging competition. It is expected that this would be a fairly short period, as the value of an unsupported trade name diminishes rather quickly.

Example B.21 – Identifying comparable market transaction

An acquirer is determining the fair value of the acquiree's parcel of land in an industrial park. An analysis of recent sales in similar locations indicated a disparity in transaction prices per unit of area. Further analysis identified some 'outlier' prices related to: (i) a sale of land by a company in liquidation; (ii) a sale between related parties; and (iii) a sale to a developer of a property for which planning consent for conversion to residential use has been obtained.

Analysis:

In this situation, judgement will be required to identify those recent market transactions that are relevant from a fair value perspective. A liquidation sale may be a distress sale rather than a willing seller. A related party sale may not be at arm's length. The price the developer paid is likely to reflect the planning consent and the highest and best use of that specific property. Further analysis is required to assess whether possible alternative uses (including, if applicable, the likelihood of planning consent) would be taken into account by market participants in agreeing a price for the acquired property.

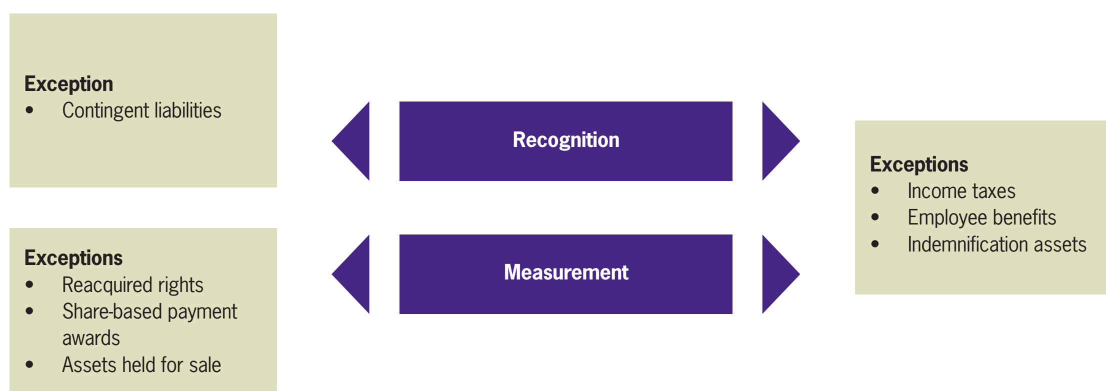
4.3 Specific recognition and measurement provisions

IFRS 3 has specific guidance on how some items are recognised and measured. This guidance is described as a series of exceptions to the general recognition and measurement principles (as discussed in Sections B.4.1 and B.4.2 respectively).

This Section briefly discusses this specific guidance and provides examples to illustrate its application. In addition, Section B.4.3.2 discusses the recognition and measurement requirements for deferred taxes and provides insights on how these are applied in practice.

4.3.1 Assets and liabilities subject to specific guidance (exceptions)

The diagram below summarises the assets and liabilities covered by IFRS 3's limited exceptions:



The specific recognition and measurement requirements for the above items are as follows:

Asset or liability	Specific IFRS 3 guidance	Relevant example
Recognition exception Contingent liabilities (IFRS 3.23)	• recognised only if a present obligation that arises from past events and fair value can be measured reliably • recognised even if an outflow of economic benefits is not probable (uncertainty is considered in the determination of fair value) • other contingent liabilities and contingent assets are not recognised	Examples B.22 and B.23 below
Measurement exceptions Reacquired rights (IFRS 3.29)	• fair value is determined based on remaining contractual term without attributing value to possible renewals	Example B.31 in Section B.6.2.2 Example B.19 and Section B.4.1.4 for the recognition requirements
Replacement share-based payment awards (IFRS 3.30)	• measured in accordance with IFRS 2 *Share-based Payment* (IFRS 2) – see Section B.6.2.5	Example B.35 in Section B.6.2.5
Assets held for sale (IFRS 3.31)	• measured at fair value less costs to sell in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*	
Recognition and measurement exceptions Income taxes (IFRS 3.24-25)	• deferred tax balances are recognised if related to temporary differences and loss carry-forwards at the acquisition date or if they arise as a result of the acquisition • measured in accordance with IAS 12 *Income Taxes*	See Section B.4.3.2 for more details
Employee benefits (IFRS 3.26)	• recognised and measured in accordance with IAS 19 *Employee Benefits*. The present value of defined benefit obligations should include items (even if not previously recognised by the acquiree), such as: – actuarial gains and losses arising before the acquisition date – past service cost arising from benefit changes or the introduction of a plan, before the acquisition date • any net plan asset recognised is limited to the extent that it will be available to the acquirer as refunds from the plan or a reduction of future contributions • the effect of any settlement or curtailment is recognised in the measurement of the obligation only if it occurred before the acquisition date	
Indemnification assets (ie assets arising from the acquiree's former owners contractually indemnifying the acquirer for a particular uncertainty) (IFRS 3.27-28)	• the indemnification asset is measured and recognised on a basis that matches the related item, subject to the contractual provisions or any collectibility considerations	Example B.24 below

Example B.22 – Possible obligation arising from a lawsuit

Company X purchased 100% of Company Y. Company Y is being sued over an alleged breach of a brand licensing agreement. As of the acquisition date, Company Y's management denies the breach and believes that the claim is unjustified. This is consistent with the view of its legal advisers which indicated that there is only a small chance (of approximately 10%) that a court of law would uphold the claim.

Analysis:
This is an example of a 'possible obligation'. Company Y assesses that it has no present obligation at the acquisition date as the available evidence indicates that the alleged breach did not happen. Accordingly, Company X does not record a separate liability for the lawsuit.

Example B.23 – Liability arising from a lawsuit

Company A purchased 100% interest of Company B. Company B is being sued over a personal injury allegedly caused by a faulty product. The claimant is suing for CU1 million in damages. The acquiree's management acknowledge that the product was faulty and may have caused injury. However, they strongly dispute the level of damages being claimed. The acquiree's legal advisers estimate such claims are usually settled for between CU100,000 and CU250,000.

Analysis:
Based on the available evidence, this is an example of a present obligation, which is consequently recognised as a contingent liability and measured at fair value. Company A will need to estimate the fair value of the liability which may involve weighting possible outcomes within the expected range using their associated probabilities.

Example B.24 – Indemnification asset

Company W acquires Company X from Company Y. The purchase price is CU1,000. Company X has a contingent liability in respect of litigation by a third party. Company Y agrees to reimburse Company W if these costs are incurred, up to a maximum of CU100. Company W's management concluded that this is a present obligation and the fair value of the liability at the acquisition date is determined to be CU60.

Analysis:
In this situation, Company W will recognise a contingent liability of CU60 and an indemnification asset of CU60, measured and recognised on the same basis as the related contingent liability, less a valuation allowance if necessary.

4.3.2 Recognising and measuring deferred taxes

IFRS 3 requires deferred taxes in a business combination to be recognised in accordance with IAS 12 *Income Tax* (IAS 12).

Items to be recognised and measured in accordance with IAS 12 (IFRS 3.24-25)

- any deferred tax asset or liability arising from the assets acquired and liabilities assumed in the business combination
- potential tax effects of temporary differences, carry forwards and income tax uncertainties of the acquiree that exist at acquisition date or that arise as a result of the combination

When applying the above requirements, the acquirer does not recognise the historical deferred tax balances recorded in the acquiree's own financial statements. Instead, a new acquisition-date exercise is performed to determine deferred tax balances to be recognised. This may require careful analysis and judgement, taking into account:

- the relevant tax laws in the jurisdiction(s) where the acquiree operates
- the tax status of the acquiree
- the nature of assets and liabilities recognised as part of the business combination
- the specific tax rules that may give rise to differences between amounts recognised and the related tax bases
- any tax loss carryforwards, uncertainties or other tax attributes of the acquiree.

The following table summarises the key steps in determining the appropriate deferred tax balances:

Steps	Guidance
Determine the recognised amounts of the assets and liabilities	• see Sections B.4.2 and B.4.3
Identify the applicable tax bases and determine temporary differences	• identify any deductible or taxable temporary differences, based on the recognised amounts of assets and liabilities in the business combination accounting, and their relevant tax bases. The specific application of the requirements will depend on the tax regime but we commonly observe that: – in a combination effected by acquisition of a legal entity, the tax bases normally reflect amounts attributed to the assets and liabilities for the purpose of the acquiree's tax filings – if an item is recognised in the business combination that was not previously recognised by the acquiree (such as some intangible assets), its tax base is often zero – for items that were recognised by the acquiree, the use of acquisition-date fair values changes the carrying amounts but will often not affect their tax bases. This creates new temporary differences or changes the amount of existing differences.
Identify acquired tax benefits or other tax attributes	• determine if there are any acquired tax losses, credit carry forwards, or other relevant tax attributes (eg tax uncertainties) that need to be recognised as part of the business combination
Record deferred tax assets and deferred tax liabilities	• determine the appropriate tax rate • recognise deferred tax liabilities on taxable temporary differences in accordance with IAS 12. However, no deferred tax liability is recognised on goodwill arising from the business combination (IAS 12.66) • assess whether deferred tax assets should be recognised for deductible temporary differences based on the provisions of IAS 12, and recognise to the extent required. Note that: – the acquisition itself may affect the analysis of the recoverability of the deferred tax assets (including the acquirer's pre-acquisition deferred tax assets), for example by changing the probability that sufficient future profits will be available – where the acquisition results in a change in the acquirer's pre-acquisition deferred tax assets, the effect is recognised in earnings in the period of the business combination. This is treated as a transaction separate from the business combination and does not affect the determination of goodwill (IAS 12.67).

4.4 Classify or designate identifiable assets acquired and liabilities assumed

The accounting for assets and liabilities depends on how they are classified or designated. The acquisition method requires the acquirer to classify and designate acquired assets and liabilities based on conditions at the acquisition date. This takes into account:

- the contractual terms of the assets and liabilities
- the acquirer's economic conditions
- the acquirer's operating or accounting policies
- other pertinent conditions (IFRS 3.15).

Therefore, the acquirer's classifications and designations may differ from those of the acquiree before the combination.

IFRS 3 provides a non-exhaustive list of examples of the classification or designation of acquired assets and liabilities.

Examples (IFRS 3.16):

- classification of particular financial assets and liabilities in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) or IFRS 9 *Financial Instruments*
- designation of a derivative instrument as a hedging instrument
- assessment of whether an embedded derivative should be separated from the host contract, which will be dependent on the classification of the host contract

The scope of this requirement is potentially broad and a large number of items may need to be assessed. In practice, the most significant area is often financial instruments, including classification in accordance with IAS 39 or IFRS 9, assessment of embedded derivatives and hedge accounting. Particular attention may need to be paid to the acquiree's hedge accounting designations (if any). The acquiree's original designations cannot be continued in the acquirer's post-combination financial statements. New designations are therefore required if the acquirer wishes to apply hedge accounting. These new designations may be susceptible to greater hedge ineffectiveness because the acquired hedging instruments (derivatives in most cases) are probably no longer 'at market'.

IFRS 3 provides two exceptions to this general principle, concerning leases and insurance contracts. A lease is classified as an operating or finance lease (under IAS 17) or a contract is classified as an insurance contract (under IFRS 4 *Insurance Contracts*) based on their contractual terms and other factors at the inception of the contract or modification date if applicable (IFRS 3.17).

5 Recognising and measuring any NCI

Step 5
Recognising and measuring any non-controlling interest (NCI)

Non-controlling interest (NCI) is IFRS 3's term to describe equity instruments of the acquiree not held directly or indirectly by the acquirer. NCI arises when an acquirer owns less than 100% of the equity of the acquiree. IFRS 3 includes an accounting policy option to initially measure some types of NCI at fair value. The measurement of NCI can affect the amount of goodwill and subsequent accounting.

IFRS 3 Definition of NCI

'the equity in a subsidiary not attributable, directly or indirectly, to a parent'

The simplest and most common form of NCI is shares in the acquiree held by non-selling shareholders. However, all instruments issued by the acquiree that meet IAS 32's definition of equity – such as some share options – are also NCI if they are not attributable to the parent. It is therefore important to distinguish the acquiree's equity instruments from its financial liabilities based on the definitions in IAS 32 *Financial Instruments: Presentation*. NCI is presented as a separate component of equity in the acquirer's post-combination financial statements and is subsequently accounted for in accordance with IAS 27.

NCI can be grouped in two broad categories. These in turn determine the available measurement options:

Category	Description	Measurement option
Present ownership instruments	• acquiree's shares held by non-selling shareholders that entitle them to a proportionate share of the acquiree's net assets in the event of liquidation (eg common or ordinary shares)	• fair value; or • proportionate share of recognised assets and liabilities (IFRS 3.19)
Other components of NCI	• other financial instruments issued by the acquiree that meet IAS 32's definition of equity (eg warrants or call options on 'fixed-for-fixed' terms)	• fair value

Note: In May 2010, the IASB issued the 2010 *Annual Improvements to IFRSs*. This clarified that the choice of measuring NCI either at the fair value model or the proportionate interest model is limited to NCI that are present ownership instruments and entitle their holders to a proportionate share of the acquiree's net assets in the event of liquidation. The amendment is effective for periods beginning on or after 1 July 2010.

The acquirer may arrange with non-selling shareholders to acquire NCI shares after the acquisition date – for example by entering into put or call options or a forward contract. An analysis is then required to determine whether, in substance, the underlying shares in question are attributable to non-controlling shareholders or to the acquirer. If the underlying shares are determined to be attributable to the acquirer, NCI is not recognised. Section B.6.2.7 discusses this assessment and its consequences on the acquisition accounting.

