IFRS 3 – Business Combinations
Objectives

- Define a business combination under IFRS 3
- Describe the steps in applying the acquisition method
- Explain the recognition and measurement principles of IFRS 3
- Determine how to account for non-controlling interest in a partial acquisition
- Identify the key differences between IFRS 3 and Ind AS
Plan for session

Session 1  Scope and key definitions under IFRS 3

Session 2  Acquisition Method

Session 3  Key differences between IFRS 3 and Ind AS 103
Key aspects

- What constitutes a business combination?
- Who is the acquirer?
- What is the date of acquisition?
- What is the cost of acquisition?
  - Contingent consideration
- What are the assets and liabilities acquired?
  - Intangibles?
  - Contingent liabilities?
- Treatment of bargain purchase
- Subsequent adjustments
- Accounting for income tax
- Accounting and presenting Non-controlling Interest (NCI)
# Primary Literature

## Under IFRS:

<table>
<thead>
<tr>
<th>IFRS 3</th>
<th>Business Combinations</th>
</tr>
</thead>
</table>

## Under Ind AS:

<table>
<thead>
<tr>
<th>Ind AS 103</th>
<th>Business Combinations</th>
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</table>
Scope of IFRS 3 (Revised 2008)

- Transactions or events that meet the definition of a Business Combination
- Formation of a joint venture
- Acquisition of an asset or group of assets not constituting a business
- A combination of entities or businesses under common control
Identifying a Business Combination

- An entity shall determine whether a transaction or other event is a business combination by applying the definition in this IFRS, which requires that the assets acquired and liabilities assumed constitute a business.

- For example, an entity may acquire a set of assets and activities that represents the ownership and management of a group of pipelines used for the transport of oil, gas and other hydrocarbons on behalf of a number of customers. The operation has a limited number of employees (mainly used in maintenance of the pipelines and billing of customers), a system used for tracking transported hydrocarbons and a minor amount of working capital. The transaction involves the transfer of employees and systems, but not the working capital.

Notwithstanding that the inputs into the process are minimal, the group of pipelines will meet the definition of a business and so the transaction will be accounted for as a business combination.
Identifying a Business Combination Contd..

• If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition.

  – For example, acquisition of a ‘shell’ or ‘shelf’ company is not a business combination as defined in IFRS 3(2008) because no business is being acquired.
Key Definitions

• Business combination
  – A transaction or other event in which an acquirer obtains control of one or more businesses.

• Control
  – The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

• Business
  – A business consists of inputs and processes applied to those inputs that have the ability to create outputs.
Example of a Common Control Transaction

B and C are wholly-owned subsidiaries of A.

A transfers its equity interest in B to C. In exchange, C issues further equity shares to A.

The transaction is a common control transaction since both B and C are under the common control of A.
Acquisition Method

All business combinations are accounted for using the acquisition method.

To apply acquisition method it is required to;

1. **Stage 1**: Identifying the acquirer
2. **Stage 2**: Determining the acquisition date
3. **Stage 3**: Recognizing and measuring the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree
4. **Stage 4**: Recognizing and measuring goodwill or a gain from a bargain purchase
Who is the acquirer

- Usually the entity that transfers the cash or other assets, or incurs the liabilities.
- If consideration is paid by issuing equity shares, the entity that issues equity shares is the acquirer.
Determining the Acquisition Date

• Date on which the acquirer obtains control of the acquiree.
  – Usually, the date on which the acquirer legally transfers the consideration, acquires the assets, and assumes the liabilities of the acquiree - the “closing date”.

On 1 December 20X7, Entity A acquires a 35% non-controlling equity interest in Entity B. On 1 January 20X9 Entity A acquires 40% interest in Entity B, which gives it control of Entity B. What is the acquisition date?

a) 1 December 20X7

b) 1 January 20X9

✔️
Identifying and Measuring Consideration

- Consideration should be measured at fair value.
- Consideration is the sum of the acquisition-date fair values of:
  - The assets transferred
  - The liabilities incurred by the acquirer
  - The equity interests issued
- Acquisition-related costs are generally expensed as incurred except for the costs that are incurred related to the issuance of debt or equity securities
Identifying and Measuring Consideration

