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Business combinations and changes in ownership interests

A guide to the revised IFRS 3 and IAS 27

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Abbreviations

AC	Acquiring Company
BC	Basis for Conclusions
CEO	Chief Executive Officer
FASB	Financial Accounting Standards Board (US)
GAAP	Generally Accepted Accounting Principles
IASB	International Accounting Standards Board (the Board)
IE	Illustrative Examples (accompanying IFRS 3(2008))
IFRIC	International Financial Reporting Interpretations Committee of the IASB and interpretations issued by that committee
IFRS(s)	International Financial Reporting Standard(s)
IG	Implementation guidance (accompanying IAS 27(2008))
NCI	Non-controlling interest(s)
OCI	Other comprehensive income
SFAS	Statement of Financial Accounting Standards (US standards)
SIC	Standing Interpretations Committee of the IASC (predecessor body to the IASB) and interpretations issued by that committee
TC	Target Company

Throughout this guide, paragraphs that represent the authors' interpretations and examples other than those cited in IFRSs are highlighted by green shading.

1. Introduction

In January 2008, the International Accounting Standards Board (the IASB) issued a revised IFRS 3 *Business Combinations* and a revised IAS 27 *Consolidated and Separate Financial Statements*, referred to in this guide as IFRS 3(2008) and IAS 27(2008) respectively. In doing so, the Board completed phase II of its business combinations project, and achieved substantial convergence between International Financial Reporting Standards (IFRSs) and US Generally Accepted Accounting Principles (US GAAP) on these topics.

This guide deals mainly with accounting for business combinations under IFRS 3(2008). Where appropriate, it deals with related requirements of IAS 27(2008) – particularly as regards the definition of control, accounting for non-controlling interests, and changes in ownership interests. Other aspects of IAS 27 (such as the requirements to prepare consolidated financial statements and detailed procedures for consolidation) are not addressed.

1.1 Summary of major changes

Five headline changes brought about by the 2008 Standards are set out in the following table, and explained below.

Acquisition costs	Expensed in profit or loss
Contingent consideration	Adjustments to liability recognised in profit or loss
Partial acquisitions	Choice of measurement basis for non-controlling interests
Step acquisitions	Previous/residual holdings remeasured to fair value
Transactions with non-controlling interests	Recognised in equity – no goodwill or profit/loss

- **Acquisition costs** All acquisition-related costs (e.g. finder's fees, advisory, legal, accounting, valuation and other professional or consulting fees) are to be recognised as period expenses and generally written-off rather than added to goodwill (as previously). Costs incurred to issue debt or equity securities will continue to be recognised in accordance with the Standards on financial instruments. This change reflects the Board's move to focus on what is given to the vendor as consideration, rather than on what is spent to achieve the acquisition. The change is explained further in section 9.4.

- **Contingent consideration** Consideration for an acquisition, including any contingent consideration arrangements, is recognised and measured at fair value at the acquisition date Subsequent changes in those fair values can only affect the measurement of goodwill where they occur during the 'measurement period' and are as a result of additional information becoming available about facts and circumstances that existed at the acquisition date. All other changes (e.g. due to the acquiree meeting an earnings target, reaching a specific share price, or meeting a milestone on a research and development project) are dealt with in accordance with relevant IFRSs. This will usually mean that changes in the fair value of consideration are recognised in profit or loss (e.g. where the contingent consideration is classified as debt under IAS 32 *Financial Instruments: Presentation*). This change is a further application of the Board's move to focus on what is given to the vendor as consideration in the business combination. The consequence is separation of, and separate accounting for, aspects of the transaction that are not part of the business combination. Contingent consideration is discussed in detail in section 9.2.

- **Partial acquisitions** A partial acquisition refers to the acquisition of a controlling interest, but with a proportion of acquiree equity interests held by other investors referred to as 'non-controlling interests' (formerly 'minority interests'). A choice is available, on an acquisition-by-acquisition basis, to measure such non-controlling interests either at their proportionate interest in the net identifiable assets of the acquiree (which is the previous IFRS 3 requirement) or at fair value (which is a new option and is mandatory under US GAAP). The choice of method has a consequential effect on the balancing amount recognised as goodwill. The principle behind the treatment of non-controlling interests is explained more fully in section 2.1 below, and accounting guidance given in section 8.3.

- **Step acquisitions** A step acquisition refers to obtaining a controlling interest through two or more separate transactions. The Board has developed the principle that a change in control is a significant economic event. Accordingly, changes to IFRS 3 and IAS 27 work together with the effect that a business combination occurs, and acquisition accounting is applied, only at the date that control is achieved. Consequently, goodwill is identified and net assets remeasured to fair value only in respect of the transaction that achieved control, and not in respect of any earlier or subsequent acquisitions of equity interests. In measuring goodwill, any previously-held interests in the acquiree are first remeasured to fair value, with any gain recognised in profit or loss (including the reclassification to profit or loss of any gains previously recognised in other comprehensive income if this would be required on disposal). Similarly, on disposal of a controlling interest, any residual interest is remeasured to fair value and reflected in any profit or loss on disposal. The principle behind this treatment is discussed more fully in section 2.2 below, and step acquisitions explained more fully in chapter 12.

- **Transactions with non-controlling interests** Once control has been achieved and acquisition accounting applied, any subsequent transactions in subsidiary equity interests between the parent and non-controlling interests (both acquisitions and disposals that do not result in a loss of control) are accounted for as equity transactions. Consequently, additional goodwill does not arise on any increase in parent interest, there is no remeasurement of net assets to fair value, and no gain or loss is recognised on any decrease in parent interest. Transactions with non-controlling interests are explained more fully in chapter 12.

A detailed list of the changes from the earlier Standards to the 2008 Standards is set out in Appendix 1.

1.2 Convergence of IFRSs and US GAAP

Phase II of the business combinations project has resulted in more changes to US GAAP than to IFRSs. The table overleaf identifies the changes to IFRSs, changes to US GAAP, and changes common to both.

Changes to IFRSs

- Removal of the reliability threshold for the recognition of contingent consideration.

Changes to US GAAP

- Date of acquisition based on control passing.
- Non-controlling interests classified as equity.
- Post-acquisition restructuring charges excluded from acquired liabilities.
- Acquired 'in-process research and development' (IPR&D) not expensed immediately.
- Adjustments to provisional fair values made fully retrospective.
- Acquired net assets in a partial acquisition remeasured to full, rather than proportionate, fair value.
- Excess in a bargain purchase recognised in profit or loss.

Changes to both IFRSs and US GAAP

- Single goodwill recognition and measurement date.
- Acquisition costs expensed.
- Adjustments to contingent consideration generally recognised in profit or loss.
- Previously-held interests remeasured to fair value.
- Non-controlling interests at fair value *(IFRS option)*.
- Transactions with non-controlling interests in equity.

Continuing differences between IFRSs and US GAAP are summarised in Appendix 2.

2. Principles underlying the revised Standards

Underlying the 2008 versions of IAS 27 and IFRS 3 is the development of two important principles.

2.1 Entity concept

Although the Standards do not use the term 'entity concept', and the Board has noted that it 'did not consider comprehensively the entity and proprietary approaches as part of the amendments to IAS 27 in 2008', nevertheless, throughout the various phases of the business combinations project, Standards have changed conceptually both in respect of classification and measurement.

In respect of classification, the Standards have changed from the position where non-controlling interests were recognised separately from both shareholders' equity and liabilities in a consolidated statement of financial position, and as a deduction in arriving at the 'bottom line' of a statement of comprehensive income, (which is usually described as a 'parent concept' or 'proprietary concept') to a position where non-controlling interests are part of equity (which is a feature of the 'entity concept'). This change has occurred in two stages.

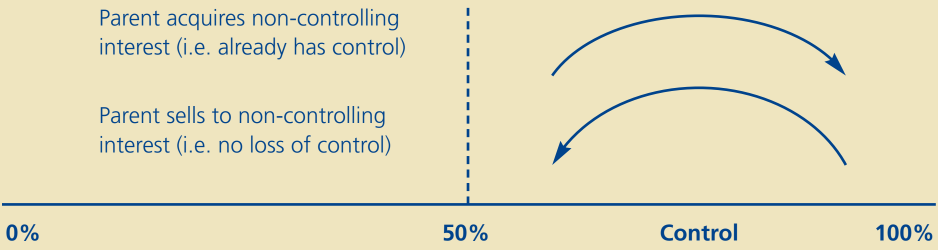
- Firstly, as part of the 2003 revision of IAS 27, the Board required minority interests (as they were then called) to be presented in the consolidated statement of financial position within equity, but separately from the equity of the shareholders of the parent. In the statement of comprehensive income, the minority's share of net income was presented as an allocation rather than as a deduction within the statement. This reflected the Board's view that a minority interest is not a liability of a group.

- Secondly, the 2008 amendments to IAS 27 implemented further changes as a consequence of their view that non-controlling interests (as they are now called) are part of equity. The effect is that transactions between non-controlling interests and parent shareholders which do not affect control are now reported as movements within equity such that goodwill is not recognised when parent interests are increased, and no profit or loss is recognised when parent interests are decreased (see section 12.3).

In respect of measurement, the Board did not fully implement the proposal in the 2005 Exposure Draft to focus on the fair value of the business combination and thereby require goodwill to be based on both parent and non-controlling interests measured at fair value (sometimes referred to as the 'gross-up' of goodwill, or the 'full goodwill' method). Rather, the Board has provided an option on an acquisition-by-acquisition basis which allows non-controlling interests to be measured initially at fair value or at a proportionate share of identifiable net assets (see section 8.3). The policy adopted to measure non-controlling interests impacts the initial measurement of goodwill, which is a residual number.

The position in the 2008 versions of IFRS 3 and IAS 27 could therefore be described as a 'partial entity concept'. As part of its Conceptual Framework project, the IASB has decided to issue an invitation to comment requesting comment on the 'entity view' of financial reporting. The IASB believes the 'entity view' is the only appropriate view and that the 'proprietary/parent entity' view is not appropriate.

Transactions that are reported wholly within equity



2.2 Crossing an accounting boundary involves a disposal

'Crossing an accounting boundary' describes a change in the method of accounting (e.g. measurement at fair value, equity accounting, proportionate consolidation or full consolidation) as a result of increasing or deceasing an equity interest in another entity. Prior to the 2008 revisions, a controlling interest achieved in stages was dealt with as a series of separate acquisition transactions with goodwill recognised as the sum of the goodwill arising on the separate transactions. On disposal, various approaches were used to measure residual interests, but commonly these were measured by reference to the residual proportion of previous carrying amounts (e.g. the residual share of net assets and goodwill).

Under the 2008 revisions, a business combination accounted for under IFRS 3 occurs only at the time that one entity obtains control over another, and does not apply to previous or subsequent transactions not involving a change in control. Any change in equity interests which crosses an accounting boundary causing a change in the method of accounting is regarded as a significant economic event. Such a transaction is therefore accounted for as if the original asset (in the case of an increase in equity interest), or the residual asset (in the case of a reduction in equity interest), were disposed of for fair value, and immediately reacquired for the same fair value. The implications of this change of principle are:

- a previously-held interest (say, 10%) which is accounted for under IAS 39 *Financial Instruments: Recognition and Measurement*, and which is increased to a controlling interest (say, 75%) through a business combination, is remeasured to fair value at acquisition date, and any gain recognised in profit or loss. Similarly, gains previously recognised in other comprehensive income are reclassified to profit or loss where required by the relevant IFRSs (see section 12.1);

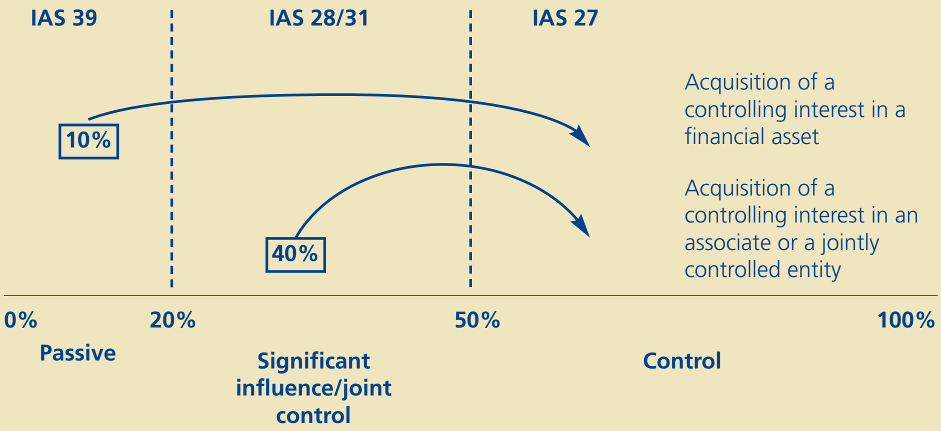
- a previously-held interest (say, 40%) which is accounted for as an associate under IAS 28 *Investments in Associates* or as a jointly controlled entity under IAS 31 *Interests in Joint Ventures*, and which is increased to a controlling interest (say, 75%) through a business combination, is remeasured to fair value, and any gain recognised in profit or loss (see section 12.1);

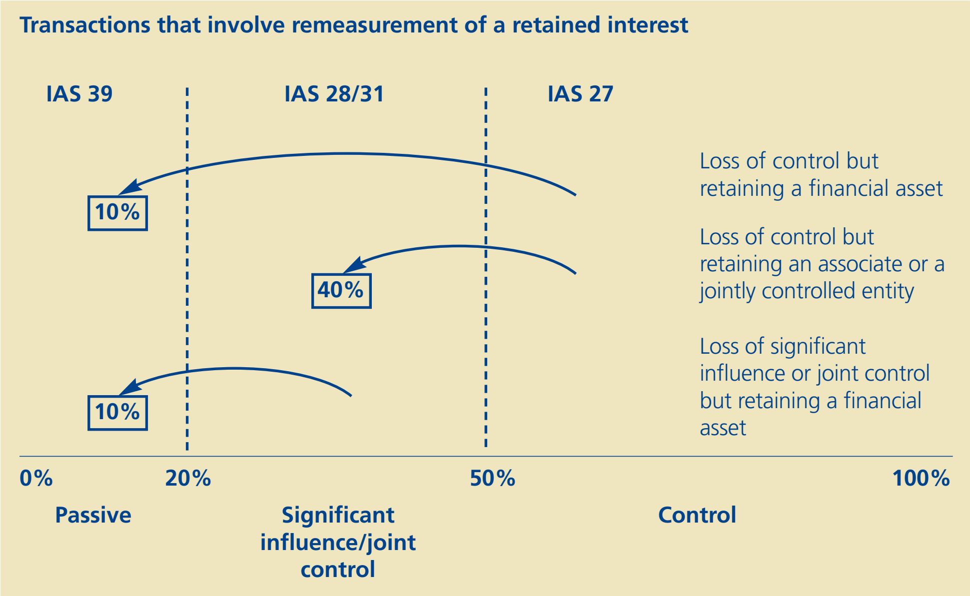
- on disposal of a controlling interest, any retained interest in the former subsidiary is measured at fair value on the date that control is lost. This fair value is reflected in the calculation of the gain or loss on disposal attributable to the parent, and becomes the initial carrying amount for subsequent accounting for the retained interest under IAS 28, IAS 31 or IAS 39 as appropriate (see section 12.4); and

- similar considerations apply to the partial disposal of an interest in an associate or a jointly controlled entity where the residual interest is accounted for as a financial asset under IAS 39 (see section 12.5).

