IFRS 3: Business combinations

BUSINESS COMBINATION DEFINED

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

Acquirer: The entity that obtains control of the **acquiree.**

Acquiree: The business or businesses that the acquirer obtains control of in a business combination

Acquisition date: The date on which the acquirer obtains control of the acquiree.

Control: An acquirer might obtain control of an acquiree in a variety of ways including;

- transferring cash, cash equivalents or other assets
- incurring liabilities to former owners of the acquiree
- issuing equity interests
- providing more than one type of consideration

A business: For business combination purposes, a business shall be taken to generally have a minimum of three elements;

- **Input:** an economic resource that creates outputs when one or more processes are applied to it.
- **Process:** a system, standard, protocol, convention or rule that when applied to an input or inputs, creates outputs such as resource management, operational process among others.
- **Output:** the result of inputs and processes applied to those inputs.

OBJECTIVE OF THE STANDARD

To improve the **relevance**, **reliability** and **comparability** of the information that a reporting entity provides in its financial statements about a business combination and its effects, by establishing principles and requirements for how the acquirer;

- Recognizes and measures the **identifiable** assets acquired, the liabilities assumed and any **non-controlling interest** in the acquiree; in its financial statements.
- Recognizes and measures the **goodwill** acquired in the business combination or a gain from a **bargain purchase.**
- Determines what information to disclose regarding the business combination.

From the above;

- An asset is **identifiable** if it;
  - is separable (i.e., capable of being separated from the entity, sold, transferred, rented or exchanged individually or together with a related identifiable asset) or,
  - arises from contractual or other legal rights.
- **Non-controlling interest** means the equity in a subsidiary not attributable, directly or indirectly, to a parent.
- **Goodwill** means an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized

SCOPE OF THE STANDARD

The standard applies to transactions or other events that meet the definition of a business combination but does not apply to;

- the accounting for the formation of a joint arrangement
- the acquisition of an asset or a group of assets that does not constitute a business
- a combination of entities or businesses under common control.

A combination of entities is taken to be under a common control if the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory (not short-lived).

ACCOUNTING FOR A BUSINESS COMBINATION

IFRS 3 requires entities to account for each business combination by applying the acquisition method. This includes the entity;

- identifying the acquirer **(IFRS 10: consolidated financial statements provides guidance on how to determine the acquirer)**
- determining the acquisition date **(being the date on which the acquirer obtains control in the acquiree – the date when it transfers the consideration)**
- **recognizing** and **measuring** the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree **(at the acquisition date).** These shall be measured at their fair values and unlike the provisions of IAS 37, the acquirer recognizes any contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation. As long as its fair value can be measured reliably. Contingent assets can not be recognized.
- recognizing and measuring goodwill or a gain from a bargain purchase

Identifying the acquirer

IFRS 3 provides additional guidance on determining who the acquirer is incase the guidance in IFRS 10 does not clearly indicate so. In this case, the acquirer is;

- the entity that transfers cash or other assets.
- usually, but not always, the entity issuing equity interests.
- usually, the entity with the largest relative size in form of assets, revenues or profit.

ACCOUNTING FOR A BUSINESS COMBINATION

Goodwill according to IFRS:3 shall be the excess of the aggregate of;

- the consideration transferred
- the amount of any **non-controlling interest** in the acquiree
- the fair value (at acquisition date) of the acquirer's previously held equity interest in the acquiree (in case of a business combination achieved in stages/step acquisition).

Over;

- the net of the amounts of the identifiable assets acquired and the liabilities assumed (at the acquisition date).

In case it is the reverse, then it means the acquirer made a bargain purchase which is recognized as a gain in the statement of profit or loss at the acquisition date. This gain is only attributed to the acquirer.

Consideration transferred is the sum of the;

- fair values of the assets transferred by the acquirer
- liabilities incurred by the acquirer to former owners of the acquiree
- equity interests issued by the acquirer
- 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.

ACCOUNTING FOR A BUSINESS COMBINATION CONT'D

Measurement of non-controlling interest (NCI)

IFRS 3 allows a choice of accounting policy to the measurement of NCI. A choice can be made by an entity to measure NCI at;

- fair value (sometimes referred to as the full goodwill method)
- the NCI's proportionate share of net assets of the acquiree.

DISCLOSURES

- The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:
  - during the current reporting period; or
  - after the end of the reporting period but before the financial statements 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 business combinations that occurred in the period or previous reporting periods