5.1 NCI measurement options

The basis on which NCI is measured affects goodwill at the acquisition date. When the fair value model is used, 100% of the goodwill in the acquiree is recognised (both the acquirer's and the NCI's share). This is sometimes described as the full goodwill model. Under the proportionate interest model only the acquirer's interest in the goodwill is recognised (a lesser amount).

The following example shows the basic effect of the two models:

Example B.25 – Measuring NCI

Company A pays CU800 for an 80% interest in Company B. Company A does not have any previously held equity interest in entity B. The fair value of Company A's identifiable net assets is estimated to be CU750. Using a valuation technique, the fair value of the remaining 20% in Company B (the NCI) on the acquisition date is determined to be CU180.

Amount of NCI and Goodwill recognised under the alternative methods:

	Fair value model	Proportionate interest model
	CU	CU
Cash consideration	800	800
NCI at fair value	180	–
NCI at 20% of identifiable net assets	–	150
Total	980	950
Fair value of 100% of identifiable net assets	750	750
Goodwill	**230**	**200**
Recognised amount of NCI	**180**	**150**

Apart from the effect on goodwill, other factors that may influence the policy choice are:

- a lower goodwill amount under the proportionate interest model can lead to lower impairment charges later. Under IAS 36 *Impairment of Assets* (IAS 36), goodwill is grossed up to include the NCI's portion. The gross amount is compared to the recoverable amount to determine any impairment but only the impairment loss relating to the parent's goodwill is recognised
- estimating the fair value of NCI may increase costs and complexity
- the measurement model chosen can affect subsequent adjustments to NCI in accordance with IAS 27 (see Section C.2.1).

5.2 Determining the fair value of NCI

IFRS 3 provides some guidance on how the fair value of NCI is determined when applicable:

IFRS 3's guidance on the fair value of NCI:

- the fair value of NCI is based on the quoted price in an active market for the equity shares not held by the acquirer, if available. Otherwise, the acquirer would measure the fair value of NCI using other valuation techniques (IFRS 3.B44)
- the fair value of the acquirer's interest in the acquiree and the NCI on a per-share basis might differ. The fair value per share of the acquirer's interest in the target company is likely to include a control premium (IFRS 3.B45)

6 Consideration transferred

Step 6
Determining consideration transferred

IFRS 3 refers to 'consideration transferred' rather than 'purchase price' or 'cost of investment'. The key distinction is that consideration transferred comprises only what is transferred in exchange for the acquiree (IFRS 3.51). This amount excludes transaction costs, but includes contingent consideration.

Consideration transferred differs from the contractual purchase price (ie the price stated in the purchase agreement) if the overall transaction or arrangement includes elements that (under IFRS 3's principles) are not part of the business combination. This Section discusses the main practical issues affecting consideration transferred, using examples to illustrate some of the requirements.

Components of consideration transferred (IFRS 3.37):

Consideration transferred is the sum of the acquisition-date fair values of:

- the assets transferred by the acquirer
- the liabilities incurred by the acquirer to former owners of the target company and
- the equity interests issued by the acquirer

in exchange for the acquiree.

It is helpful to divide the process of determining consideration transferred into two key steps:

Contractual purchase price based on the purchase agreement	See Section B.6.1
+ / –	
Adjustments for transactions not part of the business combination	See Section B.6.2
=	
Consideration transferred in exchange for the acquiree	

6.1 Contractual purchase price

The contractual purchase price may include more than one type of consideration. Certain types of consideration affect reported results at the acquisition date and subsequently, as discussed further below.

Potential forms of consideration (IFRS 3.37):

- cash
- other assets (eg property, plant and equipment)
- a business or a subsidiary of the acquirer
- contingent consideration
- equity interests issued by the acquirer such as ordinary or preference shares, options, warrants and member interests of mutual entities

Specific considerations apply to:

- contingent consideration (see Section B.6.1.1)
- transfer of acquirer's asset (see Section B.6.1.2)
- share-for-share exchanges, including combinations of mutual entities (see Section B.6.1.3)
- combinations in which no consideration is transferred (see Section B.6.1.4).

6.1.1 Contingent consideration

Many combinations include contingent consideration – defined as an obligation of the acquirer to transfer additional assets or equity interests to the acquiree's former owners if specified future events occur or conditions are met. This can be a useful mechanism to enable the acquirer and the vendor to agree on terms of the business combination in the face of uncertainties that may affect the value and future performance of the acquired business.

IFRS 3 provides guidance on the recognition and measurement of contingent consideration:

IFRS 3's recognition and measurement provisions:

- contingent consideration is recognised and measured at fair value on the acquisition date (IFRS 3.39)
- IAS 32 *Financial Instruments: Presentation* is applied to determine classification as a financial liability or as equity (IFRS 3.40)
- where the purchase agreement includes a right to the return of previously transferred consideration if specified conditions are met, the acquirer classifies that right as an asset (IFRS 3.40)

When applying IFRS 3's requirements on contingent consideration:

- the amount recognised on the acquisition date directly impacts goodwill and reported liabilities or equity
- classification either as liability or equity under IAS 32 affects post-combination reported results as follows:
  - a contingent consideration liability is subsequently remeasured at fair value through profit or loss until settled (see Section C.1.2)
  - contingent consideration classified as equity is not remeasured and its subsequent settlement is accounted for within equity
- goodwill is not adjusted after the acquisition date to reflect changes in the fair value or settlement of contingent consideration except for adjustments qualifying as measurement period adjustments (see Section B.8) or arising from corrections of errors
- some contingent consideration arrangements may include transactions that are accounted for separately from the business combination (see Section B.6.2).

The following examples illustrate some of IFRS 3's key principles on contingent consideration:

Example B.26 – deferred and contingent consideration

Company A acquires the entire equity of Company B for CU120,000. Company A also agrees to pay an additional amount that is the higher of CU1,500 and 25% of any excess of Company B's profits in the first year after the acquisition over its profits in the preceding 12 months. This additional amount is due after two years. Company B earned profits of CU20,000 in the preceding 12 months but expects to make at least CU30,000 in the year after the acquisition date.

Analysis:

In this situation, contingent and deferred payments should be differentiated. Company A agrees to pay an amount that is the higher of two amounts. The additional amount of CU1,500 is the minimum amount payable by Company A and is not subject to any contingency. Accordingly, this amount is a deferred payment rather than a contingent payment. The contingent payment only relates to the portion that will be paid if Company B exceeds its profit target.

Consideration transferred consists of cash paid and both the deferred and contingent payment, measured at fair value:

- cash at its face amount
- deferred payment at its present value – determined by discounting it using a market rate of interest for a similar instrument of an issuer with a similar credit rating
- contingent payment at its estimated fair value – determined taking into account the probability that Company B will earn profits above the level that triggers additional payment.

Example B.27 – contingent consideration payable in fixed number of shares

An acquirer purchased a business in the pharmaceutical industry. The sale and purchase agreement specifies the amount payable as:

- cash of CU100 million to be paid on the acquisition date and
- an additional 1,000,000 shares of the acquirer to be paid after 2 years if a specified drug receives regulatory approval.

Analysis:

The consideration transferred comprises the cash paid plus the fair value of the contingent obligation to pay 1,000,000 shares in 2 years' time. The fair value of the contingent element would be based on a 2-year forward price and would be reduced by the effect of the performance conditions.

The classification of the contingent consideration is based on the definitions in IAS 32. Because this obligation can be settled only by issuing a fixed number of shares, it is classified as an equity instrument. Accordingly, the initial fair value of the contingent consideration is credited to equity. There is no subsequent adjustment (although the credit might be reclassified within equity on settlement in shares or on expiry of the obligation).

Example B.28 – Contingent consideration payable in variable number of shares

On 31 December 20X1, Company X acquired business Y. The consideration is 80,000 shares of Company X, plus an additional number of shares equivalent to CU100,000 (based on the fair value of Company X shares) if the average profits of Y in 20X2 and 20X3 exceed a target level. The additional shares will be issued on 7 January 20X4, if applicable. There are no other costs of the combination.

At the acquisition date, Company X's management consider that it is 40% probable that Y will achieve its average profit target. At that date, the fair value of Company X's shares is CU10. Also, the entity determines that the prevailing rate of return for financial instruments having substantially the same terms and characteristics of the contingent consideration is 5%.

Analysis:

To account for the business combination, Company X will include the contingent consideration in determining the total consideration transferred related to the purchase of Y. On the acquisition date, the consideration transferred will then be equal to CU836,281 which consists of:

- the fixed amount of shares to be issued of CU800,000 (80,000 x CU10) plus
- the fair value of the contingent consideration of CU36,281 (CU100,000 / $(1.05)^2$ x 40%†).

The contingent consideration requires the issuance of a variable number of shares equal to a fixed monetary amount. Accordingly, it is classified as a financial liability.

Notes:

The same accounting treatment will apply in situations where contingent consideration is payable in cash.

† IFRS 3 does not specify a valuation technique for measuring fair value. A simple approach is used here but other valuation techniques may be more appropriate to use in practice.

6.1.2 Transfer of acquirer's assets

When consideration transferred includes the transfer of a non-cash asset of the acquirer to the vendor (eg property, plant and equipment or a business), the asset is remeasured at its fair value on the acquisition date. Any difference between its fair value and its carrying amount is recognised immediately in profit or loss.

However, IFRS 3 provides an exception to the use of fair value in situations where the asset is transferred to the combined entity rather than the vendor. Effectively, the acquirer retains control of the asset in such a situation. The asset does not then form part of the consideration transferred and continues to be measured at its pre-combination carrying amount (IFRS 3.38).

6.1.3 Share-for-share exchanges and combinations of mutual entities

A business combination can be effected by a share-for-share exchange (ie acquirer issues its shares to the vendors in exchange for the acquiree's shares). Under IFRS 3, consideration transferred is determined based on the fair value of the shares issued by the acquirer. However, IFRS 3 provides a mandatory alternative if the shares acquired are more reliably measurable:

IFRS 3's guidance on share-for-share exchanges (IFRS 3.33):

Consideration transferred is measured using the acquisition-date fair value of the acquiree's equity interests received if this fair value is more reliably measurable than the acquisition-date fair value of the acquirer's equity interests transferred

This situation may arise, for example, when a private company acquires a public company with shares that are traded in an active market. The quoted price of the acquiree's shares is likely to provide a more reliable measure of fair value than an estimate of the value of the acquirer's shares using a valuation method.

Some specific issues arise in business combinations between mutual entities. These are commonly effected by an exchange of members' interests. IFRS 3's alternative in determining consideration transferred for share-for-share exchanges equally applies to such situations. If more reliably measurable, the fair value of the members' interest in the acquiree (or fair value of the acquiree) is used to determine consideration transferred instead of the fair value of the acquirer's members' interest transferred (IFRS 3.B47).

IFRS 3.B47-B49 provides additional guidance on this aspect of accounting for combinations between mutual entities.

6.1.4 Business combinations with no consideration transferred

A business combination can be effected without paying any consideration (see Section B.1.2). IFRS 3 provides examples of these situations (IFRS 3.43):

- an investee repurchases its own shares held by other investors resulting in an existing shareholder becoming the majority shareholder
- cancellation or expiry of veto or similar voting rights of other shareholders that prevented the investor from exercising control
- business combinations achieved by contract alone (eg stapled arrangements or forming a dual-listed entity).

Since there is no consideration transferred in these situations, IFRS 3 provides specific guidance on how goodwill is determined:

Determining goodwill when there is no consideration transferred (IFRS 3.33)

In determining goodwill, the acquirer substitutes the fair value of consideration transferred with the acquisition-date fair value of the acquirer's interest in the acquiree (determined using an appropriate valuation technique)

In a business combination achieved by contract alone the acquirer holds no equity interest in the acquiree before or after the acquisition date. IFRS 3 then requires the acquirer to attribute all of the equity interest held by parties other than the acquirer as NCI, even if this results in 100% NCI (IFRS 3.44).

6.2 Adjustments for transactions not part of the business combination

In effecting a business combination, the acquirer may enter into transactions and arrangements with the vendor and/or acquiree that are not part of the business combination (under IFRS 3's principles). These must be accounted for separately. Some separate transactions are referred to directly in the purchase contract, an example being an agreement by the vendor to reimburse the acquirer's transaction costs. More often, identifying a separate transaction and its accounting consequences requires a careful analysis of the overall arrangement and circumstances and their substance. Many transactions that, from a commercial perspective, are consequential or integral to a business combination are not part of the combination for IFRS 3 purposes.

As discussed in Section B.6, accounting for a separate transaction often involves adjusting the contractual purchase price. Only consideration transferred in exchange for the assets and liabilities of the acquiree is included in the calculation of goodwill (or gain on a bargain purchase). Payments that, in substance, relate to separate transactions are not included in consideration transferred and may give rise to a separate gain, loss, liability or asset.