Although the revised Standards expressly deal with the above situations, they do not deal with a '15% to 25%' transaction – i.e. a transaction that takes an investment accounted for under IAS 39 to an associate interest accounted for under IAS 28 or a jointly controlled entity accounted for under IAS 31 (see section 12.2).

Transactions that involve remeasurement of an existing interest





Business combinations achieved in stages and partial disposals are considered in more detail in chapter 12.

3. Acquisition method of accounting

IFRS 3(2008) requires that all business combinations be accounted for by applying the acquisition method. [IFRS 3(2008).4] In addition to determining whether a transaction or other event is a business combination (IFRS 3(2008).3), four stages in the application of the acquisition method are listed:

[IFRS 3(2008).5]

(a) identifying the acquirer;

(b) determining the acquisition date;

(c) recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and

(d) recognising and measuring goodwill or a gain from a bargain purchase.

However, taking all of the requirements of the Standard into account, there are seven distinct steps to be considered and these are described in the chart on the next page, together with the chapter in which each is considered in this guide.

Step 1	Determining whether the transaction or event is a business combination	See chapter 5
Step 2	Identifying the acquirer	See chapter 6
Step 3	Determining the acquisition date	See chapter 7
Step 4	Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree	See chapter 8
Step 5	Measuring consideration and determining what is part of the business combination	See chapter 9
Step 6	Recognising and measuring goodwill or a gain from a bargain purchase	See chapter 10
Step 7	Subsequent measurement and accounting	See chapter 11

Subsequent chapters deal with special situations.

Business combinations achieved in stages and partial disposals	See chapter 12
Business combinations involving no consideration	See chapter 13
Reverse acquisitions	See chapter 14

Finally, two chapters deal with transition and disclosure.

Effective date and transition	See chapter 15
Disclosure	See chapter 16

4. Scope

IFRS 3(2008) applies to a transaction or other event that meets the definition of a business combination. [IFRS 3(2008).2]

4.1 Definition of a business combination

A business combination is defined as follows.

'A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in this IFRS.' [IFRS 3(2008) (Appendix A)]

4.2 Transactions outside the scope of IFRS 3(2008)

IFRS 3(2008) does not apply to the following transactions:

[IFRS 3(2008).2]

- the formation of a joint venture;
- the acquisition of an asset or a group of assets that does not constitute a business (discussed in chapter 5); and
- a combination between entities or businesses under common control (see section 4.2.2).

Business combinations involving mutual entities are within the scope of IFRS 3(2008), but were not in the scope of IFRS 3(2004) (see section 10.2.3). Similarly, combinations achieved by contract alone rather than through an exchange transaction are within the scope of IFRS 3(2008) but were excluded from IFRS 3(2004) (see chapter 13).

Scope of IFRS 3(2008) compared to IFRS 3(2004)

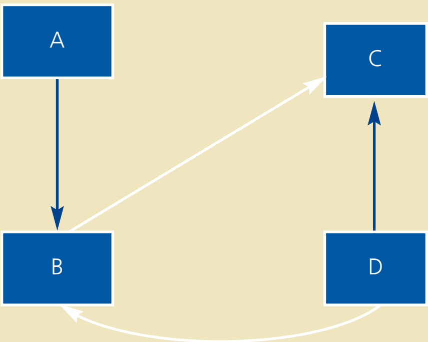
	IFRS 3(2004)	IFRS 3(2008)
Formation of a joint venture	☒	☒
Acquisition of an asset (a group of assets) that is not a business	☒	☒
Entities under common control	☒	☒
Combinations involving mutual entities	☒	✓
By contract alone (dual listing, stapling)	☒	✓

4.2.1 Formation of a joint venture

The Basis for Conclusions to IFRS 3(2008) suggests that further work would be necessary before the Board could proceed to provide guidance on accounting for the formation of a joint venture, and that the Board did not wish to delay the issue of IFRS 3(2008).

However, where a parent contributes a subsidiary to a joint venture arrangement, and receives in exchange an equity interest in the joint venture which qualifies as a jointly controlled entity under IAS 31, the transaction falls within the scope of IAS 27 so far as the parent is concerned, with the effect that the residual interest in the former subsidiary would be remeasured to fair value – see section 12.4. The IFRS 3 scope exemption would apply to the financial statements of the jointly controlled entity (i.e. entity B below).

Formation of a joint venture that is outside the scope of IFRS 3 but within the scope of IAS 27



B and D are respectively wholly-owned subsidiaries of A and C.

A and C form a new joint venture whereby B issues equity interests representing 50% of B's equity to C in return for the transfer of C's equity interest in D.

In A's consolidated financial statements, A has disposed of its controlling interest in B. Accordingly, A's residual interest in B should be fair valued – see section 12.4.

4.2.2 Common control transactions

A combination of entities or businesses under common control (commonly referred to as a 'common control transaction') is '… a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the combination, and that control is not transitory'. [IFRS 3(2008).B1]

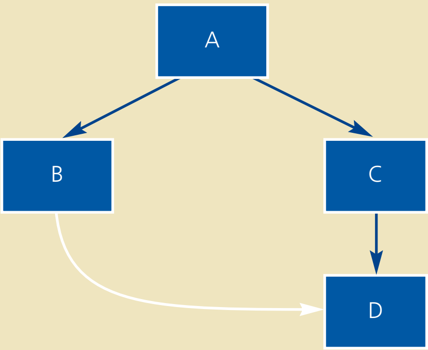
Examples of ultimate controlling parties include:

- an individual or a group of individuals who, as a result of contractual arrangements, collectively control an entity (even where those individuals are not subject to financial reporting requirements) [IFRS 3(2008).B2 – B3]; and
- a parent entity (even where the controlled entity is excluded from the parent's consolidated financial statements) [IFRS 3(2008).B4].

There is currently no specific guidance on accounting for common control transactions under IFRSs. However, in December 2007 the IASB added a project on this topic to its agenda. The project will examine the definition of common control and the methods of accounting for business combinations under common control in the acquirer's consolidated and separate financial statements.

In the absence of specific guidance, entities involved in common control transactions should select an appropriate accounting policy using the 'hierarchy' described in paragraphs 10 – 12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. As the hierarchy permits the consideration of pronouncements of other standard-setting bodies, the guidance on group reorganisations in both UK and US GAAP may be useful in some circumstances – this guidance produces a result that is similar to pooling.

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.

4.2.3 Combinations involving mutual entities

A mutual entity is defined as follows.

'An entity, other than an investor-owned entity, that provides dividends, lower costs or other economic benefits directly to its owners, members or participants. For example, a mutual insurance company, a credit union and a co-operative entity are all mutual entities.' [IFRS 3(2008) (Appendix A)]

The inclusion of credit unions and co-operatives in the definition of a mutual entity (and, consequently, within the scope of IFRS 3 (2008)) caused concern among many constituents, some of whom argued that applying the normal business combination requirements to combinations of credit unions could cause adverse economic consequences for those entities. Other constituents argued that co-operatives do not fit within the definition of a mutual entity and that they were sufficiently different from other entities to justify different methods of combination accounting.

The IASB was not persuaded by these arguments and decided to include all combinations involving such entities within the scope of the revised IFRS 3(2008) without amendment, but with limited additional guidance as to how the relevant requirements should be applied.

Combinations involving mutual entities are considered in two sections in this guide:

- identification of the acquirer is considered in section 6.3.2; and
- measurement issues, including goodwill, are considered in section 10.2.3.

5. Identifying a business combination

The first stage in accounting for an acquisition is to determine whether a transaction or other event is a business combination, which requires that the assets acquired and liabilities assumed constitute a business. [IFRS 3(2008).3] The transaction or event should be analysed by applying the definition of a business combination, and the detailed guidance set out in paragraphs B5 – B12 of the Standard.

A business combination is defined as follows.

'A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in this IFRS.' [IFRS 3(2008) (Appendix A)]

5.1 Acquirer obtains control as a result of a transaction or an event

To meet the definition of business combination, an acquirer must obtain control. This means that there must be a triggering economic event or transaction and not, for example, merely a decision to start preparing combined or consolidated financial statements for an existing group. [IFRS 3(2008).BC10]

Economic events that might result in an entity obtaining control include:

[IFRS 3(2008).B5]

(a) transferring cash or other assets (including net assets that constitute a business);

(b) incurring liabilities;

(c) issuing equity instruments;

(d) a combination of the above;

(e) a transaction not involving consideration, such as a combination by contract alone (e.g. a dual listed structure – see chapter 13).

Other examples of events that might result in an entity obtaining control:

- potential voting rights (options, convertible instruments, etc.) held by the entity in an investee becoming exercisable (see section 6.1.3);
- an investee undertaking a selective buy-back transaction which results in the entity achieving a majority ownership in the investee without changing the number of equity instruments held in that investee;
- the expiry of an agreement with other shareholders, where that agreement prevented the entity from controlling the investee (e.g. another shareholder had participative rights (right of veto) over major financing and operating policy decisions); and
- a 'creep acquisition' of equity instruments in an investee through a dividend reinvestment plan or bonus issue that increases the entity's holding to a controlling level.

5.2 Possible structures

The structure of a business combination may be determined by a variety of factors, including legal and tax strategies. Other factors might include market considerations and regulatory considerations. Examples of structures include:

[IFRS 3(2008).B6]

(a) one business becomes a subsidiary of another;

(b) two entities are legally merged into one entity;

(c) one entity transfers its net assets to another entity;

(d) an entity's owners transfer their equity interests to the owners of another entity;

(e) two or more entities transfer their net assets, or the owners transfer their equity interests, to a newly-formed entity (sometimes termed a 'roll-up' or 'put-together' transaction); and

(f) a group of former owners of one entity obtains control of a combined entity.

Examples of other legal structures that might be used to effect business combinations include:

- transactions that involve dual listing and equalisation arrangements between two entities (see section 13.2);
- a contractual arrangement between two entities that has the effect of creating one entity in substance (i.e. a 'stapling' arrangement);
- a contractual arrangement that provides a third party with all economic returns, and responsibility for risks, in relation to an investee, even though the legal ownership of ordinary capital is with another entity (e.g. a 'pass-through' arrangement); and
- arrangements whereby an entity is the beneficial owner of an interest held in trust but the trustee is the legal owner of that interest.

5.3 Identifying a business

A business is defined as follows.

'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(2008)(Appendix A)]

The application guidance in IFRS 3.B7 – B12, which is consistent with the previous version of IFRS 3, is a theoretical description of a business. While there are some useful clues, it does not provide a practical checklist for what constitutes a business.

5.3.1 Presence of goodwill

Paragraph B12 provides an over-arching test based on the presence of goodwill.

'In the absence of evidence to the contrary, a particular set of assets and activities in which goodwill is present shall be presumed to be a business. However, a business need not have goodwill.' [IFRS 3(2008).B12]

No further guidance on identifying the presence of goodwill is provided in the Standard. Goodwill may be likely to occur where the particular set of assets or activities includes a trade or operating activity that generates revenue. In addition, the requirements in relation to accounting for transactions that are not business combinations (see section 5.4) require an entity to determine the fair values of the acquired assets and liabilities so as to proportionally allocate the cost of the group of assets and liabilities. This analysis may quickly identify that the total consideration paid exceeds the aggregate fair value of the assets acquired and liabilities assumed, potentially indicating the existence of goodwill.

5.3.2 Inputs, processes and outputs

The guidance describes a business as consisting of inputs and processes applied to those inputs that have the ability to create outputs. Although outputs are usually present, they are not required for an integrated set of activities and assets to qualify as a business. [IFRS 3(2008).B7]

The following points are summarised from IFRS 3(2008).B7 – B11:

(a) inputs are economic resources including employees, materials and non-current assets (including rights of use);

(b) processes are systems, standards, protocols, conventions or rules that when applied to inputs, create outputs. Examples would include strategic management, operations and resource management. Accounting, billing, payroll and similar administrative systems typically are not used to create outputs.;

(c) outputs provide a return in the form of dividends, lower costs or other economic benefits to stakeholders;

(d) as a result of an acquisition, an acquirer may combine the acquiree's inputs and processes with its own with the result that it is not necessary that all pre-acquisition inputs and processes remain unchanged;

(e) a business may not have outputs (e.g. where it is in a development stage);

(f) a business may or may not have liabilities; and

(g) the assessment as to whether a particular set of assets and activities is a business is made by reference to whether the integrated set is capable of being conducted and managed as a business by a market participant – it is not relevant whether the seller operated the set as a business or whether the acquirer intends to operate the set as a business.

Example 5.3.2A

Outsourcing arrangements

The application of the revised guidance around the identification of a business can, in some circumstances, lead to different conclusions under IFRS 3(2008) and IFRS 3(2004) as to whether a business exists. One of these areas, depending on the nature of the arrangement, can be the treatment of an outsourcing arrangement.

For example, an entity may decide to outsource its information technology or call centre operations to a third party. Before the outsourcing, these functions generally will have been operated as a cost centre for the business as a whole, rather than as a business per se. Generally, the staff, plant and equipment and other working capital of the outsourced department are transferred to the third party, and a contractual arrangement entered into with the third party for the provision of the service to the outsourcing entity on an ongoing basis.

While they were part of the outsourcing entity, the operations generally would not have been considered a business and would not have been operated as such. However, the third party that acquires the assets and liabilities and takes on the staff could be seen to have acquired a business, as the transferred set of assets and activities is *capable* of being operated as a business. The conclusion is even clearer where the transferred assets and employees are used as the 'seed capital' to offer similar services to other parties.

Example 5.3.2B

Industries where the required inputs are minimal

When assessing whether a particular set of assets and activities is a business, it is important to consider the normal nature of the assets and activities in the relevant business sector or industry. In some industries, there may be a relatively low number of assets required as inputs, working capital requirements may be low, or the number of employees used in the process of creating outputs may be low. The acquisition of assets and activities in these types of industries must be assessed by reference to these normal levels.

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.

5.4 Accounting for a transaction that is not a business combination

Where a transaction or other event does not meet the definition of a business combination due to the acquiree not meeting the definition of a business, it is termed an 'asset acquisition'. In such circumstances, the acquirer:

[IFRS 3(2008).2(b)]

- identifies and recognises the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, intangible assets in IAS 38 *Intangible Assets*) and liabilities assumed; and
- allocates the cost of the group of assets and liabilities to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase.

