IFRS 3 Business Combinations

SCOPE

- This IFRS applies to a transaction or other event that meets the definition of a business combination.
- This IFRS does not apply to:
  - The accounting for the formation of a joint arrangement in the F/S of the joint arrangement itself.
  - The acquisition of an asset or group of assets that do not constitute a business.
  - A combination of entities or businesses under common control.

IDENTIFYING A BUSINESS COMBINATION ("BC")

An entity shall determine whether a transaction or other event is a BC by applying the definition in this IFRS, which requires that the assets acquired, and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition.

Business Combination – IFRS defines a BC as a transaction or other event in which an acquirer obtains control of one or more businesses.

Business – A business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs.

AN ENTITY SHALL ACCOUNT FOR EACH BUSINESS COMBINATION BY APPLYING THE ACQUISITION METHOD

Identify the Acquirer

For each BC, one of the combining entities shall be identified as the acquirer.

- the guidance in IFRS 10 shall be used to identify the acquirer – the entity that obtains *control* of another entity, i.e. the acquiree.
- if a BC has occurred but applying the guidance in IFRS 10 does not clearly indicate which of the combining entities is the acquirer, the following factors shall be considered in making that determination:
  - The relative voting rights in the combined entity after the BC.
  - The existence of a large minority voting interest in the combined entity if no other owner or organized group of owners has a significant voting interest.
  - The composition of the senior management of the combined entity.
  - The terms of the exchange of equity interests.

Determining the Acquisition Date

The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.

Recognizing and Measuring the Identifiable Assets Acquired, the Liabilities Assumed, and Any Non-Controlling Interest

Recognition Principle

- As of the acquisition date, the acquirer shall recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed, and any non-controlling interest ("NCI") in the acquiree.
- Recognition of identifiable assets acquired, and liabilities assumed is subject to the following conditions:
  - the identifiable assets acquired, and liabilities assumed must meet the definitions of assets and liabilities in the IFRS *Framework for the Preparation and Presentation of Financial Statements* at the acquisition date.
  - the identifiable assets acquired, and liabilities assumed must be part of what the acquirer and the acquiree (or former owners) exchanged in the business combination transaction rather than the result of separate transactions.

Classifying or designating identifiable assets acquired and liabilities assumed in a business combination

- At the acquisition date, the acquirer shall classify or designate the identifiable assets acquired and liabilities assumed as necessary to apply other IFRSs subsequently.
- The acquirer shall make those classifications or designations on the basis of the contractual terms, economic conditions, its operating and accounting policies, and other pertinent conditions as they exist at the acquisition date.
  - this IFRS provides two exceptions to this principle: (a) classification of a lease contract in which the acquiree is the lessor, and (b) classification of a contract as an insurance contract in accordance with IFRS 4.

Measurement Principle

The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.

- For each BC, the acquirer shall measure the acquisition date components of NCI in the acquiree that are present ownership interests and entitle the holders to a proportionate share of the entity's net assets in the event of liquidation at either:
  - Fair value, or
  - The present ownership instruments' proportionate share in the recognized amounts of the acquiree's identifiable net assets.

Exceptions to the Recognition and Measurement Principles

IFRS 3 specifies exceptions to its recognition and measurement principles for particular item. The acquirer shall account for the following items by applying the requirements in IFRS 3:

a. Contingent liabilities
b. Income taxes
c. Employee benefits
d. Indemnification assets
e. Leases in which the acquiree is the lessee
f. Reacquired rights
g. Share-based payment transactions
h. Assets held for sale

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Recognizing and Measuring Goodwill or a Gain from a Bargain Purchase

- The acquirer shall recognize goodwill as of the acquisition date measured as the excess of (a) over (b) below:
  a. the aggregate of:
     (i) the consideration transferred, (ii) the amount of any NCI in the acquiree, and (iii) in a BC achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree, and
  b. the net acquisition-date amounts of the identifiable assets acquired and liabilities assumed.
- A bargain purchase is a BC in which the amount in (b) exceeds the amount in (a). If that excess remains after applying the following requirements, the acquirer shall recognize the resulting gain in P/L on the acquisition date. The gain shall be attributed to the acquirer:
  - the acquirer shall reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed, and then
  - the acquirer shall review the procedures used to measure (a) the identifiable assets acquired and liabilities assumed, (b) the NCI in the acquiree, (c) for a BC achieved in stages, the acquirer's previously held equity interest in the acquiree, and the consideration transferred.