6.2.1 Identifying separate transactions

IFRS 3 provides a list of indicators to be considered in these situations, which are neither mutually exclusive nor individually conclusive:

Determining factor	Indicators (IFRS 3.B50)
Reason for the transaction	• a transaction arranged primarily for the benefit of the acquirer or the combined entity is less likely to be part of the exchange for the acquiree
Who initiated the transaction	• a transaction or arrangement initiated by the acquiree or the former owners is less likely to be for the benefit of the acquirer or the combined entity and more likely to be part of the business combination transaction
Timing of the transaction	• a transaction that takes place during the business combination negotiation needs to be carefully analysed as it may have been entered into to provide future economic benefits to the acquirer or the combined entity rather than the seller

IFRS 3 specifies three types of transactions that are separate from the business combination (IFRS 3.52). It also provides guidance on how these transactions affect the calculation of consideration transferred:

A transaction that:	IFRS 3 guidance
In effect settles pre-existing relationships between the parties	• see Section B.6.2.2
Remunerates employees or former owners of the acquiree for future services	• see Section B.6.2.3
Reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs	• see Section B.6.2.4

In addition, the following transactions or agreements may result in a consequential adjustment to the contractual price:

Description	Impact on consideration transferred
Acquiree's share-based payment awards	• see Section B.6.2.5 and 6
Contracts to acquire shares from non-selling shareholders in the future	• see Section B.6.2.7

6.2.2 Settlement of pre-existing relationship

The parties to a business combination may have an existing relationship, either through a contractual commercial arrangement (eg supplier and customer relationship) or a non-contractual relationship (eg litigation). A business combination between such parties is viewed as an effective settlement of this pre-existing relationship. It is then assumed that the contractual price will include an amount relating to the settlement. Consequently:

- on the acquisition date, the acquirer recognises a settlement gain or loss
- the contractual purchase price is adjusted for the amount deemed to relate to the effective settlement in arriving at consideration transferred in exchange for the acquiree.

IFRS 3's guidance on the settlement of pre-existing relationship (IFRS 3.B52 and IFRS 3.B53)

- a gain or loss on the settlement of the relationship is recognised in the income statement on the acquisition date. Measurement of the gain or loss depends on whether the relationship is contractual or non-contractual (see below)
- the same requirement applies to reacquired rights where the terms of the related contract are favourable or unfavourable relative to current market terms (see Section B.4.1.4)

Measurement of gain or loss on the settlement of pre-existing relationship (IFRS 3.B52)

Relationship	Measurement
Non-contractual	• measured at fair value
Contractual	• the lesser of the following: – the amount by which the contract is favourable or unfavourable from the acquirer's perspective when compared to market terms – the amount of any stated settlement provisions available to the counterparty to whom the contract is unfavourable • if the latter amount is the lesser, the difference is included as part of the accounting for the business combination

Note: any gain or loss on settlement will be affected by any related asset or liability previously recognised by the acquirer

The following examples illustrate IFRS 3's guidance on pre-existing relationships:

Example B.29 – Settlement of pre-existing non-contractual relationship

Company P is being sued by Company C for an infringement of Company C's patent. At 31 December 20X1, Company P recognised a CU5 million liability related to this litigation.

On 30 June 20X2, Company P acquired the entire equity of Company C for CU120 million. On that date, the estimated fair value of the expected settlement of the litigation is CU8 million.

Analysis:

Because of the acquisition, the litigation between the two parties is effectively settled. Company P accounts for this settlement separately and recognises a settlement loss of CU3 million (difference between the fair value and the previously recognised liability). In accounting for the business combination, the contractual purchase price of CU120 million is reduced by the CU8 million attributable to the settlement resulting in a consideration transferred of CU112 million.

Example B.30 – Settlement of pre-existing supply agreement

Company A purchases raw materials from Company B at fixed rates under a 5 year-supply agreement. Company A is able to cancel the agreement by paying a fee of CU4 million.

Two years into the agreement, Company A acquired the entire equity of Company B for CU40 million. On that date, the terms of the supply agreement are unfavourable to Company A since the fixed rates are higher than current market prices. The estimated fair value of the contract for Company B is CU5 million, with CU2 million representing the component that is 'at market' terms and a CU3 million component relating to the unfavourable pricing for Company A.

Prior to the acquisition, Company A has concluded that the supply agreement is not an onerous contract and no liability related to the agreement has been recorded in its financial statements.

Analysis:

Company A's acquisition of Company B effectively settles the supply agreement. Company A accounts for this settlement as a separate transaction and recognises a settlement loss of CU3 million* (as this amount is lower than the cancellation fee).

In accounting for the business combination, the consideration transferred is measured at CU37 million representing the contractual price of CU40 million reduced by CU3 million attributable to the loss on settlement of the supply agreement.

The CU2 million representing the 'at market' component of the fair value of the supply agreement is subsumed into goodwill. No separate intangible asset (ie a reacquired right) is recognised as the business combination does not represent a reacquisition of a previously granted right to use Company A's assets.

* If Company A had previously considered the supply agreement to be an onerous contract (under IAS 37), the loss on settlement would be reduced by any previously recognised liability for this onerous contract.

Example B.31 – Settlement of pre-existing licence agreement

Company Q granted a 5-year licence to Company S to use Company Q's technology at a fixed annual fee. Company S is able to cancel the licence agreement by paying a fee of CU2 million. Two years into the agreement, Company Q acquires Company S for CU100 million. On that date, the fair value of the licence agreement is CU4.5 million (includes CU0.5 million relating to the value of expected renewals). The terms of the licence agreement are unfavourable to Company Q when compared to market terms by CU1.5 million.

Analysis:

The business combination effectively settles the licensor-licensee relationship. Company Q accounts for this settlement as a separate transaction and recognises a settlement loss of CU1.5 million (the lower of the value of the unfavourable pricing and the contractual termination fee).

In accounting for the business combination, the consideration transferred is measured at CU98.5 million (contractual price of CU100 million reduced by the CU1.5 million loss on settlement of the licence agreement).

In this situation, an assessment is necessary to determine whether the business combination includes a reacquired right (ie reacquisition of the right to use the technology previously granted by Company Q to Company S). If there is such a reacquired right, it is recognised separately from goodwill (see Section B.4.1.4 for the recognition requirements) and measured at fair value, without attributing value to the possibility of renewals (see Section B.4.3.1).

6.2.3 Employee compensation arrangements

In many business combinations, some or all of the selling shareholders may also be key employees in the acquired business (eg owner-managers). These individuals may remain employed with the acquired business after the business combination. In addition, the purchase agreement may include contingent payments (see Section B.6.1.1) that depend both on meeting a specified target and on these employee-shareholders' continued employment for a specified period.

Such contingent payment arrangements must be analysed to determine whether some or all of the payments are, in substance, compensation for future employee services rather than payment for the acquired business. This determination will depend on the specific terms and conditions of the purchase and other related agreements, and may require judgement.

IFRS 3 provides indicators (in addition to the general indicators discussed in Section B.6.2.1) to assist in this analysis. All of these indicators should be considered. However, IFRS 3 states that if the contingent payment is automatically forfeited upon termination of employment, the payment is considered remuneration for post-combination services.

Indicators	Analysis and possible conclusions (IFRS 3.B55)
Continuing employment	• if the contingent payment is automatically forfeited upon termination of employment, it is considered remuneration for post-combination services • if payment does not require continued employment and is not affected by termination, the payment is likely to be part of consideration transferred
Duration of employment	• if the period of required employment coincides with or is longer than the contingent payment period, it is likely to be considered remuneration
Level of remuneration of the selling shareholder employee	• if the remuneration (excluding the contingent payment) of the employee is reasonable compared to other key employees, the contingent payment is likely to be considered part of consideration transferred
Incremental payments to selling shareholder employees	• if the amount of contingent payment is the same for all selling shareholders regardless of their continued employment, the payments are likely to be part of consideration transferred • if the selling shareholder employee is paid a higher amount than those who did not become employees, any incremental amount paid to the selling shareholder employee is likely to be considered remuneration
Number of shares previously owned by selling shareholder employee	• the contingent payment is likely to be a profit-sharing remuneration arrangement if the selling shareholder employee previously owned a substantial interest in the acquiree • alternatively, if the selling shareholder employee only owned a minimal amount of interest and all other selling shareholders receive the same contingent payment, the contingent payment is likely to be part of consideration transferred • when making this analysis, the ownership interests of parties related to the selling shareholder employee are also considered

Indicators	Analysis and possible conclusions (IFRS 3.B55)
Linkage of the formula for determining contingent payment to the valuation	• if the purchase price is based on the low end of a range established in the valuation of an acquiree and the formula for determining contingent payment relates to that valuation, this suggests that the contingent payment is additional consideration • alternatively, if the formula for determining contingent payment is consistent with prior profit sharing arrangements, this suggests that the payment is intended as remuneration
Formula for determining contingent payment	• if the formula is based on a multiple of earnings, this suggests that the formula is intended to establish or verify the fair value of the acquiree. In this case, the payment is likely to be part of consideration transferred • alternatively, if it is based on a specified percentage of earnings, it suggests that it is intended as a profit-sharing arrangement
Other agreements and issues	• the terms of other arrangements with the selling shareholders (eg not to compete agreements, executory contracts, consulting contracts and lease agreements) and the income tax treatment of contingent payments may indicate that the contingent payment may be other than consideration for the acquired business • for example, in conjunction with the acquisition, the acquirer may enter into a lease agreement with a selling shareholder (the lessor). If the payment terms of the lease are significantly below market, it is possible that part of the contingent payment is for payment of the lease and should be recognised as lease expense. Alternatively, if the lease payment terms are at market terms, the contingent payment is likely to be part of consideration transferred

Other employment compensation arrangements, such as key staff retention bonuses, are also post-combination expense items and not therefore part of consideration transferred (see Example B.33). Replacement of an acquiree's share-based payment awards also affects consideration transferred as discussed in Section B.6.2.5.

The following examples illustrate IFRS 3's guidance on employee compensation arrangements:

Example B.32 – Payments to selling shareholder who remains as an employee

Company X acquires a 100% interest in Company Z, a company owned by a single shareholder, for a cash payment of CU5 million and a contingent payment of CU1 million. The terms of the agreement provide for payment 2 years after the acquisition if the following conditions are met:

- the total profits of Company Z in the 2 years following the acquisition exceed a certain amount
- the former shareholder continues to be employed with company Z for at least 2 years after the acquisition. No part of the contingent payment will be paid if the former shareholder does not complete the 2 years employment period.

Analysis:

In this situation, the former shareholder is required to be continuously employed and the contingent payment will be forfeited upon termination of employment within the contingent payment period. The CU1 million contingent payment is deemed to be payment for future services and is recognised in the post-combination income statement as compensation expense.

In accounting for the business combination, only the cash payment of CU5 million is treated as consideration transferred.

Example B.33 – Compensation arrangements with employees

Company A acquired Company B for a cash payment of CU30 million. In conjunction with the business combination, Company A entered into an arrangement with certain key employees (who are not shareholders) of Company B to provide for incentive payments to employees if they remain employed for at least two years from the acquisition date. The employees will continue to receive performance bonuses under their existing employment contracts.

Analysis:
In this situation, Company A will make the incentive payments to the key employees in their capacity as employees and not owners of Company Y. Although the transaction is associated with the business combination, it is accounted for separately from the business combination:

- the incentive payments are in contemplation of the post-acquisition services to be performed by key employees. While not linked to performance, they are designed to encourage the employees to stay for a specified period. Accordingly, the payment will be recognised as remuneration in the post-combination income statement
- the incentive payment does not form part of the consideration transferred. It is also not possible to argue that the incentive payments represent an identifiable liability (contingent) of the acquired business, because there is no obligation to make such payments as of the acquisition date.

6.2.4 Acquisition costs

In most situations, the acquirer pays its own acquisition-related costs. IFRS 3 provides that such acquisitions costs are recognised as an expense when incurred.

IFRS 3's guidance on acquisition costs:

- recorded as an expense in the income statement. The only exception is the treatment of costs to issue debt or equity, which are treated as reduction of proceeds of the related instruments (IFRS 3.53)
- also applies to acquisition costs paid by the acquiree or its former owners and reimbursed by the acquirer (IFRS 3.52(c))

A purchase agreement may specify that acquisition costs are paid by the vendor. The costs may or may not be reimbursed by the acquirer. In both cases the acquirer recognises these costs as an expense. If costs are not reimbursed directly, the applicable portion of the contractual price should be treated as an in-substance reimbursement and excluded from the consideration transferred – see example below.

Example B.34 – Acquisition costs paid by the vendor

Company Q acquired Company S for CU20 million from Vendor V. The purchase agreement provides that Vendor V pays all costs related to the transaction such as legal, due diligence and other professional fees. Company Q is not required to reimburse these costs.

The acquisition related costs paid by Vendor V on behalf of Company Q amounted to CU0.5 million. Vendor V incurred an additional CU0.1 million for its own legal fees related to the transaction.

Analysis:
In this situation, the CU20 million paid by Company Q effectively includes the reimbursement for the acquisition related costs. Company Q should account for such costs separately from the business combination as an immediate expense.

In accounting for the business combination, the consideration transferred is measured at CU19.5 million (contractual purchase price reduced only by the acquisition costs paid on behalf of Company Q) which represents the amount paid in exchange for the acquired business.

6.2.5 Replacement of acquiree share-based payment awards

In business combinations where an acquiree's existing share-based payment award is replaced by the acquirer, special considerations apply when determining both consideration transferred and post-combination expenses. Acquiree awards are often replaced in order to, for example:

- avoid future dilution of the acquirer's ownership of the acquiree
- create a more effective employee incentive when the acquirer's shares will be more liquid than the acquiree's after the combination
- rationalise compensation arrangements within the expanded group.

Under IFRS 3, exchanges of share-based payment awards in conjunction with a business combination are accounted for as modifications of share-based payment awards in accordance with IFRS 2 (IFRS 3.B56).

When the acquirer is obliged[6] to replace the acquiree's share-based payment awards (the original awards) with its own awards (the replacement awards), either all or a portion of the value of the replacement awards forms part of the consideration transferred (IFRS 3.B56). The same guidance applies in situations where the acquirer replaces the original awards voluntarily. See Section B.6.2.6 for guidance on situations where the acquirer chooses not to replace the original awards.