Such a transaction or event does not give rise to goodwill.

Example 5.4A

Incorporation of a new subsidiary

In corporate groups, it is common for subsidiaries to be incorporated for specific purposes (e.g. to house particular operations, to act as service companies, or for other structuring purposes). In such circumstances, the acquisition of a 'shell' or 'shelf' company is not a business combination as defined in IFRS 3(2008) because no business is being acquired.

Accordingly, the acquisition or incorporation of such an entity should be accounted for in the separate financial statements of the legal parent in accordance with IAS 27, which would require initial measurement at cost (i.e. the costs of incorporating or acquiring the 'shelf' entity). In the consolidated financial statements, the costs would be recognised as start-up, restructuring or similar costs in accordance with IAS 38 *Intangible Assets*.

Example 5.4B

Exploration and evaluation assets held in corporate shells

In some jurisdictions, it is common for rights to tenure over exploration and evaluation interests to be held in separate companies for each tenement, area of interest, field, etc. Management of the entity's exploration and evaluation activities is centralised, including any plant and equipment used, employees, service and other contracts, and similar items.

In many cases, transactions involving the transfer of a particular exploration and evaluation interest involves the legal transfer of the company, rather than the underlying right or title over the interest.

Where an entity acquires a company in these circumstances, it is likely that the acquisition will not meet the definition of a business combination, because the acquisition is in substance the acquisition of the exploration and evaluation interest, rather than the acquisition of a business. Accordingly, in the consolidated financial statements, such a transaction would be accounted for in accordance with the entity's accounting policy for exploration and evaluation under IFRS 6 *Exploration for and Evaluation of Mineral Resources*, rather than as a business combination.

6. Identifying the acquirer

IFRS 3(2008) continues the requirement of IFRS 3(2004) that, for each business combination, one of the combining entities should be identified as the acquirer. [IFRS 3(2008).6 & (Appendix A)]

The acquirer and the acquiree are identified by applying the guidance in IAS 27(2008) regarding the concept of control. Where identification is not achieved by this analysis, application guidance in IFRS 3(2008).B14 – B18 provides additional guidance. [IFRS 3(2008).7]

6.1 IAS 27 guidance on control

Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. [IAS 27(2008).4]

Financial and operating policies are not defined in IAS 27. Operating policies generally would include those policies that guide activities such as sales, marketing, manufacturing, human resources, and acquisitions and disposals of investments. Financial policies generally would be those policies that guide dividend policies, budget approvals, credit terms, issue of debt, cash management, capital expenditures and accounting policies.

6.1.1 Policies and benefits

The definition of control encompasses both the notion of governance and the economic consequences of that governance (i.e. benefits and risks). Governance relates to the power to make decisions. In the definition of control, the phrase 'power to control' implies having the capacity or ability to accomplish something – in this case, to govern the decision-making process through the selection of financial and operating policies. This does not require active participation or ownership of shares.

In situations where one entity has the power to govern another entity's policies, but derives no benefits from its activities, there is a presumption that control does not exist.

Example 6.1.1A

General partners

A limited partnership is formed with 3 partners: A is the general partner with responsibility for management for which it receives a fee that is comparable with similar arrangements between third parties; B and C are limited partners with no responsibility for management and 50% share of profits each. A cannot be removed by B and C.

As general partner, A will govern the financial and operating policies of the partnership. However, because A does not participate in the benefits of the partnership's activities, it would be concluded that A does not control the partnership within the meaning of IAS 27.

Example 6.1.1B

Trusts

Laws around the establishment and operation of a trust usually involve the appointment of a trustee (sometimes called a 'responsible entity'). The trust arrangement usually creates an equitable obligation on the trustee to deal with the property of the trust for the benefit of beneficiaries. The trustee has legal ownership of the property of the trust, whereas the beneficiaries have 'beneficial' or 'equitable' ownership in the trust property.

Although a trustee can control the financial and operating policies of a trust, it does not control the trust because it is generally unable to obtain benefits from its activities. This generally holds true even if the trustee is compensated for the services provided to the trust, unless those compensation arrangements are structured in a way that results in a transfer of benefits to the trustee that exceeds a normal compensation arrangement.

Overall, a trustee's relationship with the trust can be viewed as a fiduciary relationship rather than one of control.

6.1.2 Presumption of control

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. In exceptional circumstances, however, it may be possible to clearly demonstrate that such ownership does not constitute control. Control also exists when the parent owns half or less of the voting power of an entity when there is:

[IAS 27(2008).13]

(a) power over more than half of the voting rights by virtue of an agreement with other investors;

(b) power to govern the financial and operating policies of the entity under a statute or an agreement;

(c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body; or

(d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.

The definition and guidance on control is intended to identify whether an entity has sole control over one or more other entities. Where two entities have joint control under a contractual agreement (i.e. they are able to exercise control by cooperating, but neither can unilaterally exercise control without the agreement of the other), then the arrangement will not fall within the scope of either IAS 27 or IFRS 3, but will fall within the scope of IAS 31.

6.1.3 Potential voting rights

An entity may own instruments (e.g. share warrants, share call options, debt or equity instruments that are convertible into ordinary shares) that have the potential (if exercised or converted) to give the entity voting power or reduce another party's voting power over the financial and operating policies of another entity (potential voting rights).

- Where potential voting rights are currently exercisable or convertible, they are considered when assessing whether an entity has the power to govern another entity's financial and operating policies. [IAS 27(2008).14]

- Where potential voting rights are not exercisable or convertible until a future date or until the occurrence of a future event, they are not considered in making that assessment. [IAS 27(2008).14]

- However, the proportions of profit or loss and changes in equity allocated to the parent and non-controlling interests are determined on the basis of present ownership, and do not reflect any exercise or conversion of potential voting rights. [IAS 27(2008).19]

In assessing whether potential voting rights contribute to control, all of the facts and circumstances that affect those rights should be considered (including the terms of exercise of the rights and any other contractual arrangements), except the intention of management and the financial ability to exercise or convert such rights. [IAS 27(2008).15]

The effect of these requirements is that where one entity, by using the threat of exercise or conversion of potential voting rights, is able to ensure that its wishes are followed, then it has the power to direct the actions of others who are affected by a change in voting power.

Five examples illustrating aspects of potential voting rights are set out in the implementation guidance accompanying IAS 27(2008).

Example 6.1.3A

Options are out of the money

[IAS 27(2008).IG8]

Entities A and B own 80 per cent and 20 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. Entity A sells one-half of its interest to Entity D and buys call options from Entity D that are exercisable at any time at a premium to the market price when issued, and if exercised would give Entity A its original 80 per cent ownership interest and voting rights.

Though the options are out of the money, they are currently exercisable and give Entity A the power to continue to set the operating and financial policies of Entity C, because Entity A could exercise its options now. The existence of the potential voting rights, as well as the other factors described in paragraph 13 of IAS 27, are considered and it is determined that Entity A controls Entity C.

Example 6.1.3B

Possibility of exercise or conversion

[IAS 27(2008).IG8]

Entities A, B and C own 40 per cent, 30 per cent and 30 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entity A also owns call options that are exercisable at any time at the fair value of the underlying shares and if exercised would give it an additional 20 per cent of the voting rights in Entity D and reduce Entity B's and Entity C's interests to 20 per cent each. If the options are exercised, Entity A will have control over more than one-half of the voting power. The existence of the potential voting rights, as well as the other factors described in paragraph 13 of IAS 27 and paragraphs 6 and 7 of IAS 28, are considered and it is determined that Entity A controls Entity D.

Example 6.1.3C

Other rights that have the potential to increase an entity's voting power or reduce another entity's voting power

[IAS 27(2008).IG8]

Entities A, B and C own 25 per cent, 35 per cent and 40 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entities B and C also have share warrants that are exercisable at any time at a fixed price and provide potential voting rights. Entity A has a call option to purchase these share warrants at any time for a nominal amount. If the call option is exercised, Entity A would have the potential to increase its ownership interest, and thereby its voting rights, in Entity D to 51 per cent (and dilute Entity B's interest to 23 per cent and Entity C's interest to 26 per cent).

Although the share warrants are not owned by Entity A, they are considered in assessing control because they are currently exercisable by Entities B and C. Normally, if an action (e.g. purchase or exercise of another right) is required before an entity has ownership of a potential voting right, the potential voting right is not regarded as held by the entity. However, the share warrants are, in substance, held by Entity A, because the terms of the call option are designed to ensure Entity A's position. The combination of the call option and share warrants gives Entity A the power to set the operating and financial policies of Entity D, because Entity A could currently exercise the option and share warrants. The other factors described in paragraph 13 of IAS 27 and paragraphs 6 and 7 of IAS 28 are also considered, and it is determined that Entity A, not Entity B or C, controls Entity D.

Example 6.1.3D

Management intention

[IAS 27(2008).IG8]

Entities A, B and C each own 33⅓ per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entities A, B and C each have the right to appoint two directors to the board of Entity D. Entity A also owns call options that are exercisable at a fixed price at any time and if exercised would give it all the voting rights in Entity D. The management of Entity A does not intend to exercise the call options, even if Entities B and C do not vote in the same manner as Entity A. The existence of the potential voting rights, as well as the other factors described in paragraph 13 of IAS 27 and paragraphs 6 and 7 of IAS 28, are considered and it is determined that Entity A controls Entity D. The intention of Entity A's management does not influence the assessment.

Example 6.1.3E

Financial ability

[IAS 27(2008).IG8]

Entities A and B own 55 per cent and 45 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. Entity B also holds debt instruments that are convertible into ordinary shares of Entity C. The debt can be converted at a substantial price, in comparison with Entity B's net assets, at any time and if converted would require Entity B to borrow additional funds to make the payment. If the debt were to be converted, Entity B would hold 70 per cent of the voting rights and Entity A's interest would reduce to 30 per cent.

Although the debt instruments are convertible at a substantial price, they are currently convertible and the conversion feature gives Entity B the power to set the operating and financial policies of Entity C. The existence of the potential voting rights, as well as the other factors described in paragraph 13 of IAS 27, are considered and it is determined that Entity B, not Entity A, controls Entity C. The financial ability of Entity B to pay the conversion price does not influence the assessment.

6.1.4 Special purpose entities

When assessing whether control exists, consideration should also be given to the guidance in SIC-12 *Consolidation – Special Purpose Entities* [SIC-12.10] which cites the following circumstances as indicative of control:

(a) the activities of the acquiree are conducted on behalf of the entity according to its specific business needs so that the entity obtains benefits from the acquiree's operations;

(b) the entity has the decision-making powers to obtain the majority of benefits or has delegated those powers through an 'autopilot' mechanism;

(c) the entity has rights to obtain the majority of benefits and, therefore, may be exposed to risks from the acquiree's activities; or

(d) the entity retains the majority of residual or ownership risks related to the acquiree or its assets in order to obtain benefits from its activities.

6.1.5 Venture capital organisations

For the avoidance of doubt, IAS 27(2008) states that an entity which meets the definition of a subsidiary may not be excluded from consolidation simply because the investor is a venture capital organisation, mutual fund, unit trust or similar entity. [IAS 27(2008).16] The requirement to consolidate due to the existence of control thus overrides any concern (frequently raised in connection with these types of entity) that the fair value of the subsidiary may be a more meaningful method of measuring its performance than underlying net assets.

6.2 Additional guidance in marginal cases

Where application of IAS 27(2008) does not clearly indicate which of the combining entities is the acquirer, a number of additional factors for consideration are set out in IFRS 3(2008).B14 – B18 as follows.

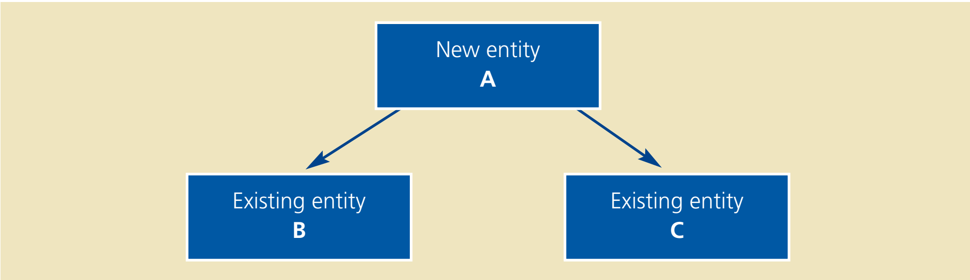
Factor	Acquirer is
Consideration primarily cash, other assets or incurring liabilities.	Usually the entity that transfers the cash or other assets, or incurs the liabilities. [IFRS 3(2008).B14]
Consideration primarily in equity interests.	Usually the entity that issues its equity interests. However, in a reverse acquisition, the acquiree may issue equity interests (see chapter 14). [IFRS 3(2008).B15]
Relative size.	Usually the entity whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entities. [IFRS 3(2008).B16]
More than two combining entities.	Consider which entity initiated the combination (as well as relative sizes). [IFRS 3(2008).B17]
New entity formed which issues equity interests.	One of the combining entities that existed before the combination, identified by applying the guidance in other paragraphs (see section 6.3). [IFRS 3(2008).B18]
New entity formed which transfers cash, other assets or incurs liabilities.	New entity may be the acquirer (see section 6.3). [IFRS 3(2008).B18]

In addition, in the case of a share exchange, other pertinent facts and circumstances may be as follows. [IFRS 3(2008).B15]

Factor	Acquirer is
Relative voting rights in the combined entity after the combination.	Usually the entity whose owners as a group retain or receive the largest portion of the combined voting rights, after considering the existence of any unusual or special voting arrangements and options, warrants or convertible notes.
No majority interest in the combined entity, but single large minority interest.	Usually the entity whose single owner or group or organised voters holds the largest minority voting interest in the combined entity. Care should be taken in applying this test to ensure that the IAS 27 test of 'power to control' is met.
Composition of the governing body of the combined entity.	Usually the entity whose owners have the ability to elect or appoint a majority of the members of the governing body.
Senior management of the combined entity.	Usually the entity whose (former) management dominates the combined management.
Terms of the exchange of equity interests.	Usually the entity that pays a premium over pre-combination fair value of the other entity or entities.

6.3 Application to specific cases

6.3.1 Combinations effected by creating a new entity



Where a new entity A is formed to effect a combination between two or more entities, say B and C, IFRS 3 identifies two distinct scenarios:

[IFRS 3(2008).B18]

- where A issues equity instruments in itself in exchange for equity instruments in B and C, then either B or C should be identified as the acquirer by applying the guidance in IAS 27 and IFRS 3; and
- where A transfers cash (or other assets) in exchange for equity instruments in B and C (e.g. from the proceeds of a debt issue to new investors or to existing investors holding a minority interest in B or C), then A may be identified as the acquirer.