Measurement Period

- If the initial accounting for a BC is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report provisional amounts for the items for which the accounting is incomplete.
- During the measurement period, the acquirer shall retrospectively adjust the provisional amounts to reflect new information about facts and circumstances that existed as of the acquisition date, and if known, would have affected the measurement of amounts recognized as of that date.
- During the measurement period, the acquirer also recognizes additional assets or liabilities if new information is obtained about facts and circumstances that existed at the measurement date, and if known would have resulted in the recognition of those assets and liabilities at that date.
- The measurement period ends when the acquirer receives the information it was seeking but shall not exceed on year from the acquisition date.

Additional Guidance for Applying the Acquisition Method

A Business Combination Achieved in Stages

An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date. This IFRS refers to such a transaction as a BC achieved in stages.

- in a BC achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognize the resulting gain or loss, if any, in P/L or other comprehensive income, as appropriate.

A Business Combination Achieved Without the Transfer of Consideration

- An acquirer sometimes obtains control of an acquiree without transferring consideration. Such circumstances include:
  - the acquiree repurchases a sufficient number of its own shares for an existing investor (the acquiree) to obtain control
  - minority veto rights lapse that previously kept the acquiror from controlling an acquiree in which the acquirer held the majority voting rights
  - the acquirer and acquiree agree to combine their businesses by contract alone.
- In a BC achieved by contract alone, the acquirer shall attribute to the owners of the acquiree the amount of the acquiree's net assets recognized in accordance with IFRS 3.

Determining What is Part of the Business Combination Transaction

Pre-existing relationships

- The acquirer and the acquiree may have a pre-existing relationship or other arrangement before negotiations for the BC began, or they may enter into an arrangement during the negotiations that is separate from the BC.
  - in either situation, the acquirer shall identify any amounts that are not part of the exchange for the acquiree.
  - the acquirer shall recognize as part of applying the acquisition method only the amounts that are not part of the exchange for the acquiree.
  - the acquirer shall recognize as part of applying the acquisition method only the consideration transferred for the acquiree and the assets acquired, and liabilities assumed in the exchange for the acquiree.
  - separate transactions shall be accounted for in accordance with the relevant IFRSs.

Acquisition-related costs

- Acquisition-related costs are costing the acquirer incurs to effect a BC (i.e. finder's fees, advisory, legal, accounting, valuation etc.)
- the acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception:
  - the costs to issue debt or equity securities shall be recognized in accordance with IAS 32 and IFRS 9.

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SUBSEQUENT MEASUREMENT AND ACCOUNTING

In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred, and equity instruments issued in a BC in accordance with the other applicable IFRSs for those items, depending on their nature.

- However, IFRS 3 provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred, and equity instruments issued in a BC:
  (a) **Reacquired rights**
    - a reacquired right recognized as an intangible asset shall be amortized over the remaining contractual period of the contract in which the right was granted.
    - an acquirer that subsequently sells a reacquired right to a third party shall include the carrying amount of the intangible asset in determining the gain or loss on the sale.

  (b) **Contingent liabilities**
    - after initial recognition and until the liability is settled, cancelled, or expires, the acquirer shall measure a contingent liability recognized in a business combination at the higher of
      (i) the amount that would be recognized in accordance with IAS 37, and
      (ii) the amount initially recognized less, if appropriate, the cumulative amount of income recognized in accordance with the principles of IFRS 15.

  (c) **Indemnification assets**
    - at the end of each subsequent reporting period, the acquirer shall measure an indemnification asset that was recognized at the acquisition date on the same basis as the indemnified liability or asset, subject to any contractual limitations on the amount, and for an indemnification asset that is not subsequently measured at its fair value, management's assessment of collectability of the indemnification asset.
    - the acquirer shall recognize the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it.

  (d) **Contingent consideration**
    - the acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows: (i) contingent consideration classified as equity shall not be remeasured and subsequent settlement shall be accounted for within equity, and (ii) other contingent consideration shall be measured at fair value at each reporting date and changes in fair value shall be recognized in P/L (if in scope of IFRS 9 in accordance with IFRS 9).

DISCLOSURES

The acquirer shall disclose information that enables users of its F/S to evaluate the nature and financial effect of a BC that occurs either:

(a) during the current reporting period, or
(b) after the end of the reporting period but before the F/S are authorized for issue.

The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognized in the current reporting period that relate to BCs that occurred in the period or previous reporting periods.