Note: In May 2010, the IASB issued the 2010 Annual Improvements to IFRSs. This amendment clarified that share-based payment transactions of the target company that are voluntarily replaced by the acquirer should be accounted for in the same way as awards that the acquirer is obliged to replace. The same amendment also clarified the accounting for acquiree awards that the acquirer chooses not to replace. This amendment is effective for periods beginning on or after 1 July 2010.

IFRS 3's objective in accounting for replacement awards is to allocate their value between the amounts attributable to:

- pre-combination service (treated as part of consideration transferred); and
- post-combination service (accounted for as compensation expense in the post-combination financial statements).

IFRS 3 provides specific guidance on how the allocation is determined. This requires the acquirer to measure both the replacement and original awards using a market-based measure (in accordance with IFRS 2) on the acquisition date. This is one of IFRS 3's measurement exceptions discussed in Section B.4.3.1 (because IFRS 2's market-based measure is not fully equivalent to fair value).

IFRS 3's guidance on the allocation of the value of the replacement awards is as follows:

Element	Specific IFRS 3 guidance
Pre-combination service: Calculation (IFRS 3.B58)	• calculated using the value of the original award multiplied by the ratio of the vesting period completed at acquisition date to the greater of: – the original vesting period of the existing awards or – total vesting period (in case changes were made)
Accounting treatment (IFRS 3.B57)	• included in consideration transferred

6 An acquirer is obliged to replace the acquiree's share-based payment awards if it is either required by the terms of the purchase agreement, the share-based payment agreement itself or by relevant laws or regulation (IFRS 3.B56).

Element	Specific IFRS 3 guidance
Post-combination service: Calculation (IFRS 3.B59)	• the difference between the value of the replacement award and the amount allocated to pre-combination service
Accounting treatment (IFRS 3.B59)	• in effect, any excess of the value of the replacement awards over the original awards is accounted for as employee compensation expense in post-combination earnings • post-combination compensation expense is recognised over the vesting period if it requires post-combination service (even if the original awards are already vested on the acquisition date) • if no further service is required, it is recognised as an immediate expense
Others: Estimate of replacement awards expected to vest (IFRS 3.B60)	• the allocation between the pre-combination and post-combination portion of the replacement awards should reflect the best available estimate of the number of replacement awards expected to vest • any changes in the estimate of vesting are recognised in post-combination earnings and not as an adjustment to consideration transferred • similarly, the effects of other events (ie modifications or revised estimates of the outcome of any performance conditions) occurring after the business combination are recognised in post-combination earnings
Effect of the classification of share-based payment awards (IFRS 3.B61)	• the same requirements apply regardless of whether the replacement award is classified as cash-settled or equity-settled in accordance with IFRS 2 • if classified as cash-settled, all subsequent changes in the value of the replacement awards and related income tax effects are recognised in post-combination earnings
Share-based payment awards that will expire as a consequence of a business combination (IFRS 3.B56)	• if the acquirer replaces awards that are due to expire because of the business combination, the value of the replacement award is treated as post-combination expense. No value is allocated to consideration transferred
Income tax effect (IFRS 3.B62)	• income tax effects of the replacement awards are recognised in accordance with IAS 12

Presentation of replacement awards related to pre-combination service

The value of the replacement share-based payment awards relating to pre-combination service is included in consideration transferred and therefore increases the amount of goodwill. For equity-settled share-based payment awards, there is a corresponding credit to equity. This credit is recorded in NCI or controlling interest equity depending on which entity will issue shares upon exercise:

- if acquiree shares will be issued, the credit is part of NCI
- if acquirer shares will be issued, the credit is part of controlling interest equity.

The following example illustrates the accounting for replacement of share-based payment awards:

Example B.35 – Replacement of acquiree share-based payment awards

Company P purchases Company S. Company S has an existing equity-settled share-based payment award (original award), which includes a clause requiring replacement with an award of at least equivalent value by any future acquirer. The original awards specify a vesting period of four years. At the acquisition date, Company S's employees have already rendered two years of service.

As required, Company P replaced the original awards with its own share-based payment awards (replacement award). Under the replacement awards, the vesting period is reduced to one year (from the acquisition date).

The value (market-based measure) of the awards at the acquisition date are as follows:

- original awards: CU100
- replacement awards: CU110.

As of the acquisition date, all awards are expected to vest.

Analysis:

The value of the replacement awards is allocated between consideration transferred and post-combination compensation expense.

The portion attributable to pre-combination service is CU50 (CU100 × 2/4 years) and is included as part of consideration transferred. This is calculated as the value of the original award (CU100) multiplied by the ratio of the pre-combination service period (2 years) to the greater of the total vesting period (3* years) or the original vesting period (4 years). This amount will be credited to the parent's equity.

The remaining CU60 (CU110 – CU50) is attributable to compensation for the employees' future services. This will be recognised as compensation expense in post-combination earnings over the remaining service period of 1 year (vesting period of the replacement award).

* 2 years rendered by employees as of the acquisition date plus 1 year vesting period of the replacement award

6.2.6 Non-replaced share-based payment awards

In some business combinations, the acquirer continues the acquiree's share-based payment scheme. Under IFRS 3 (as amended by 2010 *Annual Improvements to IFRSs*), the accounting will depend on whether the awards are vested or unvested at the acquisition date (see below). In both situations, the awards are measured at their market-based measure (in accordance with IFRS 2) at the acquisition date.

Category	Specific IFRS 3 guidance
Vested awards: Accounting treatment (IFRS 3.B62A)	• recognised as part of NCI
Unvested awards: Accounting treatment (IFRS 3.B62A)	• allocated between amounts attributable to: – pre-combination service – forms part of NCI – post-combination service – accounted for as compensation expense in the post-combination financial statements (credits are also presented as part of NCI)
Calculation (IFRS 3.B62B)	• pre-combination service – calculated using the value of the award multiplied by the ratio of the vesting period completed at acquisition date to the greater of: – the original vesting period of the existing awards or – total vesting period (in case changes were made) • post-combination service – remaining balance of the value of the award recognised over the remaining vesting period

The following example illustrates the accounting for non-replaced share-based payment awards:

Example B.36 – Continuation of acquiree share-based payment awards

Company Q purchases Company S. Company S has an existing equity-settled share-based payment scheme. The awards vest after four years of employee service. At the acquisition date, Company S's employees have rendered two years of service. None of the awards are vested at the acquisition date.

Company Q did not replace the existing share-based payment scheme but reduced the remaining vesting period from 2 years to 1 year. Company Q determines that the market-based measure of the award at the acquisition date is CU100 (based on IFRS 2's measurement principles and conditions at the acquisition date).

Analysis:

The market-based measure of CU100 is allocated between non-controlling interest and post-combination compensation expense.

The portion attributable to pre-combination service is CU50 (CU100 × 2 / 4 years) and is included as part of NCI. This is calculated as the value of the award (CU100) multiplied by the ratio of the pre-combination service period (2 years) to the original vesting period (4 years).

The remaining CU50 (CU100 – CU50) is attributed to the employees' future services. This amount will be recognised as an expense in post-combination earnings over the remaining service period of 1 year.

6.2.7 Contracts to acquire shares from non-selling shareholders

At (or around) the same time as negotiating to acquire a controlling interest in the acquiree, the acquirer may enter into an arrangement with non-selling shareholders to acquire further acquiree shares at a later date.

Types of contract to purchase additional shares in the acquiree:

- purchased call options: acquirer's right to purchase acquiree shares held by non-selling shareholders
- written put options: non-selling shareholders' right to sell acquiree shares to the acquirer
- forward contract: binding agreement to buy or sell acquiree shares at a future date

IFRS 3 has no specific guidance on these contracts. Arrangements vary considerably, and careful analysis and judgment may be required to determine the appropriate accounting treatment. A detailed discussion of the types of arrangement and their analysis is beyond the scope of this Guide but the following paragraphs summarise the key issues. At the time of writing (December 2011), the IFRS Interpretations Committee (IFRIC) was considering how to develop additional guidance[7].

The most critical factor in this analysis is to determine whether, in substance, the contract in question is:

- an arrangement to purchase additional acquiree shares at a future date that is accounted for separately from the business combination; or
- a purchase of the underlying acquiree shares for a deferred or contingent consideration that forms part of the business combination transaction.

IFRS 3's general indicators on identifying separate transactions should be applied to assist in this assessment (see Section B.6.2.1). In addition, in our view, the guidance in IAS 27 also applies to determine whether the arrangement transfers the ownership benefits of the underlying shares to the acquirer at the acquisition date. If so, we consider that the arrangement should be treated as a purchase of the underlying acquiree shares. However, assessing whether ownership benefits are transferred to the acquirer at the acquisition date is not always straightforward and may require judgement.

This assessment will impact the accounting for the business combination as summarised below:

Accounting treatment depending on whether ownership benefits are transferred to the acquirer at acquisition date

Element	Transferred	Not transferred
Contract	• considered part of the business combination (effectively as a deferred or contingent consideration arrangement)	• accounted for as a separate transaction • classified and measured in accordance with IAS 32 and IAS 39 / IFRS 9
Underlying shares	• included within controlling interests	• included as part of NCI and measured accordingly
Exercise price/amount paid or received for the contract	• present value of exercise price included in consideration transferred along with any premium paid or received for the contract	• if the arrangement is embedded in the purchase agreement, the price stated in the agreement may require adjustment to determine consideration transferred

7 The IFRIC has an ongoing project relating to the current diversity in the accounting for put options written over NCI. The Committee is considering addressing the diversity in accounting, not by changing the measurement basis of the NCI puts, but by clarifying the accounting for subsequent changes in those liabilities.

The following examples illustrate some of the concepts in accounting for contracts to acquire shares from non-selling shareholders:

Example B.37 – Purchased call option which does not transfer ownership benefits of underlying shares

Company P enters into a business combination arrangement with Vendor Q. Company P pays CU800 for 80% of the share capital of Company S. Company P also enters into a call option, exercisable a year after the acquisition date, to acquire the remaining 20% of Company S at fair value (to be determined by independent appraisal if the option is exercised).

Analysis:
In this situation, Company P determines that the ownership benefits of the remaining 20% shareholding are not transferred at the acquisition date. This is on the basis that increases or decreases in value between the acquisition date and potential exercise will accrue to the non-selling shareholders. Company P classifies the purchased call option in accordance with IAS 32. The purchased call option is not on fixed for fixed terms and is therefore accounted for as a derivative at fair value through profit or loss. The fact that the exercise price is based on fair value is likely to limit the option's value to a relatively minor amount.

Example B.38 – Written put option which transfers ownership benefits of underlying shares

Company X acquires a 70% controlling interest in Company Y. The remaining 30% interest is held by Company Z. On the same date, Company X signs a put option agreement with Company Z, which grants Company Z the right to sell its Company Y shares to Company X a year after the acquisition date at a fixed exercise price of CU1,000. Company X receives a payment of CU150 for this option.

The exercise price is substantially above the acquisition date fair value of the underlying shares. Company Y is not expected to declare any dividends during the option period.

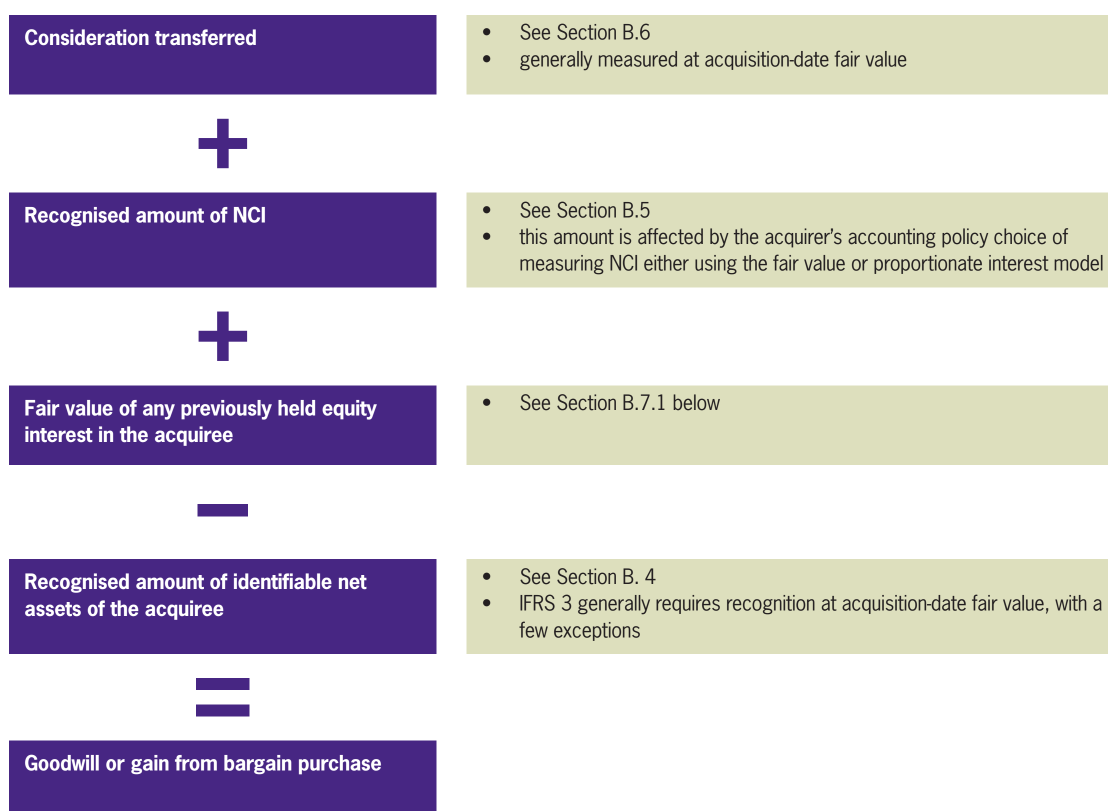
Analysis:
In this situation, Company X determines the put option is virtually certain to be exercised. Also, because the put option is at a fixed, above-market price, changes in value of the underlying shares from the acquisition date are expected to accrue to the acquirer. In this case, dividends are unlikely and are therefore not a significant part of the analysis. Based on these factors, Company X concludes that it has obtained the significant ownership benefits of the underlying shares at the acquisition date. The effects on the accounting for the business combination are as follows:

- Company X recognises a put liability of CU943, measured at the discounted present value of the expected redemption amount (CU1,000 discounted over 1 year at 6%*). This liability forms part of the consideration transferred and the amount received for the put option is deducted from consideration transferred
- subsequent unwinding of the discount is recognised as a finance cost in profit or loss
- no NCI will be recognised and 100% of Company Y's post-combination earnings will be attributed to Company X.