Example 6.3.1A

New entity issues equity instruments

B and C are existing entities, and combine through a new entity A which issues new equity shares in itself in the proportion four-fifths to the equity shareholders of B and one-fifth to the equity shareholders of C.

On the basis of the relative voting rights, and in the absence of other factors suggesting otherwise, B is identified as the acquirer.

Accounting for the combination is developed on the principle that the consolidated financial statements of the A group are presented on the same basis as if B had legally acquired C, noting that A lacks commercial substance because it is effectively a legal mechanism to achieve this outcome. Accordingly, the combination of A and B will be accounted for as a capital restructuring whereby:

- the net assets of B remain at their previous carrying amounts;
- the consolidated statement of comprehensive income of the A group, including comparatives, will be based on the reporting period of B and will include the pre-combination results of B;
- the equity of the group will be that of B plus the fair value of A; and
- the share capital of the group, if any, will be that of A the legal parent.

The combination of the A group and C will be a 'normal' acquisition whereby:

- the identifiable net assets of C are fair valued on acquisition; and
- the consolidated statement of comprehensive income of the A group will only include C's post-acquisition results.

Example 6.3.1B

New entity transfers cash

B and C are existing entities, and combine through a new entity A. The equity investors in A are a private equity business that own 60% of A and the former equity investors in C who own 40%. A pays cash to acquire the equity interests of B, and issues equity interests in A to acquire C.

C is not identified as the acquirer since the equity investors in C do not hold a majority of the equity shares in A. In this case, A is identified as the acquirer.

The combination of A and B, and A and C, are 'normal' acquisitions whereby:

- the identifiable net assets of both B and C are fair valued on acquisition; and
- the consolidated statement of comprehensive income of the A group will include only the post-combination results of B and C.

6.3.2 Mutual entities

Section 4.2.3 sets out the definition of a mutual entity.

Since a combination of mutual entities involves an exchange (albeit typically of membership interests), IFRS 3(2008) allows no exemption from its general requirements in respect of applying the acquisition method. Consequently, an acquirer must be identified in any combination of mutual entities. [IFRS 3(2008).BC104]

The Board further concluded that the guidance on identifying the acquirer in IFRS 3 is applicable to mutual entities and no additional guidance is needed. [IFRS 3(2008).BC105]

However, additional guidance is provided to assist in measuring the fair value of equity or membership interests exchanged in paragraphs B47 – B49 of IFRS 3(2008). This guidance is considered in section 10.2.3 of this guide.

7. Determining the acquisition date

7.1 Definition of acquisition date

The acquisition date is defined as the date on which the acquirer obtains control of the acquiree. [IFRS 3(2008)(Appendix A)] This is consistent with the definition in IFRS 3(2004). However, the additional guidance given in IFRS 3(2004) on successive share purchases and dates of exchange, which was necessary in the context of that Standard's approach to step acquisitions, is rendered redundant. This is due to the 2008 Standard's stipulation that a business combination occurs, and goodwill is identified, only on the date that control is achieved.

7.2 Relationship to the timing of the payment of consideration

IFRS 3(2008) explains that the date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree – the closing date. However, the acquirer should consider all pertinent facts and circumstances in identifying the acquisition date, and it might be that control is achieved on a date that is either earlier or later than the closing date. For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. [IFRS 3(2008).9]

The reference to a written agreement is taken to mean the purchase agreement or a separate agreement signed before the closing date that grants rights to the acquirer. Since the date of acquisition will be a matter of fact, it cannot be retrospectively altered (e.g. by indicating in the purchase agreement that control is deemed to exist from an earlier date, or that profits accrue to the purchaser from some earlier or later date). This latter feature may represent a mechanism to adjust the amount of purchase consideration.

In some cases, the entire purchase price may be in the form of deferred or contingent consideration. In such circumstances, the timing of the payment of the consideration will have little or no bearing on the determination of the acquisition date.

7.3 Equity securities transferred as consideration

Consistent with the requirements in the previous version of the Standard, IFRS 3(2008) requires that the measurement date for equity securities transferred as consideration is the acquisition date (see section 9.1). [IFRS 3(2008).37]

The Basis for Conclusions to IFRS 3(2008) summarises the Board's discussion of the measurement date for equity securities transferred. This is mainly to explain the Board's decision to reject the approach reflected in certain US accounting literature. There is consequently no change to the previous position that the fair value of equity securities transferred is measured on a single date, being the date control passes. No consideration is given to movements in share prices before or after this date. [IFRS 3(2008).BC342]

7.4 Practical guidance

IFRS 3(2008) does not contain any further detailed guidance on the determination of the acquisition date. The following examples may be a useful guide in some circumstances.

Public offer of shares

Where a public offer of shares is made, the date that control passes is the date when the offer becomes unconditional and a controlling interest in the acquiree has therefore been achieved. This is usually the date that the number of acceptances passes a predetermined threshold and that threshold is sufficient to provide control (i.e. usually more than 50%). In the absence of such a threshold, the acquisition date may be the date the offer is declared unconditional. In making this assessment, other factors will also need to be considered, including where offers are declared unconditional before a controlling shareholding is achieved. In these cases, the acquisition date may occur when the level of shareholding has exceeded a particular level and the acquirer is able to effect change in the board of directors of the acquiree.

Private transfer

For a private transfer, the date that control passes will be the date that an unconditional offer is accepted. Where agreements are subject to substantive preconditions, the acquisition date will usually be the date that the last of those preconditions is satisfied.

Other scenarios

A number of indicators may be relevant, including:

(a) the date that the acquirer commences direction of operating and financial policies;

(b) the date from which the flow of economic benefits changes;

(c) the date that consideration passes (although this is not conclusive, since it is capable of being adjusted either forwards or backwards or settled in instalments);

(d) the appointment of the majority of the board of directors of the acquiree (although this may serve as a measure of the *latest* possible date that control passes in many cases); and

(e) the date that competition authorities provide clearance of a referred bid.

In practice, the date identified as the acquisition date should reflect all the various circumstances surrounding the transfer of control.

8. Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

IFRS 3(2008) sets out basic principles for the recognition and measurement of identifiable assets acquired, liabilities assumed and non-controlling interests (see sections 8.1, 8.2 and 8.3). Having established those principles, the Standard provides detailed application guidance for specific assets and liabilities (see 8.4), and a number of limited exceptions to the general principles (see 8.5).

8.1 Recognition principle

IFRS 3(2008) requires that, as of the acquisition date, the acquirer should recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. [IFRS 3(2008).10]

8.1.1 Conditions for recognition

To qualify for recognition as part of applying the acquisition method, an item should:

- meet the definition of an asset or liability in *the Framework for the Preparation and Presentation of Financial Statements* at the acquisition date [IFRS 3(2008).11]; and
- be part of the business acquired (the acquiree) rather than the result of a separate transaction (see section 9.3) [IFRS 3(2008).12].

The following are outcomes as a result of applying the first recognition condition above.

- **Post-acquisition reorganisation** Costs that the acquirer expects but is not obliged to incur in the future to effect its plan to exit an activity of an acquiree or to terminate the employment of or relocate an acquiree's employees are not liabilities at the acquisition date. [IFRS 3(2008).11] This exclusion of an acquirer's post-acquisition initiated costs is consistent with IFRS 3(2004).

- **Unrecognised assets and liabilities** The acquirer may recognise some assets and liabilities that the acquiree had not previously recognised in its financial statements. For example, the acquirer recognises the acquired identifiable intangible assets (e.g. brand names, patents or customer relationships) that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense. [IFRS 3(2008).13] The recognition of assets and liabilities that were not recognised by the acquiree is consistent with IFRS 3(2004).

The following recognition criteria, which were included in IFRS 3(2004), have been eliminated from IFRS 3(2008).

- Reliability of measurement as a criterion for recognising an asset or liability separately from goodwill – the Board considered this an unnecessary duplication of the overall recognition criteria in the *Framework*. [IFRS 3(2008).BC125] The requirement to recognise a contingent liability only where its fair value can be measured reliably remains (see section 8.5.1 below).

- Probability of an inflow or outflow of economic benefits – as a result, there is a greater focus on the presence of an unconditional right or obligation. [IFRS 3(2008).BC130]

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

8.1.2.1 Conditions at the acquisition date

IFRS 3(2008) requires that, *at the acquisition date*, the identifiable assets acquired and liabilities assumed should be classified or designated as necessary to apply other IFRSs subsequently. The acquirer makes those classifications or designations on the basis of contractual terms, economic conditions, its operating or accounting policies, and other pertinent conditions as they exist at the acquisition date. [IFRS 3(2008).15]

Examples of classifications or designations made at the acquisition date include:

[IFRS 3(2008).16]

(a) classification of financial assets as at fair value through profit or loss, available-for-sale or held-to-maturity;

(b) classification of financial liabilities as at fair value through profit or loss;

(c) designation of a derivative as a hedging instrument; and

(d) assessment of whether an embedded derivative should be separated from a host contract (which is a classification matter).

8.1.2.2 Conditions not at the acquisition date

The Standard provides two exceptions to the principle (set out above) that classifications or designations are based on the terms of instruments and conditions at the acquisition date. The two exceptions relate to:

[IFRS 3(2008).17]

(a) the classification of a lease contract as either an operating lease or a finance lease in accordance with IAS 17 *Leases*; and

(b) the classification of a contract as an insurance contract in accordance with IFRS 4 *Insurance Contracts*.

The acquirer classifies such leases and insurance contracts on the basis of the contractual terms and other factors *at the inception of the contract* (or, if the terms of the contract have been modified in a manner that would change its classification, at the date of that modification, which might be the acquisition date).

8.2 Measurement principle for assets and liabilities

Identifiable assets acquired and liabilities assumed are measured at their acquisition-date fair values. [IFRS 3(2008).18]

8.2.1 Assets with uncertain cash flows (valuation allowances)

An acquirer is not permitted to recognise a separate valuation allowance as of the acquisition date for assets acquired in a business combination that are measured at their acquisition-date fair values because the effects of uncertainty about future cash flows are included in the fair value measure. For example, because IFRS 3 requires the acquirer to measure acquired receivables, including loans, at their acquisition-date fair values, the acquirer does not recognise a separate valuation allowance for the contractual cash flows that are deemed to be uncollectible at that date. [IFRS 3(2008).B41]

This is a change from IFRS 3(2004), which required receivables, beneficial contracts and other identifiable assets to be measured at the present values of the amounts to be received, determined at appropriate current interest rates, less allowances for uncollectibility and collection costs.

The principle of ‘no valuation allowance’ also extends to property, plant and equipment such that, following a business combination, such assets are stated at a single fair value amount, and not at a gross ‘deemed cost’ and accumulated depreciation.

8.2.2 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

For competitive or other reasons, the acquirer may intend not to use an acquired asset (e.g. a research and development intangible asset or a brand name of an acquired competitor that is to be taken out of service), or it may intend to use the asset in a way that is different from the way in which other market participants would use it. In these circumstances, the general principle applies and the fair value of the asset is determined in accordance with its use by other market participants. [IFRS 3(2008).B43]

This requirement is an application of the principle that the fair value of an asset should reflect its highest and best use. The requirement has been stated explicitly in IFRS 3(2008) to avoid inconsistencies in practice.

Example 8.2.2

Acquisition of an intangible that will not be used

A acquires B. The identifiable net assets of B include a trademark, being the logo previously used by B as a direct competitor to A. A has no intention of using this logo in the future.

The logo is considered to be separable because it could, for example, be licensed to a third party. It also arises from legal rights. Therefore, the intangible asset should be recognised as part of the accounting for the acquisition (section 8.4.2 below deals more fully with intangible assets).

In practice, if A has no intention of using the logo after the acquisition, it will not be possible to allocate the logo to existing cash-generating units. Consequently, it should be identified as a cash-generating unit by itself as management intends to exclude the logo from the operating process. The cash inflows related to the logo are nil. However, immediately after acquisition, it would appear reasonable that the fair value less costs to sell are not significantly different from the amount recognised and, accordingly, an impairment loss is not recognised. However, the asset must be amortised over its useful life. The useful life to the entity is the length of time for which holding the logo will be effective in discouraging competition, which is likely to be a fairly short period, as an unexploited logo loses value very quickly. As A acquired the asset with the express intention of denying others the opportunity to use the asset, it appears unlikely that the asset will be sold in the future and, accordingly, the residual value is zero. As a result, an amortisation charge for the full carrying amount of the asset is recognised over the useful life (which may be as short as a single accounting period).

8.3 Non-controlling interest in an acquiree

8.3.1 Choice of method

For each business combination, any non-controlling interest in the acquiree is measured either:

[IFRS 3(2008).19]

- at fair value; or
- at the non-controlling interest's proportionate share of the acquiree's identifiable net assets.

This choice is available for each business combination, so an entity may use fair value for one business combination and the proportionate share of the acquiree's identifiable net assets for another.

IFRS 3(2008).19 states that the choice of measurement is available for each business combination. The Basis for Conclusions reiterates that this choice is available on a transaction-by-transaction basis. [IFRS 3(2008).BC216] IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* indicates that where specific guidance is available in another Standard, that guidance overrides the requirements of IAS 8.13 to select and apply accounting policies consistently for similar transactions, other events or conditions. There is no requirement within IFRS 3(2008) to measure non-controlling interests on a consistent basis for similar types of business combinations and, therefore, an entity has a free choice between the two options for each transaction undertaken.

An example illustrating the choice, and its impact on goodwill, is set out in section 10.1.

8.3.2 Implications of choice between alternatives for measuring non-controlling interests

Where the option is taken to measure non-controlling interests at fair value (which is generally higher than the proportionate share of identified net assets), there is a corresponding impact on the residual amount of goodwill.

Further considerations include:

- the choice only affects the initial measurement of a non-controlling interest - the fair value option is not available for subsequent changes in non-controlling interests;
- an increased amount attributed to goodwill as a result of the non-controlling interest measurement choice is a permanent difference in the carrying amount of goodwill;
- this would suggest that the amount of goodwill that is subject to impairment testing under IAS 36 *Impairment of Assets* will differ. However, IFRS 3(2008) amends IAS 36 such that this effect is equalised. Where an entity measures a non-controlling interest at its proportionate interest in the net identifiable assets of a subsidiary at the acquisition date, rather than at fair value, for the purpose of impairment testing, the carrying amount of goodwill allocated to the unit is grossed up to include the goodwill attributable to the non-controlling interest. This adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the cash-generating unit is impaired [IAS 36.C4];
- the revised US standard, SFAS 141 *Business Combinations,* requires an entity to use the fair value method for non-controlling interests. Therefore, entities that have US GAAP reporting obligations should consider adopting the fair value method; and
- where the option to measure non-controlling interests at fair value is not taken, any goodwill relating to non-controlling interests acquired subsequently will never be recognised since additional transactions after control has been obtained are accounted for as equity transactions. This feature is discussed further at section 12.3.1.

