

# Business Combinations

## IFRS 3



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# Overview

## □ Objective is:

- to enhance relevance, faithful representation & comparability of information reported by entity regarding business combinations
- should be applied when accounting for any business combination, except :
  - initial formation of a joint venture

# Overview

- business combinations involving entities or businesses under common control.

# Key terminology

- Acquiree
  - business or businesses that acquirer obtains control of in a business combination.
- Acquirer
  - entity that obtains control of acquiree.
- Acquisition date
  - date on which acquirer obtains control of acquiree.

# Key terminology

## □ Business

- an integrated set of activities & assets that is capable of being conducted & managed for the purpose of providing goods & services to customers,
- generating investment income (such as dividends & interest) OR,
- generating other income from ordinary activities

# Key terminology

## □ Contingent consideration

- usually, an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree
- as part of the exchange for control of the acquiree
- if specified future events occur or conditions are met.

# Key terminology

- contingent consideration also may give acquirer right to the return of previously transferred consideration if specified conditions are met.

## □ Control

- investor controls investee when:
- investor is exposed, or has rights, to variable returns
- from its involvement with the investee &

# Key terminology

- has the ability to affect those returns through its power over the investee.

## □ Business combination

- transaction or other event in which acquirer obtains control of one or more businesses.

(external growth in contrast to internal growth)

# Key terminology

## □ Identifiable asset

- An asset is *identifiable* if it either:
  - is separable from the entity that holds it; or
  - represents a contractual &/or other legal rights

# Accounting for business combinations

- All business combinations
  - should be accounted for using the acquisition method (six steps)
    - Step 1: Identify the acquirer
      - entity that obtains control

# Acquisition method

- Step 2 – Determining acquisition date
  - date control of net assets & operations of acquiree are transferred to the acquirer
  - *N.B.* where there are conditions to be satisfied before ownership can be tfrd , there can be no tfrd until these are met

# Acquisition method

- Step 3 – Recognising & measuring identifiable A/L
  - A/L recognised separately from goodwill if they meet definition per CFW & must be part of what acquirer & acquiree exchanged in the BC.
  - measure at acquisition date FV

# Acquisition method

- contingent liabilities *exception* to principle
  - only recognise if present obligation that arises from past events, &
  - its FV can be measured reliably

# Acquisition method

- classifying & designating e.g.
  - IFRS9 business model
  - in-process research
- intangible assets must be identifiable:
  - separability criterion or
  - contractual-legal criterion

# Acquisition method

- *Exceptions* to both recognition & measurement principles
  - income taxes (IAS12)
  - employee benefits (IAS19)
  - indemnification assets

# Acquisition method

- ***Exceptions*** to measurement principle only
  - reacquired rights (acquisition of the right to use its trade name under franchise previously granted to acquiree (*measure on basis of remaining contractual term*) (recognise as IA))

# Acquisition method

- share-based payment (IFRS2)
  - non-current assets held for sell (IFRS5)
- 
- Step 4: Recognising & measuring NCI
    - at proportionate share of net assets, or
    - at FV & to allocate implied goodwill to the non-controlling interest

# Acquisition method

- Step 5: Measuring consideration transferred
  - use FV at acquisition date
  - same applies to step acquisitions
  - *exclude* acquisition-related costs *except*
  - cost to issue debt or equity instruments which should form part of the initial measurement of the liability or equity
  - include contingent consideration

# Acquisition method

- Step 6: Goodwill/ bargain purchase
  - the aggregate of:
    - FV of consideration tfrd
    - NCI
    - BC achieved in stages – FV previously held interest; **OVER**
    - net amnt of at acquisition identifiable A/L

# Acquisition method

- if bargain purchase, reassess
  - recognised all items
  - if still gain, recognise at acquisition date in P/L
  - goodwill recognised as asset, but test for impairment annually

# Acquisition method

- Particular types of business combinations
  - Business combination achieved in stages
    - treat previously held interest as if disposed of & reacquired at FV on acquisition date
    - recognise resulting gain or loss in P/L or OCI (SFS of acquirer)

# Acquisition method

- Business combination achieved without transfer of consideration e.g.
  - share buy-back by acquiree resulting in another investor (acquirer) obtaining control
  - rights issue by acquiree where the parent does not exercise any rights & thus loses control
  - lapse of veto rights held by NCI that kept acquirer from controlling acquiree
  - BC achieved by contract alone

# Acquisition method

- in a BC achieved by contract alone, acquirer transfers no consideration & may hold no equity interests in the acquiree.
- the acquirer should still allocate the amount of acquiree's net assets at fair value to NCI, even if NCI have a 100% interest in the acquiree.

# Acquisition method

## ➤ Reverse takeover

- occurs when acquirer (usually the larger entity) is the entity whose equity interest has been acquired and the issuing entity (usually the smaller entity) is the acquiree.
- the entity that issues securities (legal acquirer) is identified as the acquiree **for accounting purposes** e.g. a large private company has itself “acquired” by a smaller listed company in order to obtain a stock exchange listing

# Acquisition method

- From a legal perspective the smaller entity is the parent and the larger entity is the subsidiary.
- The economic reality of the transaction is however, that the shareholders of the subsidiary (larger entity), have in effect taken control of the parent (smaller entity) and the combined entity.

# Acquisition method

## □ Measurement period

- when accounting for BC, it is often difficult to obtain all the required information within a short period of time (FV & other info.)
- IFRS3 allows initial use of provisional values
- maximum 1 yr allowed to finalise values
- provisional values adjusted retrospectively

# IFRS3