* determined to be the applicable discount rate for the put liability

7 Recognising and measuring goodwill or a gain from a bargain purchase

The final step in accounting for the business combination is determining goodwill or a gain from a bargain purchase:



Three of the elements included in the above formula were discussed in earlier Sections. This Section covers:

- situations where the acquirer has previously held an equity interest in the acquiree (see Section B.7.1)
- accounting for goodwill or gain from a bargain purchase (see Section B.7.2).

7.1 Business combination achieved in stages

Prior to a business combination, the acquirer may already own an equity interest in the acquiree (which may have been accounted for under IAS 28 *Interests in Associates*, IAS 31 *Interests in Joint Ventures*, IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*). When the acquirer obtains control over the acquiree, this existing investment is viewed as part of what is given up to obtain control. Consequently, the existing investment is derecognised as if the acquirer disposed of it at fair value, and a related gain or loss is recognised. This situation is commonly referred to as a business combination achieved in stages or a step acquisition.

Treatment of previously held equity interest (IFRS 3.42):

- the acquirer remeasures its previously held equity interest in the acquiree at its acquisition-date fair value
- any resulting gain or loss is recognised in profit or loss*
- if, in prior reporting periods, the acquirer recognised changes in the value of its equity interest in other comprehensive income (eg for an investment classified as available for sale), the cumulative change is reclassified into profit or loss (ie same basis as would be required if the acquirer had disposed of the interest directly)*

* unless the investment was designated at fair value through other comprehensive income (OCI) in accordance with IFRS 9. If so, any gain or loss is reported in OCI without reclassification to profit or loss

The following examples illustrate the accounting for business combinations achieved in stages:

Example B.39 – Acquirer had an existing investment accounted for under IAS 28

Company A owns a 35% interest in Company B. The investment, with an original cost of CU50, is accounted for as an associate using the equity method. On 30 December 20X1, the carrying value of the investment in Company B was CU230 and its fair value was CU308. The fair value of Company B's identifiable net assets on that date was CU800.

On 31 December 20X1, Company A purchased an additional 40% interest in Company B for CU352, thereby obtaining control. Company A opted to measure NCI at fair value, which was determined to be CU220.

Determining goodwill:

	CU
Cash consideration for 40% interest	352
NCI measured at fair value	220
Fair value of previously held equity interest	308
Total	880
Fair value of 100% of identifiable net assets	800
Goodwill	**80**

- The difference between the fair value and the carrying value of the investment in the associate of CU78 (CU308 – CU230) will be recognised as a gain in profit or loss.

Example B.40 – Acquirer had an existing investment accounted for under IAS 39

Company X holds a 10% investment in Company Y, which was purchased for CU100 at 1 January 20X5. The investment is classified as available for sale in accordance with IAS 39. Changes in the fair value of the investment are recognised in other comprehensive income. On 31 December 20X9, the investment has a fair value of CU250. On the same day, Company X purchased the remaining 90% of Company Y's shares for a cash consideration of CU2,250, increasing its interest to 100% and obtaining control.

The fair value of the identifiable net assets of Company Y (excluding goodwill) at the acquisition date was CU2,100.

Determining goodwill:

	CU
Cash consideration	2,250
Fair value of previously held equity interest	250
Total	2,500
Fair value of 100% of identifiable net assets	2,100
Goodwill	**400**

- The change in the fair value of investment classified as available for sale recognised in other comprehensive income amounting to CU150 (CU250 – CU100) is reclassified into profit and loss as if Company X had directly disposed of its investment.

7.2 Determining goodwill or a gain from a bargain purchase

Applying IFRS 3's formula may result in a positive amount (goodwill) or a negative amount (gain from a bargain purchase). These amounts are accounted for differently.

Resulting amount	IFRS 3 treatment
Goodwill	• recognised as a separate asset in the acquirer's consolidated financial statements • goodwill is not amortised but is subject to at least an annual impairment test under IAS 36
Gain from a bargain purchase	• recognised in profit or loss immediately

A gain from a bargain purchase is expected to arise relatively infrequently and can normally be attributed to specific commercial factors such as a forced sale by the vendors. Before recognising a bargain purchase gain, IFRS 3 specifically requires the acquirer to review:

- whether all of the assets acquired and liabilities assumed have been identified; and
- the related accounting measurements.

Elements of the business combination requiring review (IFRS 3.36):

- identifiable assets acquired and liabilities assumed
- NCI in the acquiree, if any
- acquirer's previously held equity interest in the acquiree in a business combination achieved in stages
- consideration transferred

8 Initial accounting for the business combination is incomplete at the reporting date

8.1 Use of provisional amounts at the reporting date

The complexity of business combination accounting and the associated workload mean that it is not always practical to finalise the accounting before issuing the financial statements covering the period when the combination occurs. In such circumstances, IFRS 3 requires the acquirer to initially report the business combination using provisional amounts. A defined period of time – referred to as the measurement period (see Section B.8.2) – is then available to complete the accounting.

Amounts that may be reported provisionally and then (potentially) revised include (IFRS 3.46):

- fair values of identified assets and liabilities
- fair values of previously-held interests, consideration transferred and non-controlling interests
- acquired tax benefits that meet certain criteria (IAS 12.68)
- resulting goodwill or gain on a bargain purchase

When provisional amounts are used, the acquirer discloses:

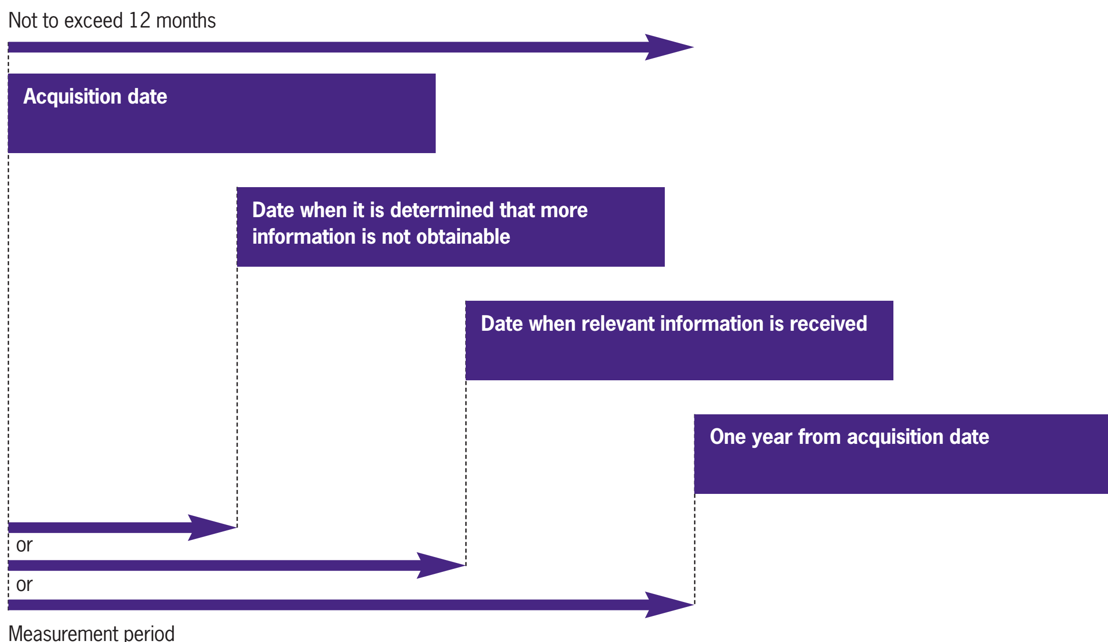
- the particular accounts where provisional amounts are used and
- the reasons why the accounting for the business combination is incomplete (see IFRS 3.B67 and Appendix A.3.3).

8.2 The measurement period and related adjustments

Measurement period ends at the earlier of (IFRS 3.45):

- date on which required information is obtained (or found to be unavailable)
- one year from the acquisition date

The following diagram illustrates the measurement period definition:



Measurement period adjustments must be distinguished from normal accounting adjustments that may arise during the measurement period. The former are limited to those that arise from new information obtained about facts and circumstances that existed at the acquisition date. Developments after this date may also lead to changes in estimates and give rise to new assets and liabilities. However, these are not measurement period adjustments and are reported as they occur in the normal way. In making this distinction the acquirer should consider:

- the timing of the receipt of the new information (information received shortly after the acquisition date is more likely to indicate that the facts and circumstances existed on the acquisition date)
- the reason for the adjustment.

Type of adjustment	IFRS 3 treatment
Measurement period adjustments	• retrospectively adjust the provisional amounts and/or recognise additional assets and liabilities to reflect new information (IFRS 3.45) • adjustments are recognised as if the accounting for the business combination had been completed at the acquisition date. Comparative information from prior periods is revised by: – increasing or decreasing the amount of goodwill or gain from a bargain purchase. If the adjustment affects more than one asset or liability, the adjustment to goodwill reflects the net effect of those adjustments – making any change in depreciation, amortisation or other income effects recognised in the initial accounting for the business combination (IFRS 3.48-49)
Other adjustments within the measurement period	• prospectively adjust the provisional amounts to reflect new facts and circumstances arising after the acquisition date (ie recognise adjustments in earnings in the period the adjustment is made, without adjusting goodwill) • correcting any error retrospectively in accordance with IAS 8
Adjustments after the measurement period	• no adjustment to the accounting for the business combination is allowed except for correction of an error in accordance with IAS 8 (IFRS 3.50)

The following illustrates how measurement period adjustments are reported:

Example B.41 – Changes to provisional amounts

On 1 October 20X1, Company Q acquired 100% interest in Company S. When Company Q issued its 31 December 20X1 financial statements, the valuation of an acquired trademark was incomplete. Company Q used CU10 million as the provisional fair value of trademarks and determined a 5-year amortisation life. Company Q appropriately disclosed in its 31 December 20X1 financial statements that the trademark was measured at a provisional amount. On 30 April 20X2, the valuation of the trademark was finalised. The fair value at the acquisition date amounted to CU12 million.

Adjustments in the 31 December 20X2 financial statements:

Company Q will make retrospective adjustments to the accounting for the business combination in the comparative amounts for 20X1 as follows:

- the carrying amount of trademarks as of 31 December 20X1 is increased by CU1.9 million, representing the increase in fair value of CU2 million less additional amortisation from the acquisition date to 31 December 20X1 of CU0.1 million (CU 2 million x 3 months/60 months)
- amortisation expense for 20X1 is increased by CU0.1 million. The amortisation adjustment is intended to reflect that the trademark's final fair value of CU12 million has been recognised on the acquisition date
- goodwill is decreased by CU2 million.

C. Accounting after the acquisition date (selected topics)

In the reporting periods following a business combination, the acquirer (now referred to as the parent) consolidates the acquired subsidiary in accordance with the consolidation procedures in IAS 27 *Consolidated and Separate Financial Statements*. However, acquiring a subsidiary and its underlying assets and liabilities in a business combination has some implications on how the general consolidation principles are put into practice. This Section discusses:

- the more significant practical implications of a business combination on post-combination financial reporting
- IAS 27's related requirements on accounting for changes in ownership interest in a subsidiary[8].

Practical implications for post-combination reporting

- General issues (see Section C.1.1)
- Post-combination reporting for specific items (see Section C.1.2)

Accounting for subsequent changes in ownership interest in a subsidiary

- Changes in ownership interest not resulting in loss of control (see Section C.2.1)
- Loss of control of a subsidiary (see Section C.2.2)

8 As noted in Section B.1.2, the IASB published IFRS 10 *Consolidated Financial Statements* in May 2011which changes the definition of control that is used to determine the scope of consolidation. However, IFRS 10 did not change IAS 27's mechanics of consolidation (eg uniform accounting policies, eliminations, etc), accounting for non-controlling interests and changes in the parent's ownership interest. The related provisions of IAS 27 (which are referred to in this Section) have been carried forward to IFRS 10 with no substantial changes.

1 Practical implications for post-combination reporting

Practical implications for post-combination reporting

1.1 General issues

The parent must undertake a number of practical steps in order to prepare financial statements that include the acquired subsidiary (both for the first post-combination reporting date and subsequently). The following table highlights accounting policy and procedure considerations that must be addressed in the initial consolidation of the acquired subsidiary. The parent will also need to consider the impact on the subsidiary's reporting systems, processes and procedures to ensure the appropriate consolidation information is captured.