8.3.3 Measuring the fair value of non-controlling interests

For the purpose of measuring non-controlling interests at fair value, it may be possible to determine the acquisition-date fair value on the basis of active market prices for the equity shares not held by the acquirer. When a market price for the equity shares is not available because the shares are not publicly traded, the acquirer should measure the fair value of the non-controlling interests using other valuation techniques. [IFRS 3(2008).B44]

The fair values of the acquirer's interest in the acquiree and the non-controlling interest on a per-share basis may differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquiree or, conversely, the inclusion of a discount for lack of control in the per-share fair value of the non-controlling interest. [IFRS 3(2008).B45]

Example 8.3.3

Potential for fair values reflecting different circumstances

A acquired B in two separate transactions:

- a one-third equity interest for which A paid CU10 per share, which resulted in A having significant influence over B; and
- a further one-third equity interest for which A paid CU15 per share, which resulted in A having a controlling interest.

Based on the market prices of the remaining shares, A assesses the fair value of the non-controlling interest at CU9 per share.

In this case, it appears that three different fair values have been attributed to similar sized equity interests. However, each fair value reflects a different fact pattern and, therefore, a different market:

- CU10 represents the fair value of an equity interest carrying significant influence in an entity where other holdings are dispersed and the holder has the potential to launch a bid for a controlling interest;
- CU15 represents the fair value of a controlling interest, including a control premium; and
- CU9 represents the fair value of a minority non-controlling interest in an entity which is controlled by another party.

8.3.4 Subsequent measurement of non-controlling interests

Whichever choice is made as regards the initial measurement of non-controlling interests, the amount initially recognised when accounting for the business combination is subsequently adjusted by the non-controlling interests’ share of changes in equity from the date of the combination. [IAS 27(2008).18(c)] In other words, where an entity elects to measure a non-controlling interest based on fair value at the date of the business combination, subsequent changes in the fair value of the non-controlling interest are not recognised.

8.3.5 Debit balances on non-controlling interests

IAS 27(2008) requires that total comprehensive income be attributed to the owners of the parent and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. [IAS 27(2008).28]

This differs from the previous version of IAS 27 where a deficit balance was allocated against the parent except to the extent that the non-controlling interests had a binding obligation and were able to make an additional investment to cover losses.

8.4 Guidance on specific assets and liabilities

8.4.1 Operating leases

IFRS 3(2008) includes specific guidance on how operating leases should be recognised and measured when accounting for a business combination.

- **Classification as operating or finance** Classification of a lease contract as either an operating or a finance lease at the acquisition date is based on factors at the inception of the lease, which is generally before the acquisition date. If the terms of the contract have been changed subsequent to the inception of the lease such that the classification of the lease would change, then the classification at the acquisition date is based on the contractual terms and other factors at the date of that change. This means that an acquiree's lease classifications are not changed when accounting for the business combination, unless a lease contract is modified at the date of acquisition. [IFRS 3(2008).17]

- **Measurement where acquiree is the lessee** In general, the acquirer should not recognise any asset or liability related to an operating lease in which the acquiree is the lessee. [IFRS 3(2008).B28] It follows that any lease incentive that is being amortised by the acquiree will not be recognised by the acquirer. However, the acquiree may be party to operating lease arrangements that involve future lease payments at below or above market rates. The acquirer determines whether the terms of each operating lease in which the acquiree is the lessee are favourable or unfavourable. The acquirer recognises an intangible asset if the terms of an operating lease are favourable relative to market terms, and a liability if the terms are unfavourable relative to market terms. [IFRS 3(2008).B29]

- **Separate identifiable intangible** An identifiable intangible asset may be associated with an operating lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms. For example, a lease of gates at an airport or of retail space in a prime shopping area might provide entry into a market or other future economic benefits that qualify as identifiable intangible assets (e.g. as a customer relationship). In such circumstances, a separate identifiable intangible is recognised – see section 8.4.2 below. [IFRS 3(2008).B30]

- **Measurement where acquiree is the lessor** Where an asset such as a building or a patent is leased out by the acquiree under an operating lease, the acquirer takes the terms of the lease into account in measuring the acquisition-date fair value of the asset. In other words, the acquirer does not recognise a separate asset or liability if the terms of the operating lease are either favourable or unfavourable when compared with market terms (as is required for leases in which the acquiree is the lessee), but instead reflects the terms of the lease in the determination of the fair value of the leased asset. [IFRS 3(2008).B42]

8.4.2 Intangible assets

The acquirer should recognise, separately from goodwill, the identifiable intangible assets acquired in a business combination. An asset is identifiable if it meets either the separability or contractual-legal criteria in IAS 38.12 (see below). [IFRS 3(2008).B31]

8.4.2.1 Separability criterion

An intangible is separable if it is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so. [IAS 38.12(a)] An acquired intangible meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those transactions are infrequent and regardless of whether the acquirer is involved in them. [IFRS 3(2008).B33]

Example 8.4.2.1A

Customer lists

[IFRS 3(2008).B33]

Customer and subscriber lists are frequently licensed and thus meet the separability criterion. Even if an acquiree believes its customer lists have characteristics different from other customer lists, the fact that customer lists are frequently licensed generally means that the acquired customer list meets the separability criterion. However, a customer list acquired in a business combination would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its customers.

An intangible asset that is not individually separable from the acquiree or combined entity meets the separability criterion if it is separable in combination with a related contract, identifiable asset or liability. [IFRS 3(2008).B34]

Example 8.4.2.1B

Depositor relationships

[IFRS 3(2008).B34(a)]

Market participants exchange deposit liabilities and related depositor relationship intangible assets in observable exchange transactions. Therefore, the acquirer should recognise the depositor relationship intangible asset separately from goodwill.

Example 8.4.2.1C

Trademarks

[IFRS 3(2008).B34(b)]

An acquiree owns a registered trademark and documented but unpatented technical expertise used to manufacture the trademarked product. To transfer ownership of a trademark, the owner is also required to transfer everything else necessary for the new owner to produce a product or service indistinguishable from that produced by the former owner. Because the unpatented technical expertise must be separated from the acquiree or combined entity and sold if the related trademark is sold, it meets the separability criterion.

8.4.2.2 Contractual-legal criterion

An intangible that arises from contractual or other legal rights is identifiable regardless of whether those rights are transferable or separable from the acquiree or from other rights and obligations. [IFRS 38.12(b)]

IFRS 3(2004) included reliability of measurement as a recognition condition for intangible assets. IFRS 3(2008) presumes that where an intangible asset satisfies either of the criteria above, sufficient information should exist to measure its fair value reliably.

Example 8.4.2.2A

Manufacturing facility under an operating lease

[IFRS 3(2008).B32(a)]

An acquiree leases a manufacturing facility under an operating lease that has terms that are favourable relative to market terms. The lease terms explicitly prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favourable compared with the terms of current market transactions for the same or similar items is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even though the acquirer cannot sell or otherwise transfer the lease contract.

Example 8.4.2.2B

Nuclear power plant subject to a licence

[IFRS 3(2008).B32(b)]

An acquiree owns and operates a nuclear power plant. The licence to operate that power plant is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even if the acquirer cannot sell or transfer it separately from the acquired power plant. An acquirer may recognise the fair value of the operating licence and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.

Example 8.4.2.2C

Technology patent

[IFRS 3(2008).B32(c)]

An acquiree owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future foreign revenue in exchange. Both the technology patent and the related licence agreement meet the contractual-legal criterion for recognition separately from goodwill even if selling or exchanging the patent and the related licence agreement separately from one another would not be practical.

The recognition and measurement of intangible assets has always been one of the difficult areas of IFRS 3 to apply in practice. Valuation practices have developed over time and their interpretation and implementation remains varied.

8.4.2.3 Examples of identifiable intangible assets

The following examples of identifiable intangible assets are taken from the Illustrative Examples accompanying IFRS 3(2008), and are not intended to be all-inclusive. They include examples under 5 headings: marketing-related, customer-related, artistic-related, contract-based, and technology-based intangible assets. The text indicates whether examples are contractual or non-contractual. Intangible assets identified as having a contractual basis are those that arise from contractual or other legal rights. Those designated as having a non-contractual basis do not arise from contractual or other legal rights but are separable. Intangible assets identified as having a contractual basis might also be separable but separability is not a necessary condition for an asset to meet the contractual-legal criterion. [IFRS 3(2008).IE17]

Example 8.4.2.3A

Marketing-related intangible assets

[IFRS 3(2008).IE18-IE22]

Marketing-related intangible assets are used primarily in the marketing or promotion of products or services. Examples of marketing-related intangible assets are:

Class	**Basis**
Trademarks, trade names, service marks, collective marks and certification marks	Contractual
Trade dress (unique colour, shape or package design)	Contractual
Newspaper mastheads	Contractual
Internet domain names	Contractual
Non-competition agreements	Contractual

Trademarks, trade names, service marks, collective marks and certification marks

Trademarks are words, names, symbols or other devices used in trade to indicate the source of a product and to distinguish it from the products of others. A service mark identifies and distinguishes the source of a service rather than a product. Collective marks identify the goods or services of members of a group. Certification marks certify the geographical origin or other characteristics of a good or service.

Trademarks, trade names, service marks, collective marks and certification marks may be protected legally through registration with governmental agencies, continuous use in commerce or by other means. If it is protected legally through registration or other means, a trademark or other mark acquired in a business combination is an intangible asset that meets the contractual-legal criterion. Otherwise, a trademark or other mark acquired in a business combination can be recognised separately from goodwill if the separability criterion is met, which normally it would be.

The terms *brand* and *brand name*, often used as synonyms for trademarks and other marks, are general marketing terms that typically refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise. IFRS 3 does not preclude an entity from recognising, as a single asset separately from goodwill, a group of complementary intangible assets commonly referred to as a brand if the assets that make up that group have similar useful lives.

Internet domain names

An Internet domain name is a unique alphanumeric name that is used to identify a particular numeric Internet address. Registration of a domain name creates an association between that name and a designated computer on the Internet for the period of the registration. Those registrations are renewable. A registered domain name acquired in a business combination meets the contractual-legal criterion.

Example 8.4.2.3B

Customer-related intangible assets

[IFRS 3(2008).IE23-IE31]

Examples of customer-related intangible assets are:

Class	Basis
Customer lists	Non-contractual
Order or production backlog	Contractual
Customer contracts and related customer relationships	Contractual
Non-contractual customer relationships	Non-contractual

Customer lists

A customer list consists of information about customers, such as their names and contact information. A customer list also may be in the form of a database that includes other information about the customers, such as their order histories and demographic information. A customer list does not usually arise from contractual or other legal rights. However, customer lists are often leased or exchanged. Therefore, a customer list acquired in a business combination normally meets the separability criterion.

Order or production backlog

An order or production backlog arises from contracts such as purchase or sales orders. An order or production backlog acquired in a business combination meets the contractual-legal criterion even if the purchase or sales orders can be cancelled.

Customer contracts and the related customer relationships

If an entity establishes relationships with its customers through contracts, those customer relationships arise from contractual rights. Therefore, customer contracts and the related customer relationships acquired in a business combination meet the contractual-legal criterion, even if confidentiality or other contractual terms prohibit the sale or transfer of a contract separately from the acquiree.

A customer contract and the related customer relationship may represent two distinct intangible assets. Both the useful lives and the pattern in which the economic benefits of the two assets are consumed may differ.

A customer relationship exists between an entity and its customer if (a) the entity has information about the customer and has regular contact with the customer and (b) the customer has the ability to make direct contact with the entity. Customer relationships meet the contractual-legal criterion if an entity has a practice of establishing contracts with its customers, regardless of whether a contract exists at the acquisition date. Customer relationships may also arise through means other than contracts, such as through regular contact by sales or service representatives.

As noted [above], an order or a production backlog arises from contracts such as purchase or sales orders and is therefore considered a contractual right. Consequently, if an entity has relationships with its customers through these types of contracts, the customer relationships also arise from contractual rights and therefore meet the contractual-legal criterion.

Examples

The following examples illustrate the recognition of customer contract and customer relationship intangible assets acquired in a business combination.

(a) Acquirer Company (AC) acquires Target Company (TC) in a business combination on 31 December 20X5. TC has a five-year agreement to supply goods to Customer. Both TC and AC believe that Customer will renew the agreement at the end of the current contract. The agreement is not separable.

The agreement, whether cancellable or not, meets the contractual-legal criterion. Additionally, because TC establishes its relationship with Customer through a contract, not only the agreement itself but also TC's customer relationship with Customer meet the contractual-legal criterion.

(b) AC acquires TC in a business combination on 31 December 20X5. TC manufactures goods in two distinct lines of business: sporting goods and electronics. Customer purchases both sporting goods and electronics from TC. TC has a contract with Customer to be its exclusive provider of sporting goods but has no contract for the supply of electronics to Customer. Both TC and AC believe that only one overall customer relationship exists between TC and Customer.

The contract to be Customer's exclusive supplier of sporting goods, whether cancellable or not, meets the contractual-legal criterion. Additionally, because TC establishes its relationship with Customer through a contract, the customer relationship with Customer meets the contractual-legal criterion. Because TC has only one customer relationship with Customer, the fair value of that relationship incorporates assumptions about TC's relationship with Customer related to both sporting goods and electronics. However, if AC determines that the customer relationships with Customer for sporting goods and for electronics are separate from each other, AC would assess whether the customer relationship for electronics meets the separability criterion for identification as an intangible asset.

(c) AC acquires TC in a business combination on 31 December 20X5. TC does business with its customers solely through purchase and sales orders. At 31 December 20X5, TC has a backlog of customer purchase orders from 60 per cent of its customers, all of whom are recurring customers. The other 40 per cent of TC's customers are also recurring customers. However, as of 31 December 20X5, TC has no open purchase orders or other contracts with those customers.

Regardless of whether they are cancellable or not, the purchase orders from 60 per cent of TC's customers meet the contractual-legal criterion. Additionally, because TC has established its relationship with 60 per cent of its customers through contracts, not only the purchase orders but also TC's customer relationships meet the contractual-legal criterion. Because TC has a practice of establishing contracts with the remaining 40 per cent of its customers, its relationship with those customers also arises through contractual rights and therefore meets the contractual-legal criterion even though TC does not have contracts with those customers at 31 December 20X5.

(d) AC acquires TC, an insurer, in a business combination on 31 December 20X5. TC has a portfolio of one-year motor insurance contracts that are cancellable by policyholders.

Because TC establishes its relationships with policyholders through insurance contracts, the customer relationship with policyholders meets the contractual-legal criterion. IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets* apply to the customer relationship intangible asset.

Non-contractual customer relationships

A customer relationship acquired in a business combination that does not arise from a contract may nevertheless be identifiable because the relationship is separable. Exchange transactions for the same asset or a similar asset that indicate that other entities have sold or otherwise transferred a particular type of non-contractual customer relationship would provide evidence that the relationship is separable.