Contingent consideration

- Recognize at acquisition-date fair value as part of the consideration transferred.
- Obligation to pay contingent consideration is classified as a liability or equity
- Subsequent measurement:
  - If classified as equity, no re-measurement.
    - Subsequent settlement shall be accounted for within equity.
  - If classified as liability and that liability is:
    - A financial instrument within the scope of IAS 39, re-measure to fair value through earnings or comprehensive income each period until settled
    - Not within scope of IAS 39, account for in accordance with IAS 37 or other IFRSs as appropriate
Entity A acquired controlling interest in Entity B and issued 100,000 shares to its owners as a consideration for the acquisition. The fair value of the share issued by Entity A was as follows;

- Rs. 350,000 as at the date of the acquisition agreement
- Rs. 425,000 as at the date of the acquisition as identified by the agreement

Entity A incurred the following expenses in relation with the acquisition;

- Legal and consulting fees of Rs. 20,000
- General administrative costs of Rs. 10,000
- Costs related to issuance of equity Rs. 15,000

Entity A also agrees with Entity B that if it meets certain performance based targets within next two year, an additional consideration (in cash) of Rs. 70,000 will be paid to it. Entity A determines the fair value of this additional consideration as Rs. 45,000.

Compute the amount of consideration paid in the above transaction?
Case Study – Solution

Computation of consideration paid

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of equity issued as at the date of acquisition</td>
<td>425,000</td>
</tr>
<tr>
<td>Fair value of the contingent consideration</td>
<td>45,000</td>
</tr>
<tr>
<td><strong>Total consideration paid</strong></td>
<td><strong>470,000</strong></td>
</tr>
</tbody>
</table>

Expenses incurred in relation with the acquisition

<table>
<thead>
<tr>
<th>Other expenses</th>
<th>Accounting treatment</th>
</tr>
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<tr>
<td>Legal and consulting fees of Rs. 20,000</td>
<td>To be charged to expenses as incurred</td>
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<tr>
<td>General administrative costs of Rs. 10,000</td>
<td>To be charged to expenses as incurred</td>
</tr>
<tr>
<td>Costs related to issuance of equity Rs. 15,000</td>
<td>To be recognized in accordance with IAS 32 and IAS 39.</td>
</tr>
</tbody>
</table>
Recognition and Measurement Principles

• As of the acquisition date, the acquirer shall recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree.

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

• For each business combination, the acquirer shall measure non-controlling interest either
  – at fair value, or
  – at non-controlling interest’s proportionate share of the acquiree’s identifiable net assets.
Recognition and Measurement Principles

- Free choice of measuring NCI is limited to NIC that are present ownership interest and entitle their holders to a proportionate share of the entity’s net assets in the event of liquidation.

Case studies:

Assume NEWRON (acquirer) adopted the amendment on 1 January 2010.

- Which measurement basis can be applied to each of following components of NCI assuming those components existed at the acquisition date?
  - Ordinary shares
• Class 1 preference shares: The shares are classified as equity by KTKK (the acquiree) under IFRSs. The preference shares have a nominal value of $1. The preference shares give their holders a right to a preferential dividend in priority to the payment of any dividend to the holders of ordinary shares. Upon liquidation of KTKK, the holders of the preference shares are entitled to receive out of the assets available for distribution the amount of $1 per share in priority to the holders of ordinary shares. The holders of the preference shares do not have any further rights on liquidation.
Recognition and Measurement Principles

- Class 2 preference shares: Facts and characteristics of the preference shares are the same as the Class 1 preference shares except a characteristic that the Class 2 preference shares entitle their holders to receive a proportionate share of the assets available for distribution upon liquidation of KTKK. That is, the holders of the preference shares have equal right and ranking to the holders of ordinary shares in the event of liquidation.
Written call options: KTKK has entered into a written call option with an investor and received $5 million from the investor. The option is classified as equity by KTKK under IFRSs. The option entitles the holder to purchase 2% of KTKK’s ordinary shares within a defined period at a fixed purchase price. The options do not represent an in-substance forward contract. They do not represent present ownership interest and do not entitle their holders to a proportionate share of KTKK’s net assets in the event of liquidation.
• Non-controlling interest could have a **negative** carrying balance.
  – If there are accumulated net losses attributable to non-controlling interest.
Goodwill Measurement

Goodwill =
Aggregate Consideration (+)
Non-controlling interest (+)
Previously held equity interest (acquisition date fair value) (-)
Net Identifiable assets acquired and liabilities assumed

Tested for impairment and is not amortized
Goodwill Measurement – Illustration

Case facts:

• P pays Rs. 800 to purchase 80% of the shares of S.
• Fair value of 100% of S’s identifiable net assets is Rs. 600.
• Fair value of the non-controlling interest is Rs. 185.
Goodwill Measurement (Alternative I)

If P elects to measure non-controlling interests as their proportionate interest in the net assets of S;

<table>
<thead>
<tr>
<th>Description</th>
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</tr>
</thead>
<tbody>
<tr>
<td>Fair value of the considerations transferred</td>
<td>800</td>
</tr>
<tr>
<td>Add: Proportionate fair value of the non-controlling interest</td>
<td></td>
</tr>
<tr>
<td>(20% of S’s identifiable net assets of $ 600)</td>
<td>120</td>
</tr>
<tr>
<td><strong>Sub total</strong></td>
<td>920</td>
</tr>
<tr>
<td>Less: Fair value of S’s identifiable net assets</td>
<td>(600)</td>
</tr>
<tr>
<td><strong>Goodwill</strong></td>
<td>320</td>
</tr>
</tbody>
</table>
Goodwill Measurement (Alternative II)

If P elects to measure non-controlling interests at fair value;

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<tr>
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<td>800</td>
</tr>
<tr>
<td>Add: Fair value of the non-controlling interest</td>
<td>185</td>
</tr>
<tr>
<td><strong>Sub total</strong></td>
<td><strong>985</strong></td>
</tr>
<tr>
<td>Less: Fair value of S’s identifiable net assets</td>
<td>(600)</td>
</tr>
<tr>
<td><strong>Goodwill</strong></td>
<td><strong>385</strong></td>
</tr>
</tbody>
</table>
Gain From Bargain Purchase

• Bargain purchase occurs if the fair value of the identifiable net assets of the acquiree exceeds the aggregate of:
  – The consideration transferred,
  – The non-controlling interests, and
  – The fair value of any previously held equity interest.

• Gain on bargain purchase is recognized in profit or loss on the acquisition date.

• Reassessment required prior to recognizing a bargain purchase gain.
Impact on goodwill impairment on NCI measurement choice

• Facts:

NCI : 19% ;

Recoverable amount of CGU: Rs 500 million;

Carrying amount of CGU without goodwill : Rs 274 million;

Goodwill as reported: Rs 197 million (partial goodwill); Rs 236 million (full goodwill)

Determine the impairment loss attributable to the group and NCI under both full goodwill and partial goodwill
Non-control to Control Transactions

Transactions that involve remeasurement of an existing interest

- IAS 39
- IAS 28/31
- IAS 27

- Acquisition of a controlling interest in a financial asset
- Acquisition of a controlling interest in an associate or a jointly controlled entity
Entity A acquired a 75% controlling interest in Entity B in two stages.

In 20X4, Entity A acquired a 15% equity interest for cash consideration of Rs. 10,000. Entity A classified the interest as available-for-sale under IAS 39. From 20X4 to the end of 20X7, Entity A reported fair value increase of Rs. 2,000 in other comprehensive income (OCI).

In 20X8, Entity A acquired a further 60% equity interest for cash consideration of Rs. 60,000. Entity A identifies net assets of Entity B with a fair value of Rs. 80,000. Entity A elected to measure non-controlling interests at their share of net assets. On the date of acquisition, the previously-held 15% interest had a fair value of Rs. 12,500.

Compute the goodwill and gain/loss on account fair value changes in the investment upon acquisition of controlling interest in 20X8.
# Case Study – Solution

## Computation of goodwill on the second acquisition

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of consideration given for controlling interest</td>
<td>60,000</td>
</tr>
<tr>
<td>Non-controlling interest (25% * Rs. 80,000)</td>
<td>20,000</td>
</tr>
<tr>
<td>Fair value previously-held interest</td>
<td>12,500</td>
</tr>
<tr>
<td><strong>Sub-total</strong></td>
<td><strong>92,500</strong></td>
</tr>
<tr>
<td>Less: Fair value of net assets of acquire</td>
<td>(80,000)</td>
</tr>
<tr>
<td><strong>Goodwill</strong></td>
<td><strong>12,500</strong></td>
</tr>
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## Expenses incurred in relation with the acquisition

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</table>
Case Study – Solution Contd..