Accounting requirements	Matters for consideration
Align the acquired subsidiary's accounting policies with those used for the consolidated financial statements	• review the consistency of the acquired subsidiary's accounting policies with the parent's. Areas where differences often arise include: – revenue recognition policies – inventory costing and capitalisation policies – depreciation policies for property, plant and equipment and intangibles, including estimates of useful lives and residual values – accounting policy options (for example cost model or revaluation model for property, plant & equipment) • develop accounting policies and estimates for transaction types, assets and liabilities that are new to the group and not addressed in existing policies
Align the accounting period of the subsidiary with that of the parent[9]	• when the accounting periods are different, the parent should change the subsidiary's year-end to match its own year-end if practical • if alignment is impractical, the parent needs to implement procedures to make adjustments for the effects of significant transactions or events between the respective year-ends of the parent and the subsidiary
Classify and designate assets acquired and liabilities assumed	• the subsidiary's assets and liabilities should be classified and designated based on their contractual terms, economic conditions and the parent's accounting policies (see Section B.4.4 for further information)
Allocate goodwill to cash generating units (CGUs) or groups of CGUs and test for impairment (see IAS 36 *Impairment of Assets*)	• before the end of the reporting period, test any CGU to which goodwill is allocated for impairment • when the initial accounting for the business combination is incomplete as of the first reporting date (see Section B.8), and allocation of goodwill also cannot be completed, the parent: – discloses the amount of any unallocated goodwill, including the reason why such allocation is not yet completed (IAS 36.133) – completes the initial allocation of goodwill before the end of the reporting period beginning after the acquisition date (IAS 36.84)

9 IAS 27 allows a parent to use a subsidiary's financial statements prepared at a different reporting date. However, the difference in the reporting dates cannot exceed three months. In addition, the parent is required to make adjustments to account for the effects of significant transactions or events between the reporting dates of the parent and the subsidiary.

Accounting requirements	Matters for consideration
Update segment reporting disclosures	• a parent that applies IFRS 8 *Operating Segments* needs to determine the impact of the acquisition on its segment disclosures. It may result in a new reportable segment, an addition to an existing reportable segment or part of a non-reportable segment (which may cause such a segment to exceed the quantitative threshold for reporting) • under IFRS 8, changes in segment disclosures are triggered when a change is made in the component information reported to the chief operating decision maker.

1.2 Post-combination reporting for specific items

IFRS 3 is not intended to provide guidance on the subsequent measurement and accounting of items recognised in a business combination. However for a limited number of items, specific guidance is provided on how they should be subsequently accounted for, as follows:

Asset or liability	Specific IFRS 3 guidance
Reacquired rights (IFRS 3.55)	• amortised over the remaining contractual period of the original contract, excluding any renewal period • if the reacquired right is subsequently sold to a third party, the carrying amount of the intangible asset is included in the determination of the gain or loss on sale
Contingent liabilities (IFRS 3.56)	• after initial recognition and until the liability is settled, cancelled or expires, contingent liabilities shall be measured at the higher of: – the amount that would be recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (IAS 37) and – the amount initially recognised less, if appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue* • this requirement does not apply to contracts accounted for in accordance with IAS 39/IFRS 9
Indemnification assets (IFRS 3.57)	• any recognised indemnification asset is subsequently measured at each reporting date on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount. If the indemnification asset is not subsequently measured at fair value, the valuation used should consider management's assessment of its collectibility • the indemnification asset is only derecognised when the acquirer collects, sells or otherwise loses the right to the asset
Contingent consideration (IFRS 3.58)	• changes in the fair value of contingent consideration (other than measurement period adjustments – see Section B.8.2) are accounted for as follows: – if classified as equity: not remeasured and subsequent settlement reported in equity – if classified as an asset or liability and within the scope of IAS 39/ IFRS 9: remeasured at fair value through profit or loss or other comprehensive income in accordance with IAS 39/IFRS 9 – if classified as an asset or liability and not within the scope of IAS 39/IFRS 9: accounted for in accordance with IAS 37 or other IFRSs as appropriate (although this seldom occurs in practice).

Note: The above requirements on contingent consideration only apply to business combinations accounted for under IFRS 3 as revised in 2008, or any later version. This was clarified by the 2010 *Annual Improvements to IFRSs* issued in May 2010 which specified that contingent consideration arrangements from a business combination that occurred before the entity adopted the 2008 version of IFRS 3 are accounted for in accordance with the previous version of the Standard.

The following examples illustrate aspects of this guidance:

Example C.1 – Contingent consideration liability

Company X acquired business Y on 31 December 20X1. The purchase agreement included a contingent consideration clause that requires Company X to issue an additional number of shares equivalent to CU100,000 if the average profits of Y in 20X2 and 20X3 exceed a target level. On the acquisition date, the fair value of the contingent consideration was determined to be CU36,281 based on an assumed discount rate and a 40% probability that Y will achieve its profit target.

Subsequent events information:

- in 20X2, Y's performance exceeds forecasts and at 31 December 20X2, Company X considers that it is 80% probable that the profit target will be achieved
- on 31 December 20X3, business Y has achieved its target. The additional shares are issued on 7 Jan 20X4. The fair value of Company X's share on that date is CU16

Analysis and subsequent accounting:

In this situation, the contingent consideration arrangement requires the issuance of a variable number of shares equal to a fixed monetary amount. Accordingly, it is classified as a liability at the acquisition date and is remeasured at each reporting date until settlement or expiry.

At 31 December 20X2, the fair value of the contingent consideration is determined to be CU76,190. The change in the estimate results from changed circumstances during 20X2 (Y's performance was better than anticipated) and the passage of time rather than arising from additional information relating to conditions at the acquisition date. Consequently, the change in fair value of CU39,909 (CU76,190 – CU36,281) is recognised in profit or loss, with the amount relating to the unwinding of the discount recognised as a finance cost.

At 31 December 20X3, the recorded liability is increased to CU100,000 by recording an additional expense of CU23,810 (CU100,000 – CU76,190), with the amount relating to unwinding of the discount recognised as a finance cost.

On 7 January 20X4, 6,250 (CU100,000 / CU16 per share) shares are issued to settle the liability.

Example C.2 – Contingent liability with a related indemnification asset

As part of its acquisition of Company X, Company W assumed a contingent liability in respect of a third party litigation. The former owner of Company X agreed to reimburse Company W for the losses from the litigation up to CU100. On the acquisition date, Company W concludes that the lawsuit gives rise to a present obligation and determines that the acquisition date fair value of the contingent liability is CU40. In accounting for the business combination, Company W recognises a contingent liability of CU40. At the same time, Company W recognises a CU40 indemnification asset for the former owner's promise to reimburse up to CU100. The indemnification asset is measured on the same basis as the related contingent liability.

At the next reporting date, Company W determines that the amount that would be recognised under IAS 37 for the contingent liability is CU120, based on developments in the case after the acquisition date. The liability measured in accordance with IAS 37 is the best estimate of the expenditure required to settle the contingent liability at the end of the reporting period.

Subsequent accounting:

The CU120 exceeds the amount recognised at acquisition, so Company W remeasures the recorded contingent liability to CU120. Company W also recognises an increase in the value of the indemnification asset, measured on the same basis as the contingent liability. However, the asset is capped at the CU100 promised by Company X's former owner. A net expense of CU20 is recognised in profit or loss.

2 Accounting for subsequent changes in ownership interest in a subsidiary

Accounting for subsequent changes in ownership interest in a subsidiary

A change in the parent's ownership interest in a subsidiary may result from a purchase or sale of shares by the parent or from transactions between the subsidiary and non-controlling interests.

This Section discusses the accounting for changes in ownership interests that:

- do not result in loss of control of the subsidiary (see Section C.2.1)
- do result in loss of control of the subsidiary (see Section C.2.2).

2.1 Changes in ownership interest that do not result in loss of control

Non-controlling interests (NCI) in a subsidiary are presented as a separate component of equity in the consolidated statement of financial position. Consequently, changes in a parent's ownership interest in a subsidiary that do not result in loss of control are accounted for as equity transactions.

Parent's accounting treatment:

- no gain or loss is recognised when the parent sells shares in the subsidiary (so increasing NCI)
- a parent's purchase of additional shares in the subsidiary (so reducing NCI) does not result in additional goodwill or other adjustments to the initial accounting for the business combination
- in both situations, the carrying amount of the parent's equity and NCI's share of equity is adjusted to reflect changes in their relative ownership interest in the subsidiary. Any difference between the amount of NCI adjustment and the fair value of the consideration received or paid is recognised in equity, attributed to the parent (IAS 27.30-31)
- the parent should also take the following into consideration:
  - the allocated amounts of accumulated OCI (including cumulative exchange differences relating to foreign operations) are adjusted to reflect the changed ownership interests of the parent and the NCI. The re-attribution of accumulated OCI is similarly treated as an equity transaction (ie a transfer between the parent and the NCI)
  - for a partial disposal of a subsidiary with foreign operations, the parent must re-attribute the proportionate share of cumulative exchange differences recognised in OCI to NCI in that foreign operation (IAS 21.48C)
  - IAS 27 does not have any specific guidance for costs directly related to changes in ownership interests but, in our view, costs that are incremental should be deducted from equity (consistent with IAS 32's rules on other types of transaction in the entity's own equity).

The following examples illustrate IAS 27's requirements. Where relevant, the examples also illustrate how the adjustment to the carrying amount of NCI is determined under the two NCI measurement models (see Section B.5.1).

Transaction or event	Relevant example
Sale of shares in a subsidiary	• Example C.3 – Parent sells shares in a subsidiary
Acquisition of additional shares in a subsidiary	• Example C.4 – Parent acquires additional shares in a subsidiary
Dilution of a parent's interest	• Example C.5 – Subsidiary issues new shares

Example C.3 – Parent sells shares in a subsidiary

Company A acquired 80% of Company B in 20X6. On 1 January 20X9, Company A sells Company B shares equivalent to 20% of Company B's outstanding shares for CU260. On that date, the carrying value of Company B's net assets in the consolidated financial statements, excluding goodwill, amounted to CU900. Goodwill measured using the fair value and proportionate interest model amounts to CU230 and CU200, respectively. Company A's recorded goodwill is not impaired. Company B has no accumulated OCI. After the sale, Company A still has a 60% interest in Company B and continues to control its operations.

Adjustments to NCI and equity:

	NCI at fair value model	NCI at proportionate interest model
	CU	CU
Carrying value of Company B's net assets	900	900
Goodwill recognised at acquisition	230	200
Carrying amount – 1 January 20X9	**1,130**	**1,100**
Cash consideration received	260	260
Less additional NCI to be recognised (20% of carrying amount)	226	220
Amount to be credited to parent's equity	**34**	**40**

- The choice of recording NCI either using the fair value or proportionate interest model only applies on the acquisition date. Adjustment to NCI is based on NCI's proportionate share of the subsidiary.

Example C.4 – Parent acquires additional shares in a subsidiary

Company A has an 80% interest in Company B. On the acquisition date, NCI measured using the fair value and proportionate interest model amounts to CU180 and CU150, respectively. On 1 January 20X9, Company A purchases the remaining 20% interest in Company B for CU280. Company A's recorded goodwill is not impaired. From the date of acquisition up to 1 January 20X9, the balance of NCI has increased by CU80 related to the NCI's share of Company B's profits (CU70) and other comprehensive income (CU10).

Adjustments to NCI and equity:

	NCI at fair value model	NCI at proportionate interest model
	CU	CU
NCI recognised on acquisition date	180	150
NCI's accumulated share of profits	70	70
NCI's accumulated share of other comprehensive income	10	10
Carrying amount of NCI – 1 January 20X9	**260**	**230**
Cash consideration paid	280	280
Less amount debited to NCI (carrying amount)	260	230
Amount to be debited to parent's equity	**20**	**50**

With the change in ownership interest, the NCI's share of the accumulated other comprehensive income is re-attributed to the parent and will be included in the balance of accumulated other comprehensive income. Company A will then record the following entry:

	Debit CU	Credit CU
Equity	10	
Accumulated other comprehensive income		10

Example C.5 – Subsidiary issues new shares

Company Q owns 90% of 100 outstanding shares of Company R. On 1 January 20X9, Company R issued 20 new shares to an independent third party for CU200. This diluted Company Q's ownership interest from 90% to 75% (90/(100+20)). The carrying value of the identifiable net assets (excluding goodwill) of Company R in the consolidated accounts immediately before the new share issue is CU800, of which CU720 is attributable to Company Q. The carrying value of the NCI at the same date is CU80.

Accounting for the change in ownership interest:

	Carrying Value	Parent's share		NCI's share	
	CU	%	CU	%	CU
Net assets immediately before share issue	800	90	720	10	80
Proceeds from share issue	200				
Net assets immediately after share issue	1,000	75	750	25	250
Change in balances			**30**		**170**

- proceeds from the issuance of shares increases the net assets of Company R and also increases NCI's ownership interest from 10% to 25%. The increase in NCI is determined to be CU170 based on NCI's proportional interest in the adjusted net assets of Company R.
- The difference between the increase in NCI of CU170 and the fair value of the consideration for such shares of CU200, amounting to CU30, is recorded as an adjustment to equity. No gain or loss is recognised.

In the consolidated financial statements of Company Q, the following entry will be recorded:

	Debit CU	Credit CU
Cash	200	
NCI		170
Equity attributable to the parent		30

2.2 Accounting for the loss of control of a subsidiary

The loss of control of a subsidiary usually occurs when the parent sells or otherwise transfers its controlling interest in a single transaction or as a result of multiple transactions. However, other events may also result in the loss of control, such as:

- expiration of a contractual agreement that conferred control of the subsidiary
- the subsidiary becomes subject to the control of a government, court, administrator or regulator (without any change in the ownership interest in the subsidiary) or
- the subsidiary issues shares that dilutes the parent's controlling interest.