Example 8.4.2.3C

Artistic-related intangible assets

[IFRS 3(2008).IE32-IE33]

Examples of artistic-related intangible assets are:

Class	Basis
Plays, operas and ballets	Contractual
Books, magazines, newspapers and other literary works	Contractual
Musical works such as compositions, song lyrics and advertising jingles	Contractual
Pictures and photographs	Contractual
Video and audiovisual material, including motion pictures or films, music videos and television programmes	Contractual

Artistic-related assets acquired in a business combination are identifiable if they arise from contractual or legal rights such as those provided by copyright. The holder can transfer a copyright, either in whole through an assignment or in part through a licensing agreement. An acquirer is not precluded from recognising a copyright intangible asset and any related assignments or licence agreements as a single asset, provided they have similar useful lives.

Example 8.4.2.3D

Contract-based intangible assets

[IFRS 3(2008).IE34-IE38]

Contract-based intangible assets represent the value of rights that arise from contractual arrangements. Customer contracts are one type of contract-based intangible asset. If the terms of a contract give rise to a liability (for example, if the terms of an operating lease or customer contract are unfavourable relative to market terms), the acquirer recognises it as a liability assumed in the business combination.

Examples of contract-based intangible assets are:

Class	**Basis**
Licensing, royalty and standstill agreements	Contractual
Advertising, construction, management, service or supply contracts	Contractual
Lease agreements (whether the acquiree is the lessee or the lessor)	Contractual
Construction permits	Contractual
Franchise agreements	Contractual
Operating and broadcast rights	Contractual
Servicing contracts, such as mortgage servicing contracts	Contractual
Employment contracts	Contractual
Use rights, such as drilling, water, air, timber cutting and route authorities	Contractual

Servicing contracts, such as mortgage servicing contracts

Contracts to service financial assets are one type of contract-based intangible asset. Although servicing is inherent in all financial assets, it becomes a distinct asset (or liability) by one of the following:

(a) when contractually separated from the underlying financial asset by sale or securitisation of the assets with servicing retained;

(b) through the separate purchase and assumption of the servicing.

If mortgage loans, credit card receivables or other financial assets are acquired in a business combination with servicing retained, the inherent servicing rights are not a separate intangible asset because the fair value of those servicing rights is included in the measurement of the fair value of the acquired financial asset.

Employment contracts

Employment contracts that are beneficial contracts from the perspective of the employer because the pricing of those contracts is favourable relative to market terms are one type of contract-based intangible asset.

Use rights

Use rights include rights for drilling, water, air, timber cutting and route authorities. Some use rights are contract-based intangible assets to be accounted for separately from goodwill. Other use rights may have characteristics of tangible assets rather than of intangible assets. An acquirer should account for use rights on the basis of their nature.

Example 8.4.2.3E

Technology-based intangible assets

[IFRS 3(2008).IE39-IE44]

Examples of technology-based intangible assets are:

Class	Basis
Patented technology	Contractual
Computer software and mask works	Contractual
Unpatented technology	Non-contractual
Databases, including title plants	Non-contractual
Trade secrets, such as secret formulas, processes and recipes	Contractual

Computer software and mask works

Computer software and program formats acquired in a business combination that are protected legally, such as by patent or copyright, meet the contractual-legal criterion for identification as intangible assets.

Mask works are software permanently stored on a read-only memory chip as a series of stencils or integrated circuitry. Mask works may have legal protection. Mask works with legal protection that are acquired in a business combination meet the contractual-legal criterion for identification as intangible assets.

Databases, including title plants

Databases are collections of information, often stored in electronic form (such as on computer disks or files). A database that includes original works of authorship may be entitled to copyright protection. A database acquired in a business combination and protected by copyright meets the contractual-legal criterion. However, a database typically includes information created as a consequence of an entity's normal operations, such as customer lists, or specialised information, such as scientific data or credit information. Databases that are not protected by copyright can be, and often are, exchanged, licensed or leased to others in their entirety or in part. Therefore, even if the future economic benefits from a database do not arise from legal rights, a database acquired in a business combination meets the separability criterion.

Title plants constitute a historical record of all matters affecting title to parcels of land in a particular geographical area. Title plant assets are bought and sold, either in whole or in part, in exchange transactions or are licensed. Therefore, title plant assets acquired in a business combination meet the separability criterion.

Trade secrets, such as secret formulas, processes and recipes

A trade secret is 'information, including a formula, pattern, recipe, compilation, program, device, method, technique, or process that (a) derives independent economic value, actual or potential, from not being generally known and (b) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.' If the future economic benefits from a trade secret acquired in a business combination are legally protected, that asset meets the contractual-legal criterion. Otherwise, trade secrets acquired in a business combination are identifiable only if the separability criterion is met, which is likely to be the case.

8.4.2.4 Assembled workforce and other items that are not identifiable

The acquirer subsumes into goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. [IFRS 3(2008).B37]

Example 8.4.2.4A

Assembled workforce

[IFRS 3(2008).B37]

An acquirer may attribute value to the existence of an assembled workforce, which is an existing collection of employees that permits the acquirer to continue to operate an acquired business from the acquisition date. An assembled workforce does not represent the intellectual capital of the skilled workforce – the (often specialised) knowledge and experience that employees of an acquiree bring to their jobs, which would be included in the fair value of an entity's other intangible assets, such as proprietary technologies and processes and customer contracts and relationships. Because the assembled workforce is not an identifiable asset to be recognised separately from goodwill, and any value attributed to it is subsumed into goodwill.

Example 8.4.2.4B

Agreements with independent contractors

Although an entity's arrangements with its independent contractors are similar in many ways to its arrangements with its at-will employees making up an assembled workforce, the existence of contractual arrangements with independent contractors can represent an intangible asset in some cases. Although individual employees might have employment contracts that are similar to arrangements with independent contractors, it is the collection of employees that permits the acquirer to continue to operate an acquired business from the acquisition date and this collection is not an identifiable asset.

Independent contractors are often engaged to perform specific tasks and are not employees of the organisation. There are often negotiated rights for the contractor to retain intellectual property generated during a contract phase. They usually provide services to a number of different entities. Accordingly, the nature of the relationship with independent contractors is often quite different to that with employees and, where that relationship leads to the existence of an intangible asset, it should be recognised and measured in accordance with IFRS 3(2008).

The acquirer also subsumes into goodwill any value attributed to items that do not qualify as assets at the acquisition date. [IFRS 3(2008).B38]

Example 8.4.2.4C

Potential contracts

[IFRS 3(2008).B38]

The acquirer might attribute value to potential contracts the acquiree is negotiating with prospective new customers at the acquisition date. The acquirer does not recognise those potential contracts separately from goodwill, because they are not themselves assets at the acquisition date. The acquirer should not subsequently reclassify the value of those contracts from goodwill for events that occur after the acquisition date. However, the acquirer should assess the facts and circumstances surrounding events occurring shortly after the acquisition to determine whether a separately recognisable intangible asset existed at the acquisition date.

Example 8.4.2.4D

Expansion of business

In negotiating the purchase consideration, an acquirer may place significant value on the 'critical mass' or 'base' that an entity's existing customers, sales channels and other systems may provide to allow a significant expansion of the business after the combination. Sometimes, the acquiree's resources and systems are planned to be used in conjunction with the acquirer's own.

In such an acquisition, the customer base of the acquiree at the acquisition date will usually be a separately identifiable intangible asset. However, where the acquirer attributes value to the future customers that the acquiree might obtain, this will not represent a separately identifiable asset and this amount should be subsumed within goodwill.

Example 8.4.2.4E

Future growth in monopoly businesses

An acquiree may operate its business under a monopoly created by legislation. This might occur in telecommunications, utilities and similar industry sectors where individual entities are given rights to be the exclusive supplier of a utility or telecommunication service in a particular geographical region. Because of these monopoly rights, any future customers in that region will be *required* to use the acquiree to provide its service.

In these cases, the acquirer will usually ascribe significant value to the monopoly licence asset rather than customer-related intangible assets. In addition, future growth expected in the geographical region would be factored into the value of the monopoly licence rather than being subsumed within goodwill.

The identifiability criteria determine whether an intangible asset is recognised separately from goodwill. However, the criteria neither provide guidance for measuring the fair value of an intangible asset nor restrict the assumptions used in estimating the fair value of an intangible asset. [IFRS 3(2008).B40]

Example 8.4.2.4F

Contract renewal

[IFRS 3(2008).B40]

The acquirer would take into account assumptions that market participants would consider, such as expectations of future contract renewals, in measuring fair value. It is not necessary for the renewals themselves to meet the identifiability criteria.

However there is an exception to this measurement principle for reacquired rights recognised in a business combination [see section 8.5.2].

Paragraphs 36 and 37 of IAS 38 provide guidance for determining whether intangible assets should be combined into a single unit of account with other intangible or tangible assets.

8.5 Exceptions to the recognition and measurement principles

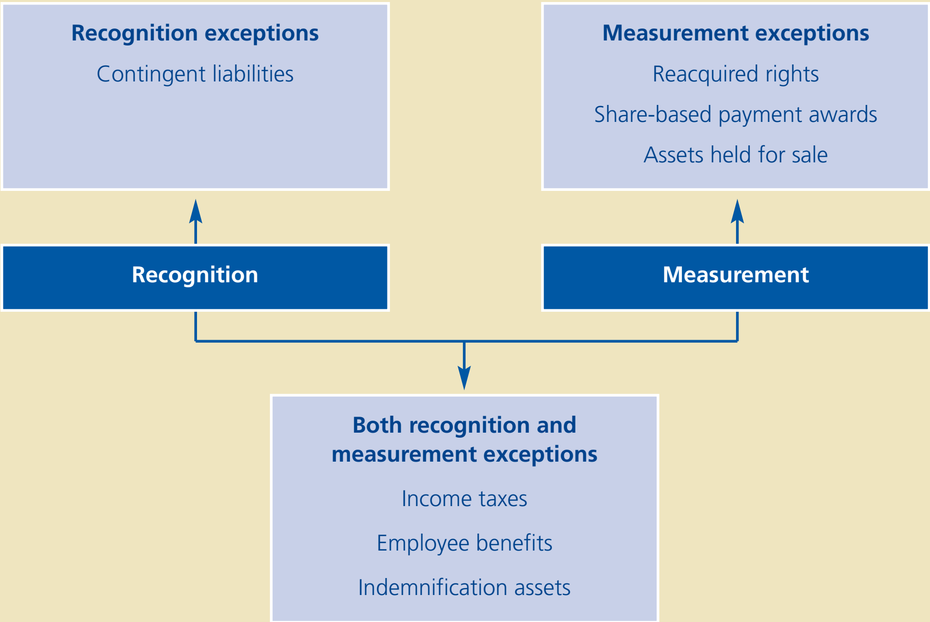
IFRS 3(2008) sets out limited exceptions to its general recognition and measurement principles. This results in particular items being:

[IFRS 3(2008).21].

(a) recognised either by applying recognition conditions in addition to those set out at section 8.1 above, or by applying the requirements of other IFRSs, with results that differ from applying the recognition principle and conditions; or

(b) measured at an amount other than their acquisition-date fair values.

Summary of recognition and measurement exceptions



8.5.1 Contingent liabilities

8.5.1.1 Background

IFRS 3(2004) required the contingent liabilities of the acquiree to be recognised and measured in a business combination at acquisition-date fair value. IFRS 3(2008) effectively reapplies the requirement of IFRS 3(2004) to measure at acquisition-date fair value regardless of probability, but retains a filter based on whether fair value can be measured reliably.

This may result in the recognition of contingent liabilities that would not qualify for recognition under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Consequently, IFRS 3(2008) also includes guidance on the subsequent measurement of contingent liabilities recognised in a business combination.

8.5.1.2 Requirements

IAS 37 defines a contingent liability as:

[IAS 37.10]

(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control or the entity; or

(b) a present obligation that arises from past events but is not recognised because:

   (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

   (ii) the amount of the obligation cannot be measured with sufficient reliability.

In a business combination, the requirements of IAS 37 are not applied in determining which contingent liabilities should be recognised as of the acquisition date. Instead, IFRS 3(2008) requires that the acquirer should recognise a contingent liability assumed in a business combination as of the acquisition date if:

[IFRS 3(2008).23]

- it is a present obligation that arises from past events; and
- its fair value can be measured reliably.

Therefore, contrary to IAS 37, the acquirer recognises a 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. [IFRS 3(2008).23]

8.5.1.3 Implications

In practice, the application of IAS 37 to past events focuses on the future outcome of those events. Where the occurrence or non-occurrence of an uncertain future event will determine whether an obligation will arise, it is classified as 'possible' under IAS 37, included within contingent liabilities, and therefore not recognised as a liability in the statement of financial position, but disclosed by way of note.

Under the fair value principle of IFRS 3(2008), the fact that there is a past event giving rise to ongoing uncertainty and, therefore, a present obligation, means that the risk has a fair value since the entity would rationally pay to have the risk removed. This is true regardless of the probability of outcomes. In practice, it will be necessary to determine whether a present obligation exists (recognised if reliably measurable), or whether there is just a possible obligation (not recognised).

The Board's original intention was to revise IAS 37 as part of phase II of the business combinations project. At present, the Board is continuing its deliberations on this related topic.

8.5.1.4 Subsequent remeasurement

As noted above, contingent liabilities recognised in a business combination are initially measured at their acquisition-date fair values. After initial recognition and until the liability is settled, cancelled or expires, the acquirer should measure a contingent liability recognised in a business combination at the higher of:

[IFRS 3(2008).56]

(a) the amount that would be recognised in accordance with IAS 37; and

(b) 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.

Example 8.5.1.4

Contingent warranty payment

Company A acquired Company B in a prior reporting period. At the time of the business combination, Company A recognised a contingent liability of CU41 in respect of a warranty claim in progress against Company B. At 31 December 20X5, the revised estimate of the liability is CU32 and the amount has met the recognition criteria of IAS 37 to be recognised as a provision.

IFRS 3(2008) requires the acquirer to measure contingent liabilities subsequent to the date of acquisition at the higher of the amount that would be recognised in accordance with IAS 37, and the amount initially recognised, less any appropriate cumulative amortisation in accordance with IAS 18. These requirements should be applied only for the period in which the item is considered to be a contingent liability, and usually will result in the contingent liability being carried at the value attributed to it in the initial business combination.

In this case, the contingent liability has subsequently met the requirements to be reclassified as a provision, and will be measured in accordance with IAS 37 rather than IFRS 3(2008). Accordingly, the liability is measured at 31 December 20X5 at CU32, and the decrease in the recognised liability is recognised through profit or loss during the year ended 31 December 20X5.