Computation of fair value differences on the investment

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Gain on disposal of 15% investment</td>
<td>500</td>
</tr>
<tr>
<td>(Rs. 12,500 – Rs. 12,000)</td>
<td></td>
</tr>
<tr>
<td>Gain previously reported in OCI</td>
<td>2,000</td>
</tr>
<tr>
<td>(Rs. 12,000 – Rs. 10,000)</td>
<td></td>
</tr>
<tr>
<td>Total gain</td>
<td>2,500</td>
</tr>
</tbody>
</table>

Entity A should include Rs. 2,500 (as computed above) in statement of comprehensive income in 20X8.
Measurement Period

• Measurement period is the period after the acquisition date during which the acquirer adjust the provisional amounts recognized for a business combination.
  – Cannot exceed one year from the acquisition date.

• If the initial accounting for a business combination is incomplete by the end of reporting period, the financial statements should be prepared using the provisional values for the items for which the accounting is incomplete.
  – Revise comparative information for prior periods.
  – Need to adjust the income statement for changes in depreciation and amortization.
Separate Transactions

• The acquirer and the acquiree may have
  – a pre-existing relationship or other arrangement before negotiations for the business combination began; or
  – they may enter into an arrangement during the negotiations that is separate from the business combination.

• The acquirer should identify amounts that are not part of the exchange for the acquiree and should recognize only
  – the consideration transferred for the acquiree; and
  – the assets acquired and liabilities assumed in the exchange for the acquiree

• Separate transactions should be accounted for in accordance with the relevant IFRSs
Examples of Separate Transactions

- A transaction that in effect settles pre-existing relationships between the acquirer and acquiree;
- A transaction that remunerates employees or former owners of the acquiree for future services; and
- A transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs.
Recognition and Measurement Exceptions

- Recognition Exceptions
  - Contingent liabilities
- Measurement Exceptions
  - Reacquired rights
  - Share-based payment awards
  - Assets held for sale

Both Recognition and Measurement exceptions
- Income taxes
- Employee benefits
- Indemnification assets
## Measurement Considerations – Other Items

<table>
<thead>
<tr>
<th></th>
<th><strong>Initial Measurement</strong></th>
<th><strong>Subsequent Measurement</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Reacquired Rights</strong></td>
<td>• Measure as an identifiable intangible asset apart from goodwill.</td>
<td>Amortized over the remaining contractual period of the contract in which the right was granted.</td>
</tr>
<tr>
<td></td>
<td>• Value based upon remaining contractual term.</td>
<td></td>
</tr>
<tr>
<td><strong>Contingent Liabilities</strong></td>
<td>Recognized at fair value if liability arises from a past event and can be measured reliably.</td>
<td>Higher of acquisition-date fair value less cumulative amortization into income, if any, or amount based on IAS 37 (best estimate of settlement).</td>
</tr>
<tr>
<td><strong>Indemnification Assets</strong></td>
<td>Generally, measured at the acquisition date fair value.</td>
<td>Measured on the same basis as the indemnified liability or asset.</td>
</tr>
<tr>
<td></td>
<td>• If related to a contingent liability, then it is not recognized at the acquisition date because its fair value is not reliably measurable at that date.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• If related to an asset or liability, for example, that results from an employee benefit that is measured on a basis other than acquisition-date fair value.</td>
<td></td>
</tr>
</tbody>
</table>
Disposal of controlling Interests

• Increase/ decrease in ownership percentage of subsidiary (as long as parent retains control)
  – Recorded as equity transactions
  – No gain or loss is recognized

• If the parent retains a non-controlling interest after control is lost:
  – Non-controlling interest is remeasured to fair value on the date control is lost
  – Recognize gain or loss in the income statement
## Key Differences IFRS Vs. Indian GAAP

<table>
<thead>
<tr>
<th>Topic</th>
<th>IFRS</th>
<th>Ind AS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Common control transactions</td>
<td>Common control transactions are excluded from the scope</td>
<td>Common control transactions are included in the scope; and additional guidance is provided. The additional guidance provides that business combination transactions between entities under common control should be accounted for using the „pooling of interest“ method.</td>
</tr>
<tr>
<td>2 Gain on bargain purchase</td>
<td>Gain on bargain purchase is recognised in profit or loss after reassessment of the fair value of assets acquired and liabilities assumed.</td>
<td>Gain on bargain purchase is recognised in OCI and accumulated in equity as capital reserve if there is a clear evidence of the underlying reason for classification of the business combination as a bargain purchase; otherwise, the resulting gain is recognised directly in equity as capital reserve.</td>
</tr>
</tbody>
</table>