Regardless of the nature of the transaction or event, the loss of control represents a significant economic event that requires the parent to stop consolidating the subsidiary and to recognise any gain or loss.

On the date when control is lost, the parent is required to (IAS 27.34):

- derecognise the assets (including goodwill) and liabilities of the subsidiary at their carrying amounts
- derecognise the carrying amount of any NCI (including any components of OCI attributable to them)
- recognise the fair value of the consideration received, if any, and any shares distributed as dividends as part of the transaction that resulted in the loss of control
- recognise any investment retained in the former subsidiary at fair value
- reclassify to profit or loss (if required by other IFRS) or transfer directly to retained earnings, any amount included in OCI
- recognise any resulting difference as a gain or loss in profit or loss attributable to the parent

The following example illustrates how IAS 27's guidance is applied:

Example C.6 – Disposal of a subsidiary while retaining an investment

Company Q acquired its wholly-owned subsidiary, Company R for CU1,000 on 1 January 20X5. On 31 December 20X9, Company Q sold 90% of its interest in Company R for cash of CU1,440. On that date, the carrying value of the net assets of Company R is CU1,350. These net assets include goodwill and a financial asset classified as an available for sale investment with a fair value of CU200 and original cost of CU150. Company R applied the revaluation model of IAS 16 for its property, plant and equipment and has a revaluation reserve balance of CU60. For the purposes of this example, income tax on the gain on sale of the subsidiary is ignored.

Accounting for the sale of the subsidiary:

	CU
Cash consideration	1,440
Fair value of retained investment (financial asset)	160
Subtotal	1,600
Carrying value of net assets	1,350
Gain	250
Add: available for sale reserve reclassified to profit or loss	50
Total gain	**300**

- In this example, the fair value of the retained investment is calculated with reference to the fair value of the consideration paid for the controlling interest (1,440 x 10% / 90%). In practice, the fair value of the retained interest may need to be separately determined to exclude any control premium included in the sale price of the controlling interest.
- IAS 27.34(e) requires reclassification of any gains or losses previously recognised in OCI (when required by other IFRSs) as though the entity had directly disposed of the assets and liabilities. Accordingly, the available for sale investment reserve is included in determining the gain on sale of the subsidiary.

Entry to record the sale:

	Debit CU	Credit CU
Cash	1,440	
Financial asset	160	
Available for sale investment reserve	50	
Identifiable net assets and goodwill		1,350
Gain (profit or loss)		300

Example C.6 – Disposal of a subsidiary while retaining an investment (continued)

Accounting for the subsidiary's revaluation reserve:

IAS 27.34(e) also applies to the subsidiary's revaluation reserve related to its property, plant and equipment. IAS 16 *Property, Plant and Equipment* requires that the revaluation surplus included in equity may be transferred directly to retained earnings when the asset is derecognised (IAS 16.41). Upon sale of the subsidiary, any revaluation reserve is then transferred directly to retained earnings and does not form part of the gain on sale of the subsidiary.

Entry to transfer the revaluation reserve to retained earnings:

	Debit CU	Credit CU
Revaluation reserve	60	
Retained earnings		60

Disclosure of the components of the gain on sale:

The CU300 gain calculated above comprises (1) the gain on sale of the controlling interest and (2) the gain on the retained investment. IAS 27 requires separate disclosure of these two components, together with the line item in the income statement in which the gains or losses are recognised (IAS 27.41(f)).

This will require a separate calculation of the gain on the retained investment, as follows:

	CU
Fair value of the retained investment	160
Carrying value (10% of net carrying value of net identifiable asset of CU1,350)	135
Gain	25
Plus: share of the available for sale investment reserve reclassified to profit or loss (CU50 x 10%)	5
Gain on retained investment	**30**

The total gain recorded by Company Q comprises:

	CU
Gain on disposal of subsidiary	270
Gain on retained investment	30
Total gain	**300**

Multiple transactions that result in loss of control

Transactions resulting in loss of control affect profit or loss while other transactions with NCI do not. In some situations, a single transaction that does not lead to loss of control in isolation may in fact be part of a series of linked transactions that will have this effect when considered together. IAS 27 requires the parent to consider the terms and conditions of the transactions and their economic effects to determine whether two or more transactions should be considered as a single transaction for accounting purposes.

Factors that may indicate that multiple arrangements are accounted for as a single transaction (IAS 27.33):

- they are entered into at the same time or in contemplation of each other
- they form a single transaction designed to achieve an overall commercial effect
- the occurrence of one arrangement is dependent on the occurrence of at least one other arrangement
- one arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements (eg when one disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market)

Firm plan to sell a controlling interest in a subsidiary

The parent stops consolidating the subsidiary on the date it loses control. However, if the parent becomes committed to a sale plan involving the loss of control at a future date and the plan meets the relevant conditions in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, the parent classifies the subsidiary's assets and liabilities separately as summarised below.

Effect of classification as held-for-sale under IFRS 5:

- the net assets of the subsidiary will be classified as a disposal group, measured and disclosed in accordance with IFRS 5
- the general measurement principle of IFRS 5 requires non-current assets within its scope to be measured at the lower of carrying amount and fair value less costs to sell
- other assets and liabilities (as listed in IFRS 5.5) are measured according to the requirements of other IFRSs
- an impairment loss for any initial write-down of the disposal group to fair value less costs to sell is recognised as part of the result of the discontinued operations in profit or loss (IFRS 5.20). This means that, if appropriate, an impairment loss would be recognised for the goodwill and non-current assets of a subsidiary that will be sold or otherwise disposed of before control of the subsidiary is lost, in the reporting period when IFRS 5 criteria have been met
- these accounting requirements apply even if the parent will retain a non-controlling interest in the subsidiary after the sale (IFRS 5.8A)

Appendix A – Disclosures under IFRS 3: Understanding the requirements

A business combination often results in a fundamental change to a company's operations. The nature and extent of the financial statement disclosures have a significant bearing on a user's ability to assess the effects of the acquisition on the consolidated financial statements. Accordingly, the disclosure requirements for business combinations under IFRS 3 are quite extensive.

This Section covers IFRS 3's disclosure requirements. An illustrative disclosure is provided at the end of this Section, including insights on certain disclosure areas.

1 General objectives of the disclosure requirements

The acquirer discloses information that enables users of its financial statements to evaluate:

- the nature and financial effect of a business combination (IFRS 3.59)
- the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods (IFRS 3.61).

2 Business combinations that require disclosures

IFRS 3's disclosures are required for:

- each material business combination that occurred during the current reporting period
- individually immaterial business combinations that occurred during the reporting period that are collectively material (disclosures are made on an aggregate basis)
- business combinations occurring after the reporting period but before the financial statements are authorised for issue[10].

3 Minimum disclosure requirements

This Section summarises IFRS 3's disclosure requirements. It is helpful to divide these requirements into:

- disclosures applicable to most business combinations (see Appendix A.3.1)
- specific disclosures for contingent consideration, indemnification assets and contingent liabilities arising from a business combination (see Appendix A.3.2)
- disclosures applicable only to certain business combinations (see Appendix A.3.3).

Although IFRS 3 specifies the minimum disclosure requirements, management should use judgement to determine the adequacy of the disclosures and should not be limited by those specified by IFRS 3. Additional information should be provided if it will help the users of the financial statements better understand the effects of the business combination (IFRS 3.63).

10 The only exception to this requirement is when the initial accounting for the business combination is not yet complete. In that case, the acquirer shall describe which disclosures could not be made and the reasons why they cannot be made (IFRS 3.B66).

3.1 Required disclosures applicable to most business combinations

Presented below is a summary of the required disclosures applicable to most business combinations. The parent is required to disclose this information in the reporting period the business combination occurred or in certain cases, in the subsequent reporting period.

Disclosure area	Required disclosures
Details of the business combination (IFRS 3.B64(a)-(d))	• name and description of the acquiree • acquisition date • percentage of voting equity interests acquired • primary reasons for the acquisition and a description of how the acquirer obtained control of the acquiree
Details of goodwill (IFRS 3.B64(e)) (IFRS 3.B64(k))	• qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations of the acquiree and the acquirer, intangible assets that do not qualify for separate recognition or other factors • total amount of goodwill that is expected to be deductible for tax purposes
Fair value of consideration transferred (IFRS 3.B64(f))	• acquisition-date fair value of the total and each major class of consideration, such as: – cash – other tangible or intangible assets, including a business or subsidiary of the acquirer – liabilities incurred, for example, liability for contingent consideration (see Appendix A.3.2) – equity 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
Details of assets acquired and liabilities assumed (IFRS 3.B64(i)) (IFRS 3.B64(h))	• amounts recognised at the acquisition date for each major class of assets acquired and liabilities assumed • additional disclosures for each major class of acquired receivables: – fair value of the receivables – gross contractual amounts receivable – the best estimate at the acquisition date of the contractual cash flows not expected to be collected
Details of transactions recognised separately from the business combination (IFRS 3.B64(l))	• description of each transaction and how it was accounted for • amounts recognised for each transaction and the line item in the financial statements in which each amount is recognised • if the transaction is the effective settlement of a pre-existing relationship, the method used to determine the settlement amount
Acquisition-related costs (IFRS 3.B64(m))	• amount of acquisition-related costs, including the: – amount recognised as an expense and the line item or items in the statement of comprehensive income in which those expenses are recognised – amount of any issue costs not recognised as an expense and how they were recognised

Disclosure area	Required disclosures
Operating results of the new subsidiary included in the consolidated statement of comprehensive income for the reporting period (IFRS 3.B64(q))	• amounts of revenue and profit or loss of the new subsidiary for the current reporting period since the acquisition date • revenue and profit or loss of the combined entity for the current reporting period as though the acquisition occurred at the beginning of the reporting period • if disclosure of any of this information is impracticable, disclose that fact and explain why it is impracticable
Reconciliation of the carrying amount of goodwill balance (IFRS 3.B67(d))	• the gross amount and accumulated impairment losses at the beginning and end of the reporting period with details of the movements in the reporting period: – additional goodwill recognised (except goodwill included in a disposal group classified as held for sale on the acquisition date) – adjustments resulting from the subsequent recognition of deferred tax assets – goodwill included in a disposal group classified as held for sale and goodwill derecognised (without having previously been included in a disposal group classified as held for sale) – impairment losses recognised in accordance with IAS 36 (IAS 36 requires disclosure of other information in addition to this requirement) – net exchange rate differences – any other changes in the carrying amount
Material gains or losses recognised in the reporting period (IFRS 3.B67(e))	• the amount and an explanation of any gain or loss recognised in the current reporting period that both: – relates to identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period – is of such a size, nature or incidence that disclosure is relevant to understanding the combined entity's financial statements.

3.2 Specific disclosures for contingent consideration, indemnification assets and contingent liabilities arising from a business combination

IFRS 3 requires disclosure of specific items recognised as part of the business combination, as follows:

Disclosure area	Required disclosures
Contingent consideration arrangements (asset or liability) and indemnification assets: In reporting period when the business combination occurred (IFRS 3.B64(g))	• amount recognised as of the acquisition date • description of the arrangement and the basis for determining the amount of the payment • estimate of the range of outcomes (undiscounted) – if it cannot be estimated, disclose that fact and the underlying reason – if amount of the payment is unlimited, disclose that fact
Continuing disclosures (IFRS 3.B67(b))	The following disclosures are required until the parent collects, sells or otherwise loses the right to a contingent consideration asset, or until a contingent consideration liability is settled, cancelled or expires: • any changes in the recognised amounts, including any differences arising upon settlement • any changes in the range of outcomes (undiscounted) and the reasons for those changes • the valuation techniques and key model inputs used to measure contingent consideration

Disclosure area	Required disclosures
Contingent liability: In reporting period when the business combination occurred (IFRS 3.B64(j))	• the information required by IAS 37.85 for each contingent liability recognised, such as: – nature of the obligation and the expected timing of outflows of economic benefits – indication of the uncertainties about the amount or timing of those outflows – amount of any expected reimbursement and any related asset that has been recognised • if a contingent liability is not recognised because its fair value cannot be measured reliably, disclose the underlying reason and the information required by IAS 37.86, as follows: – nature of the contingent liability – where practicable, an estimate of the financial effect and indication of the uncertainties relating to the amount or timing of any outflow – the possibility of any reimbursement
Continuing disclosure of the details of the contingent liability and reconciliation of the balance of contingent liability (IFRS 3.B67(c))	The following disclosures are required until contingent liability is settled, cancelled or expires: • information required by IAS 37.85 (as discussed above) • the information required by IAS 37.84 as follows: – the carrying amount at the beginning and end of the period – additional contingent liabilities recognised in the period, including increases to existing contingent liabilities – amounts used (ie incurred and charged against the contingent liability) during the period – unused amounts reversed in the period – the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

3.3 Disclosures applicable only to certain business combinations

In certain situations, IFRS 3 requires specific additional disclosures:

Disclosure area	Required disclosures
Business combinations accounted using provisional amounts: Details of provisional amounts used (IFRS 3.B67(a))	• the reasons why the initial accounting for the business combination is incomplete • the particular assets, liabilities, equity interests or items of consideration for which the initial accounting is incomplete • the nature and amount of any measurement period adjustments recognised during the reporting period
Business combinations resulting in a gain from a bargain purchase: Details of a bargain purchase (IFRS 3.B64(n))	• the amount of any gain recognised and the line item in the statement of comprehensive income in which the gain is recognised • a description of the reasons why the transaction resulted in a gain

Disclosure area	Required disclosures
Business combinations where less than 100% interest is acquired: Details of NCI (IFRS 3.B64(o))	• the amount of the NCI recognised at the acquisition date and the measurement basis used (ie fair value or proportionate interest model) • for each NCI measured at fair value, the valuation techniques and key model inputs used for determining that value
Business combinations achieved in stages: Details of business combination achieved in stages (IFRS 3.B64(p))	• the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date • the related amount of any gain or loss recognised related to the remeasurement to fair value of such equity interest and the line item in the statement of comprehensive income in which that gain or loss is recognised

4 Illustrative disclosure

This Section provides an example of the type of disclosures required by IFRS 3. It is not intended to illustrate all of the required disclosures in all circumstances. The form and content of the disclosures will depend on the specifics of each business combination. Accordingly, these illustrative disclosures should be amended, amplified or abbreviated to reflect such specific circumstances.