8.5.2 Pre-existing relationships and reacquired rights

8.5.2.1 Overview

IFRS 3(2008) deals with reacquired rights and the wider issue of pre-existing relationships in three inter-related sections:

- first, the section on identifying and measuring assets acquired includes a requirement to identify and recognise reacquired rights;
- second, the section on determining what is part of the business combination requires an adjustment to be made to the purchase consideration for transactions that in effect settle pre-existing relationships between the acquirer and the acquiree; and
- third, the section on subsequent measurement and accounting includes a requirement in respect of reacquired rights.

8.5.2.2 Recognition of reacquired rights as an intangible asset

As part of a business combination, an acquirer may reacquire a right that it had previously granted to the acquiree to use one or more of the acquirer's recognised or unrecognised assets. Examples of reacquired rights include a right to use the acquirer's trade name under a franchise agreement or a right to use the acquirer's technology under a technology licensing agreement. A reacquired right is an intangible asset that the acquirer recognises separately from goodwill. [IFRS 3(2008).B35]

There are two specific requirements regarding the measurement of a reacquired right.

- **Ignoring the potential for contract renewal** The acquirer is required to measure the value of a reacquired right recognised as an intangible asset on the basis of the remaining contractual term of the related contract, regardless of whether market participants would consider potential contractual renewals in determining its fair value. [IFRS 3(2008).29]
- **Recognition of a settlement gain or loss** If the terms of the contract giving rise to a reacquired right are favourable or unfavourable to the acquirer relative to the terms of current market transactions for the same or similar items, the acquirer should recognise a settlement gain or loss. [IFRS 3(2008).B36] The consequence of this requirement is that the consideration for the business combination is adjusted down (and that amount recognised as an expense) where part of the consideration effectively settles an unfavourable exposure from the acquirer's perspective, and adjusted up (a gain) where the consideration is lower due to the effective settlement of a favourable arrangement from the acquirer's perspective. The measurement of any such gain or loss is described in section 8.5.2.3.

The effect of these requirements is that the amount recognised for the reacquired right asset is based on the 'at market' valuation of the contract, but only by reference to the contracted term of the right.

8.5.2.3 Measurement of gain or loss on settlement of a pre-existing relationship

The acquirer and acquiree may have a relationship that existed before they contemplated the business combination, referred to as a 'pre-existing relationship'. A pre-existing relationship between the acquirer and the acquiree may be contractual (e.g. vendor and customer, or licensor and licensee) or non-contractual (e.g. plaintiff and defendant). [IFRS 3(2008).B51]

If the business combination in effect settles a pre-existing relationship, the acquirer recognises a gain or loss, measured as follows:

[IFRS 3(2008).B52]

(a) for a pre-existing non-contractual relationship (such as a lawsuit), fair value;

(b) for a pre-existing contractual relationship, the lesser of (i) and (ii):

   (i) the amount by which the contract is favourable or unfavourable from the perspective of the acquirer when compared with terms for current market transactions for the same or similar items. (An unfavourable contract is a contract that is unfavourable in terms of current market terms. It is not necessarily an onerous contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it); and

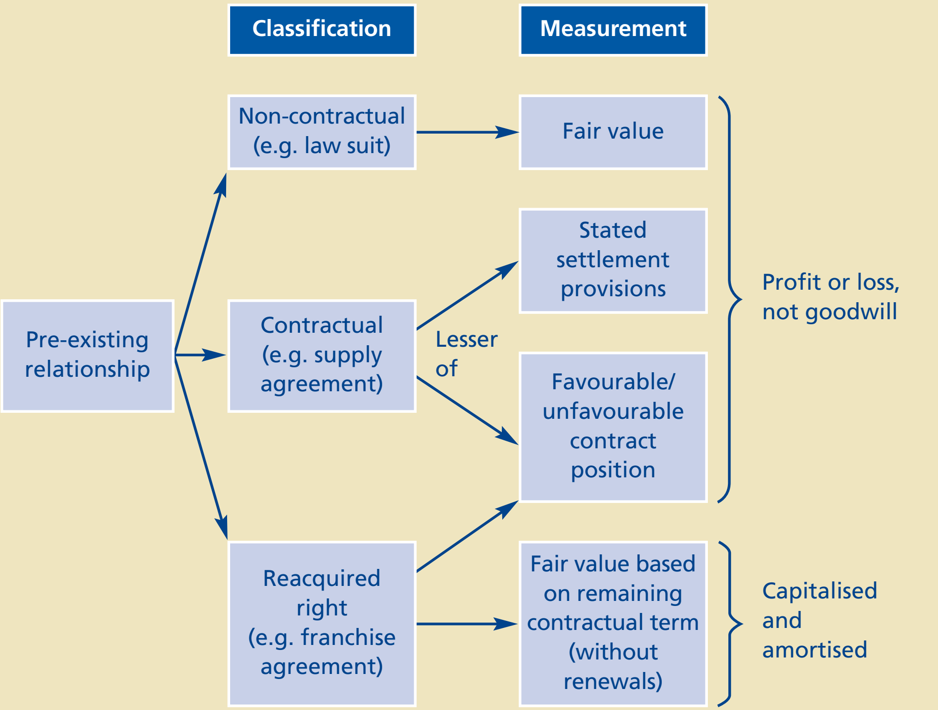
   (ii) the amount of any stated settlement provisions in the contract available to the counterparty to whom the contract is unfavourable.

   If (ii) is less than (i), the difference is included as part of the business combination accounting.

The amount of gain or loss recognised may depend in part on whether the acquirer had previously recognised a related asset or liability, and the reported gain or loss therefore may differ from the amount calculated by applying the above requirements. [IFRS 3(2008).B52]

A pre-existing relationship may be a contract that the acquirer recognises as a reacquired right. If the contract includes terms that are favourable or unfavourable when compared with pricing for current market transactions for the same or similar items, the acquirer recognises, separately from the business combination, a gain or loss for the effective settlement of the contract, measured in accordance with IFRS 3(2008).B52. [IFRS 3(2008).B53]

Summary of accounting for a pre-existing relationship



Example 8.5.2.3A

Settlement of a pre-existing relationship - contractual supply agreement

[IFRS 3(2008).IE54-IE57]

AC purchases electronic components from TC under a five-year supply contract at fixed rates. Currently, the fixed rates are higher than the rates at which AC could purchase similar electronic components from another supplier. The supply contract allows AC to terminate the contract before the end of the initial five-year term but only by paying a CU6 million penalty. With three years remaining under the supply contract, AC pays CU50 million to acquire TC, which is the fair value of TC based on what other market participants would be willing to pay.

Included in the total fair value of TC is CU8 million related to the fair value of the supply contract with AC. The CU8 million represents a CU3 million component that is ‘at market’ because the pricing is comparable to pricing for current market transactions for the same or similar items (selling effort, customer relationships and so on) and a CU5 million component for pricing that is unfavourable to AC because it exceeds the price of current market transactions for similar items. TC has no other identifiable assets or liabilities related to the supply contract, and AC has not recognised any assets or liabilities related to the supply contract before the business combination.

In this example, AC calculates a loss of CU5 million (the lesser of the CU6 million stated settlement amount and the amount by which the contract is unfavourable to the acquirer) separately from the business combination. The CU3 million ‘at-market’ component of the contract is part of goodwill.

The consequence of recognising a CU5 million loss is that the purchase consideration used to calculate goodwill is adjusted down from CU50 million to CU45 million. No intangible asset is recognised in this example since the supply contract is not the reacquisition of a right granted by AC for the use of its assets. Rather, the business combination transaction results in the effective settlement of a pre-existing contractual supply arrangement between AC and TC.

Whether AC had recognised previously an amount in its financial statements related to a pre-existing relationship will affect the amount recognised as a gain or loss for the effective settlement of the relationship. Suppose that IFRSs had required AC to recognise a CU6 million liability for the supply contract before the business combination, perhaps because it met the definition of an onerous contract under IAS 37. In that situation, AC recognises a CU1 million settlement gain on the contract in profit or loss at the acquisition date (the CU5 million measured loss on the contract less the CU6 million loss previously recognised). In other words, AC has in effect settled a recognised liability of CU6 million for CU5 million, resulting in a gain of CU1 million.

Example 8.5.2.3B

Reacquired right at market terms

X grants a franchise right to Y to operate under X's name in the northeast region of the country in which it operates. Two years later, X decides to expand its business and enters into an agreement to acquire 100% of Y for CU50,000. Y's business consists of the franchise right (fair value CU20,000), a customer list (fair value CU10,000), some operating assets and liabilities (net fair value CU15,000), an assembled workforce (recognised as part of goodwill) and processes. At the time of the acquisition, the franchise right is at market terms and, therefore, X does not recognise an off-market settlement gain or loss. Assume that the franchise right has a fixed term and is not renewable.

Under IFRS 3(2008), X recognises an identified intangible asset for the reacquired right at its fair value of CU20,000. This right will be amortised over the remaining term of the franchise agreement.

Goodwill will therefore be CU5,000 (CU50,000 less (20,000 + 10,000 + 15,000)).

Example 8.5.2.3C

Reacquired right at off-market terms

Facts as in example 8.5.2.3B, except that the franchise right contract terms are favourable to X compared to market terms at the acquisition date by CU3,000.

As before, X recognises an identified intangible asset for the reacquired right at its fair value of CU20,000. This right will be amortised over the remaining term of the franchise agreement.

In addition, X recognises a gain of CU3,000 for the effective settlement of the contract and consequently increases the consideration used in the acquisition accounting to CU53,000.

Goodwill will therefore be CU8,000 (CU53,000 less (20,000 + 10,000 + 15,000)).

8.5.2.4 Subsequent measurement

A reacquired right recognised as an intangible asset should be amortised 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 should include the carrying amount of the intangible asset in determining the gain or loss on the sale. [IFRS 3(2008).55] In such cases, care should be taken to ensure that the intangible asset being sold is the same asset that was previously reacquired. Thus, the reacquisition through a business combination of a 'master franchise agreement', and the subsequent granting of sub-franchises for specific geographical areas to third parties, would be dealt with separately and the master franchise agreement retained in the acquirer's statement of financial position.

8.5.3 Share-based payment awards

Where an acquirer issues share-based payment awards to replace those of an acquiree, it is necessary to allocate the replacement awards between:

- the element which represents purchase consideration for accrued share rights earned before the acquisition; and
- the element which represents compensation for post-acquisition services.

As an exception to the fair value measurement principle, any liability or equity instrument recognised by the acquirer is based on a ‘market-based measure’ determined in accordance with IFRS 2 *Share-based Payment*. Share-based payments are dealt with fully in section 9.3.4 below.

8.5.4 Assets held for sale

The acquirer should measure an acquired non-current asset (or disposal group) that is classified as held for sale at the acquisition date in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* at fair value less costs to sell in accordance with paragraphs 15 -18 of that Standard. [IFRS 3(2008).31]

8.5.5 Income taxes

IFRS 3(2008) requires the acquirer to recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with IAS 12 *Income Taxes*. [IFRS 3(2008).24]

The acquirer should account for potential tax effects of temporary differences and carry forwards of an acquiree that exist at the acquisition date or that arise as a result of the acquisition in accordance with IAS 12. [IFRS 3(2008).25]

Amendments to IAS 12 relating to the post-acquisition recognition of deferred tax assets are discussed in section 11.3.6. Transitional arrangements are discussed in section 15.3.3.

8.5.6 Employee benefits

The acquirer should recognise and measure a liability (or asset, if any) related to the acquiree’s employee benefit arrangements in accordance with IAS 19 *Employee Benefits*. [IFRS 3(2008).26]

8.5.7 Indemnification assets

8.5.7.1 Initial measurement

The seller in a business combination may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability. For example, the seller may indemnify the acquirer against losses above a certain amount on a liability arising from a particular contingency, such as legal action or income tax uncertainty. As a result, the acquirer obtains an indemnification asset. [IFRS 3(2008).27]

IFRS 3(2008) requires the acquirer to recognise an indemnification asset at the same time that it recognises the indemnified item and that the indemnification asset be measured on the same basis as the indemnified item, assuming that there is no uncertainty over the recovery of the indemnification asset. Therefore, if the indemnification relates to an asset or liability that is recognised at the acquisition date and that is measured at fair value, the acquirer should recognise the indemnification asset at the acquisition date measured at its fair value. [IFRS 3(2008).27]

For an indemnification asset measured at fair value, the effects of uncertainty about future cash flows because of collectibility considerations are included in the fair value measure and a separate valuation allowance is not necessary. [IFRS 3(2008).27]

In some circumstances, the indemnification may relate to an asset or liability that is an exception to the recognition or measurement principles. For example, an indemnification may relate to a contingent liability that is not recognised at the acquisition date because its fair value is not reliably measurable at that date. Alternatively, an indemnification may relate to an asset or liability (e.g. one that results from an employee benefit that is measured on a basis other than acquisition-date fair value. In those circumstances, the indemnification asset is recognised and measured using assumptions consistent with those used to measure the indemnified item, subject to management's assessment of the collectibility of the indemnification asset and any contractual limitations on the indemnified amount. [IFRS 3(2008).28]

The requirement that an indemnification asset be measured using assumptions consistent with the measurement of the indemnified item does not necessarily mean that the indemnification asset and indemnified item are measured at the same amount. For instance, an indemnity may be capped at a certain amount, be determined as a portion of any final settlement amount, represent an amount over a particular amount, or be recovered in a later time period than when the indemnified item is settled. In these cases, it is likely that the indemnified item will be recognised at a different amount to the indemnification asset because the cash outflows and inflows will be different.

However, the recognition and measurement of the asset and liability will be determined on a consistent basis, by reference to any relevant Standards. Therefore, an indemnification asset in relation to:

- an employee benefit will be measured using the principles of IAS 19;
- a liability recognised as a provision will be measured in accordance with IAS 37; and
- an income tax exposure, will be measured by reference to IAS 12.

8.5.7.2 Subsequent measurement

At the end of each subsequent reporting period, the acquirer should measure an indemnification asset that was recognised at the acquisition date on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount and, for an indemnification asset that is not subsequently measured at its fair value, management's assessment of the collectibility of the indemnification asset. The acquirer should derecognise the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it. [IFRS 3(2008).57]

The effect of the requirements for indemnification assets is to achieve matching of the asset recognised with the item that is the subject of the indemnity. In most cases, it is expected that remeasurement of both asset and liability would be in profit or loss, although IFRS 3(2008) does not provide for this.