The illustrative disclosures presented below are excerpts from the 31 December 2011 consolidated financial statements of a fictional company, ABC Corporation Group (the Group). The Group is a manufacturer and distributor of household appliances and has two reportable segments, retail and wholesale segments.

4.1 Significant accounting policy disclosures

Business combinations

The Group applies the acquisition method in accounting for business combinations. The consideration transferred by the Group to obtain control of a subsidiary is calculated as the sum of the acquisition-date fair values of assets transferred, liabilities incurred and the equity interests issued by the Group, which includes the fair value of any asset or liability arising from a contingent consideration arrangement. Acquisition costs are expensed as incurred.

The Group recognises identifiable assets acquired and liabilities assumed in a business combination regardless of whether they have been previously recognised in the acquiree's financial statements prior to the acquisition. Assets acquired and liabilities assumed are generally measured at their acquisition-date fair values.

Goodwill is stated after separate recognition of identifiable intangible assets. It is calculated as the excess of the sum of a) fair value of consideration transferred, b) the recognised amount of any non-controlling interest in the acquiree and c) acquisition-date fair value of any existing equity interest in the acquiree, over the acquisition-date fair values of identifiable net assets. If the fair values of identifiable net assets exceed the sum calculated above, the excess amount (ie gain on a bargain purchase) is recognised in profit or loss immediately.

4.2 Disclosure of the business combination transaction

Acquisition of XYZ Limited

IFRS 3.B64 (a)-(d)

The Group held a 10% interest in XYZ, a manufacturer of household appliances based in Euroland. On 31 March 2011, the Group obtained majority control of XYZ by acquiring an additional 70% of XYZ's share capital thereby increasing its ownership interest to 80%. With this acquisition, the Group expects to increase its market share in Euroland's wholesale market. Details of the business combination are as follows:

		CU'000
IFRS 3.B64(f)(i)	Amount settled in cash	9,500
IFRS 3.B64(f)(iv)	Fair value of equity shares issued	7,500
IFRS 3.B64(f)(iii)	Fair value of contingent consideration	600
	Total	17,600
IFRS 3.B64(l)(iii)	Effect of the settlement of pre-existing relationship	(1,000)
	Fair value of consideration transferred	16,600
IFRS 3.B64(p)(i)	Fair value of previously held investment in XYZ	2,000
IFRS 3.B64(o)(i)	Fair value of non-controlling interest in XYZ	3,800
		22,400
IFRS 3.B64(i)	Recognised amounts of identifiable net assets:	
	Property plant and equipment	7,800
	Intagible assets (provisional amounts)	3,500
	Inventories	9,500
	Trade and other receivables	5,400
	Cash and cash equivalents	300
	Borrowings	(2,500)
	Deferred tax liabilities	(300)
	Other liabilities	(2,600)
	Trade and other payables	(4,200)
	Net dentifiable assets and liabilities	**16,900**
	Goodwill	**5,500**

Consideration transferred

IFRS 3.B64 (f)(i), (iv)

The acquisition was settled in cash of CU9,500,000 and by issuing 500,000 shares of ABC Corporation. The fair value of the equity shares issued was based on the market value of ABC Corporation's traded shares on the acquisition date.

IFRS 3.B64 (g)(i-iii)

The purchase agreement included an additional consideration of CU1,500,000, payable only if the average profits of XYZ for 2011 and 2012 exceed a target level agreed by both parties. The additional consideration is payable on 1 April 2013. The CU600,000 fair value[11] of the contingent consideration liability recognised on the acquisition date represents the present value of the Group's estimate of the probability-weighted cash outflow. It reflects management's estimate of a 50% probability that the targets will be achieved and a discount rate of 4.4%. As at 31 December 2011, there have been no changes in the estimate of the probable cash flow but the liability has increased to CU620,000 due to the unwinding of the discount.

11 The determination of the acquisition-date fair value of the contingent consideration should consider the expected outcome of the contingency. This example illustrates one possible approach in estimating the fair value of contingent consideration.

IFRS 3.B64 (l)(i-iv)

Prior to the acquisition, XYZ had an existing lawsuit against the Group for infringement of a certain patent. The Group has previously recorded a related estimated liability of CU800,000. At the acquisition date, the estimated fair value of the expected settlement amount of the litigation is CU1,000,000. The business combination effectively settled this litigation and accordingly, the Group recorded an additional loss of CU200,000 for such settlement, recognised as part of other expenses in the consolidated statement of comprehensive income. As the settlement of the lawsuit is accounted for separately from the business combination, the fair value of the settlement amount is deducted from consideration transferred.

IFRS 3.B64(m)

Acquisition-related costs amounting to CU300,000 have been recognised as an expense in the consolidated statement of comprehensive income, as part of other expenses.

Previously held investment in XYZ

IFRS 3.B64 (p)(i-ii)

On the acquisition date, the Group's 10% investment in XYZ, previously accounted for as an available for sale financial asset, has been remeasured to fair value. On that date, a cumulative gain of CU100,000 arising from changes in the fair value of the investment and recognised in other comprehensive income was reclassified to profit and loss. This is presented as a separate line item in the consolidated statement of comprehensive income. The previously held investment is considered part of what was given up by the Group to obtain control of XYZ. Accordingly, the fair value of the investment is included in the determination of goodwill.

Non-controlling interest in XYZ

IFRS 3.B64 (o)(i-ii)

The non-controlling interest in XYZ is measured at fair value at the acquisition date. The Group determined the fair value by applying a combination of market and income approaches. The key assumptions are: a discount rate range of 15-20 percent, terminal value based on a range of terminal EBITDA multiples between 3 and 5 times, financial multiples of companies deemed similar to XYZ.

Identifiable net assets

IFRS 3.B64(i)
IFRS 3.B67(a)

At 31 December 2011, the fair values of acquired patents and trademarks amounting to CU1,500,000 and CU1,000,000, respectively are provisional pending receipt of their final valuation.

IFRS 3.B64(h) (i-iii)

The fair value of the trade and other receivables acquired as part of the business combination amounted to CU5,400,000, with a gross contractual amount of CU5,770,000. As of the acquisition date, the Group's best estimate of the contractual cash flow not expected to be collected amounted to CU370,000.

Goodwill

IFRS 3.B64(e)
IFRS 3.B64(k)

Goodwill recognised on the acquisition relates to the expected growth, cost synergies and the value of XYZ's workforce which cannot be separately recognised as an intangible asset. This goodwill has been allocated to the Group's wholesale segment and is not expected to be deductible for tax purposes.

Changes in goodwill

The reconciliation of the carrying amount of goodwill is as follows:

		December 2011 CU'000	2010 CU'000
IFRS 3.B67(d)	**Gross carrying amount**		
IFRS 3.B67(d)(i)	Balance, beginning of the year	6,405	6,500
IFRS 3.B67(d)(ii)	Acquired through business combination	5,500	–
IFRS 3.B67(d)(vi)	Net exchange difference	(146)	(95)
IFRS 3.B67(d)(viii)	**Balance, end of the year**	**11,759**	**6,405**
	Accumulated impairment		
IFRS 3.B67(d)(i)	Balance, beginning of the year	(955)	(1,000)
IFRS 3.B67(d)(vi)	Net exchange difference	25	45
IFRS 3.B67(d)(viii)	Balance, end of the year	(930)	(955)
	Carrying amount at the end of the year	**10,829**	**5,450**

XYZ's contribution to the Group results

IFRS 3.B64 (q)(i-ii)

XYZ has contributed CU12,232,000 and CU1,954,000 to the Group's revenues and profit, respectively from the acquisition date to 31 December 2011. Had the acquisition occurred on 1 January 2011, the Group's revenue for the period to 31 December 2011 would have been CU128,386,000 and the Group's profit for the period would have been CU15,755,000. These amounts have been determined by applying the Group's accounting policies and adjusting the results of XYZ to reflect additional depreciation and amortisation that would have been charged assuming the fair value adjustments to property, plant and equipment and intangible assets had been applied from 1 January 2011, together with their consequential tax effects.

Appendix B – Comparison of IFRS 3 and the previous version of the Standard

This Section provides a snapshot of the key differences between the 2008 version of IFRS 3 and the previous version of the Standard.

IFRS 3 (as revised in 2008)	Previous requirements
Scope • includes business combinations involving two or more mutual entities • includes businesses brought together to form a reporting entity by contract alone (eg by forming a dual-listed corporation)	• excludes business combinations involving two or more mutual entities • excludes businesses brought together to form a reporting entity by contract alone (eg by forming a dual-listed corporation)
Definition of a business • an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants • a business consists of inputs and processes applied to those inputs that have the ability to create outputs.	• an integrated set of activities and assets conducted and managed for the purpose of providing a return to investors; or lower costs or other economic benefits directly and proportionately to policyholders or participants • a business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate revenues
Acquisition costs • recognised as an immediate expense	• included in the cost of the business combination and in the determination of goodwill
Contingent consideration • recognised and measured at fair value on acquisition date, irrespective of probability of outflow of resources • subsequent changes in contingent consideration classified as a liability affect post-combination earnings	• recognised on the acquisition date when outflow of resources is probable and reliably measurable • when recognition criteria are met after the acquisition date, recognition of contingent consideration is taken as an adjustment to goodwill
Measurement of NCI for partial acquisitions • acquirer has an option to measure NCI that are present ownership interests either at fair value or at the proportionate interest in recognised net assets. Other types of NCI are measured at fair value	• all types of NCI are measured at the proportionate interest in recognised net assets

IFRS 3 (as revised in 2008)	Previous requirements
Recognition and measurement of assets acquired and liabilities assumed General recognition principle Conditions for recognition: • should meet the definition of an asset or liability in the *Conceptual Framework for Financial Reporting* at the acquisition date (specifically cross-referenced to the Framework) • should be part of what the acquirer and the acquiree exchanged in the business combination rather than a separate transaction	Conditions for recognition: • should meet the definition of an asset or liability in the *Conceptual Framework for Financial Reporting* at the acquisition date (not specifically cross-referenced to the Framework but described in the same terms)
General measurement principle • measured at acquisition-date fair values with limited exceptions	• generally measured at acquisition-date fair values, as amended by specific rules for numerous items
Specific recognition and measurement provisions (exceptions) for specific items Recognition exceptions • contingent liabilities are recognised even if an outflow is not considered probable • explicitly requires recognition of indemnification assets and reacquired rights Measurement exceptions • measurement of reacquired right excludes renewal options • replacement share-based payment awards are measured in accordance with IFRS 2 • assets held for sale are measured in accordance with IFRS 5 Both recognition and measurement exceptions: • IAS 12 is applied for income taxes • IAS 19 is applied for employee benefits • indemnification assets are recognised and measured on the same basis as the related indemnified item	Specific rules for measurement of: • inventory • property, plant and equipment • intangible assets • financial instruments • tax • employee benefits • onerous contracts • contingent liabilities
Consideration transferred • refers to what the former owners of the acquiree received, which is the sum of the acquisition-date fair values of the: – assets transferred by the acquirer – liabilities incurred by the acquirer and – equity interests issued by the acquirer – excludes acquisition costs – includes contingent consideration • requires that transactions consequential to the business combination but not part of the business combination for IFRS 3 purposes, are accounted for as separate transactions	• used the term 'cost of a business combination' which is the aggregate of: – fair values of assets given, liabilities incurred or assumed and equity instruments issued – includes any costs directly attributable to the business combination
Measurement of goodwill • measured as the excess of the sum of the: – fair value of consideration transferred – any recognised amount of NCI – fair value of any previously held equity interest (see below) over • the recognised amount of the acquiree's identifiable net assets	• measured as the excess of the: – cost of the combination over – the acquirer's share of the recognised amounts of the acquiree's identifiable net assets
Calculation of goodwill in business combinations achieved in stages • goodwill is determined on the date the acquirer obtains control • any previously held equity investment in the acquiree is remeasured at its acquisition date fair value and is included in the goodwill calculation (see above). Any gain or loss resulting from the remeasurement is recognised in earnings	• goodwill is measured as at each stage of the combination, using the original cost of each investment and the proportionate fair value of the acquiree's net assets at each stage

Notes

www.gti.org

© 2011 Grant Thornton International Ltd. All rights reserved. Grant Thornton International Ltd and the member firms are not a worldwide partnership. Services are delivered independently by the member firms.

Grant Thornton International Ltd is a company limited by guarantee incorporated in England and Wales.
Registered number: 05523714
Registered office: Grant Thornton House, 22 Melton Street, Euston Square, London NW1 2EP