9. Identifying and measuring consideration

9.1 Consideration transferred

IFRS 3(2008) requires the consideration transferred in a business combination to be measured at fair value. This is calculated as the sum of the acquisition-date fair values of:

[IFRS 3(2008).37]

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

However, any portion of the acquirer's share-based payment awards exchanged for awards held by the acquiree's employees that is included in the consideration transferred in the business combination should be measured in accordance with IFRS 2 *Share-based Payment* (see section 9.3.4). [IFRS 3(2008).37]

Potential forms of consideration include cash, other assets, a business or a subsidiary of the acquirer, contingent consideration (see section 9.2), ordinary or preference equity instruments, options, warrants and member interests of mutual entities. [IFRS 3(2008).37]

The consideration transferred may include assets or liabilities of the acquirer with carrying amounts that differ from their fair values at the acquisition date (e.g. non-monetary assets or a business of the acquirer). If so, the acquirer should remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognise any resulting gains or losses in profit or loss. [IFRS 3(2008).38]

The recognition of a gain or loss on assets or liabilities transferred is a further application of the principle that crossing an accounting boundary involves a disposal, which is discussed in section 2.2 of this guide. It is also consistent with the definition of cost in the IASB *Glossary* which defines cost as 'the amount of cash or cash equivalents paid *or the fair value of the other consideration* given to acquire an asset at the time of its acquisition …'. In the case of a subsidiary, this would imply the date of acquisition of the subsidiary.

However, sometimes the transferred assets or liabilities remain within the combined entity after the business combination (e.g. because the assets and liabilities were transferred to the acquiree rather than to its former owners), and the acquirer therefore retains control of them. In that situation, the acquirer should measure those assets and liabilities at their carrying amount immediately before the acquisition date. No gain or loss should be recognised in profit or loss in respect of assets or liabilities controlled by the acquirer both before and after the business combination. [IFRS 3(2008).38]

The implication of not remeasuring assets and liabilities that remain within the group to fair value is that goodwill will be correspondingly lower than the situation where assets and liabilities are transferred outside the group and remeasured to fair value.

9.2 Contingent consideration

9.2.1 Recognition at acquisition date

The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. [IFRS 3(2008).39] Contingent consideration is defined as follows.

'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. However, contingent consideration may also give the acquirer the right to the return of previously transferred consideration if specified conditions are met.'
[IFRS 3(2008)(Appendix A)]

Contingent consideration is recognised as part of the consideration transferred in exchange for the acquiree, measured at its acquisition-date fair value. [IFRS 3(2008).39]

An obligation to pay contingent consideration is classified as a liability or as equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of IAS 32 *Financial Instruments: Presentation*. [IFRS 3(2008).40]

Where the purchase agreement includes a right to the return of previously-transferred consideration if specified conditions for a repayment are met, that right to return is classified as an asset by the acquirer. [IFRS 3(2008).40]

Example 9.2.1

Contingent consideration

A acquires B. The consideration is payable in 3 tranches:

- an immediate payment of CU1m;
- a further payment of CU0.5m after one year if profit before interest and tax for the first year following acquisition exceeds CU200,000; and
- a further payment of CU0.5m after two years if profit before interest and tax for the second year following acquisition exceeds CU220,000.

The two payments that are conditional upon reaching earnings targets are contingent consideration. At the date of acquisition, the fair value of these two payments is assessed as CU250,000.

Consequently, on the date of acquisition, consideration of CU1,250,000 is recognised.

9.2.2 Subsequent accounting

As noted above, contingent consideration is measured at its acquisition-date fair value. IFRS 3(2008) has introduced a new approach to the accounting for changes in the value of contingent consideration subsequent to the acquisition date.

9.2.2.1 Changes based on additional information about facts and circumstances at the acquisition date

Changes that are the result of the acquirer obtaining additional information about facts and circumstances that existed at the acquisition date, and that occur within the measurement period (which may be a maximum of one year from the acquisition date), are recognised as adjustments against the original accounting for the acquisition (and so may impact goodwill) – see section 11.3. [IFRS 3(2008).58]

9.2.2.2 Post-combination changes

Changes resulting from events after the acquisition date (e.g. meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project) are not measurement period adjustments. Such changes are therefore accounted for separately from the business combination. The acquirer accounts for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:

[IFRS 3(2008).58]

(a) contingent consideration classified as equity is not remeasured and its subsequent settlement is accounted for within equity; and

(b) contingent consideration classified as an asset or a liability that:

 (i) is a financial instrument and is within the scope of IAS 39 is measured at fair value, with any resulting gain or loss recognised either in profit or loss or in other comprehensive income in accordance with IAS 39; and

 (ii) is not within the scope of IAS 39 is accounted for in accordance with IAS 37 or other IFRSs as appropriate.

In practice, most changes in contingent consideration will be recognised in profit or loss. However, the above requirements mean that shares, some options and other equity instruments issued by the acquirer are not remeasured once initially recognised when accounting for the business combination.

9.2.3 Implications

The requirements in respect of contingent consideration represent a fundamental change to IFRS 3(2004) in two respects:

- under IFRS 3(2004), contingent consideration was only recognised at the date of acquisition where it met both a 'probable' test and a 'reliably measurable' test. If either test was only met after the date of acquisition, the additional consideration was recognised at that later date and treated as an adjustment to goodwill. IFRS 3(2008) requires contingent consideration to be measured at fair value at the date of acquisition irrespective of the level of probability or measurement reliability, in order to provide a complete picture of liabilities; and

- once the fair value of the contingent consideration at the acquisition date has been determined, any subsequent adjustments which do not reflect fair value at the acquisition date, or which occur outside the measurement period, are treated in accordance with other Standards – typically this means remeasurement of financial liabilities through profit or loss.

Importantly, contingent consideration arising in relation to business combinations that occur prior to the initial application of the IFRS 3(2008) will continue to be accounted for under IFRS 3(2004), meaning that retrospective adjustments to the initial accounting for these business combinations will still be possible. The treatment of contingent consideration relating to business combinations that occurred prior to the implementation of IFRS 3(2008) is considered in section 15.3.1.

9.3 Determining what is part of the business combination transaction

9.3.1 Principles to determine what is part of the business combination

The acquirer and the acquiree may have a pre-existing relationship or other arrangement before negotiations for the business combination begin, or they may enter into an arrangement during the negotiations that is separate from the business combination. [IFRS 3(2008).51]

In either situation, the acquirer is required to identify any amounts that are not part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination, i.e. amounts that are not part of the exchange for the acquiree. [IFRS 3(2008).51]

The acquirer is required to recognise as part of applying the acquisition method only the consideration transferred for the acquiree, and the assets acquired and liabilities assumed in exchange for the acquiree. Separate transactions are accounted for in accordance with the relevant Standards. [IFRS 3(2008).51]

A transaction entered into by or on behalf of the acquirer or primarily for the benefit of the acquirer or the combined entity, rather than primarily for the benefit of the acquiree (or its former owners) before the combination, is likely to be a separate transaction. [IFRS 3(2008).52]

An acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, to determine whether a transaction is part of the exchange for the acquiree or whether the transaction is separate from the business combination.

[IFRS 3(2008).B50]

(a) **The reasons for the transaction**
Understanding the reasons why the parties to the combination entered into a particular transaction or arrangement may provide insight into whether it is part of the consideration transferred and the assets acquired or liabilities assumed. For example, if a transaction is arranged primarily for the benefit of the acquirer or the combined entity rather than primarily for the benefit of the acquiree or its former owners before the combination, that portion of the transaction price paid (and any related assets or liabilities) is less likely to be part of the exchange for the acquiree. Accordingly, the acquirer would account for that portion separately from the business combination.

Example 9.3.1A

Acquirer pays vendor's costs

In some cases, the vendor and the acquirer may agree, for tax or other reasons, that the acquirer will pay selling expenses incurred by the vendor in the sale and purchase transaction. Although these amounts are not paid directly to the vendor, they will still form part of the purchase consideration for the business combination as the acquirer is acting on behalf of the vendor in making the payments, which are primarily for the benefit of the former owners. However, this principle would not apply to any costs incurred by the acquirer on its own behalf in making the acquisition, as these must be accounted for outside the business combination (see section 9.3.5)

(b) **Who initiated the transaction**
Understanding who initiated the transaction may also provide insight into whether it is part of the exchange for the acquiree. For example, a transaction or other event that is initiated by the acquirer may be entered into for the purpose of providing future economic benefits to the acquirer or combined entity with little or no benefit received by the acquiree or its former owners before the combination. On the other hand, a transaction or arrangement initiated by the acquiree or its 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.

Example 9.3.1B

Acquisition from government with employee obligations

An acquirer may acquire a business from government in a privatisation transaction. These legal arrangements sometimes have obligations that are effectively imposed upon the acquirer by the government (e.g. a requirement to retain a certain level of staff, maintain a presence in a certain geographical location, or to meet other government policy objectives). In some cases, these arrangements may impact the purchase consideration that the acquirer is prepared to pay, which might generally be higher if the obligations did not exist.

These transactions are generally initiated by the relevant government as the vendor for its own benefit (i.e. meeting the policy objectives). Therefore, no adjustment would be made to the purchase consideration as a result of the obligations. However, in some cases, a liability may be recognised as part of the business combination accounting where the relevant criteria are met.

(c) The timing of the transaction
The timing of the transaction may also provide insight into whether it is part of the exchange for the acquiree. For example, a transaction between the acquirer and the acquiree that takes place during the negotiations of the terms of a business combination may have been entered into in contemplation of the business combination to provide future economic benefit to the acquirer or the combined entity. If so, the acquiree or its former owners are likely to receive little or no benefit from the transaction except for the benefits they receive as part of the combined entity.

The following are examples of separate transactions that are not to be included in applying the acquisition method:

[IFRS 3(2008).52]

(a) a transaction that settles pre-existing relationships between the acquirer and the acquiree (see section 8.5.2 above);

(b) a transaction that remunerates employees or former owners of the acquiree for future services (see section 9.3.3 for contingent payments to employees or selling shareholders, and section 9.3.4 for share-based payment awards); and

(c) a transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs (see section 9.3.5).

9.3.2 Settlement of a pre-existing relationship between the acquirer and acquiree in a business combination

This is discussed in section 8.5.2 above, which deals with both reacquired rights and the wider issue of pre-existing relationships.

9.3.3 Arrangements for contingent payments to employees or selling shareholders

The acquirer or vendor may make payments to the employees of the acquiree (who may or may not also be selling shareholders), which are contingent on a post-acquisition event such as a period of continuing service as an employee. In such cases, it is necessary to determine what element of the payment qualifies as consideration, and what element is for post-acquisition services. IFRS 3(2008) provides guidance as to how to make the allocation.

As discussed in section 9.3.1 above, understanding the reason why the acquisition agreement includes a provision for contingent payments, who initiated the arrangement, and when the parties entered into the arrangement may be helpful in assessing the nature of the arrangement. [IFRS 3(2008).B54]

The acquirer should consider the following indicators to determine whether an arrangement for payments to employees or selling shareholders is part of the exchange for the acquiree or a separate transaction:

[IFRS 3(2008).B55]

(a) Continuing employment
A contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services. Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration.

(b) Duration of continuing employment
If the period of required employment coincides with or is longer than the contingent payment period, that fact may indicate that the contingent payments are, in substance, remuneration.

(c) Level of remuneration
Situations in which employee remuneration other than the contingent payments is at a reasonable level in comparison with that of other key employees in the combined entity may indicate that the contingent payments are additional consideration rather than remuneration.

(d) Incremental payments to employees
If selling shareholders who do not become employees receive lower contingent payments on a per-share basis than the selling shareholders who become employees of the combined entity, that fact may indicate that the incremental amount of contingent payments to the selling shareholders who become employees is remuneration.

(e) Number of shares owned
The relative number of shares owned by the selling shareholders who remain as key employees may be an indicator of the substance of the contingent consideration arrangement. If the selling shareholders who owned substantially all of the shares in the acquiree continue as key employees, that fact may indicate that the arrangement is, in substance, a profit-sharing arrangement intended to provide remuneration for post-combination services. If selling shareholders who continue as key employees owned only a small number of shares of the acquiree and all selling shareholders receive the same amount of contingent consideration on a per-share basis, that fact may indicate that the contingent payments are additional consideration.

(f) **Linkage to the valuation**
If the initial consideration transferred at the acquisition date is based on the low end of a range established in the valuation of the acquiree and the contingent formula relates to that valuation approach, that fact may suggest that the contingent payments are additional consideration. Alternatively, if the contingent payment formula is consistent with prior profit-sharing arrangements, that fact may suggest that the substance of the arrangement is to provide remuneration.

(g) **Formula for determining consideration**
The formula used to determine the contingent payment may be helpful in assessing the substance of the arrangement. For example, if a contingent payment is determined on the basis of a multiple of earnings (i.e. more than one year's earnings), that might suggest that the obligation is contingent consideration in the business combination and that the formula is intended to establish or verify the fair value of the acquiree. In contrast, a contingent payment that is a specified percentage of earnings (i.e. a proportion of one year's earnings) might suggest that the obligation to employees is a profit-sharing arrangement to remunerate employees for services rendered.

(h) **Other agreements and issues**
The terms of other arrangements with selling shareholders (such as agreements not to compete, executory contracts, consulting contracts and property lease agreements) may indicate that contingent payments are attributable to something other than consideration for the acquiree. For example, in connection with the acquisition, the acquirer might enter into a property lease arrangement with a significant selling shareholder. If the lease payments specified in the lease contract are significantly below market, some or all of the contingent payments to the lessor (the selling shareholder) required by a separate arrangement might be, in substance, payments for the use of the leased property that the acquirer should recognise separately in its post-combination financial statements. In contrast, if the lease contract specifies lease payments that are consistent with market terms for the leased property, the arrangement for contingent payments to the selling shareholder may be contingent consideration in the business combination.

Example 9.3.3A

Contingent payments to employees recognised as a liability

[IFRS 3(2008).IE58-IE59]

TC appointed a candidate as its new CEO under a ten-year contract. The contract required TC to pay the candidate CU5 million if TC is acquired before the contract expires. AC acquires TC eight years later. The CEO was still employed at the acquisition date and will receive the additional payment under the existing contract.

In this example, TC entered into the employment agreement before the negotiations of the combination began, and the purpose of the agreement was to obtain the services of the CEO. Thus, there is no evidence that the agreement was arranged primarily to provide benefits to AC or the combined entity. Therefore, the liability to pay CU5 million is included in the application of the acquisition method.

Example 9.3.3B

Contingent payments to employees recognised as post-acquisition remuneration

Facts as in example 9.3.3A, except that TC entered into the agreement with the CEO at the suggestion of AC during the negotiations for the business combination, and the payment is contingent on the CEO remaining in employment for 3 years following a successful acquisition.

The primary purpose of the agreement appears to be to retain the services of the CEO. Since the CEO is not a shareholder, and the payment is contingent on continuing employment, the payment is accounted for as post-acquisition remuneration separately from the application of the acquisition method.

9.3.4 Acquirer share-based payment awards exchanged for awards held by the acquiree's employees

9.3.4.1 Overview

An acquirer may exchange its share-based payment awards (replacement awards) for awards held by employees of the acquiree. IFRS 3(2008) introduces a number of guidelines and examples for when to treat particular replacement share-based payment awards as part of the cost of the combination and when to treat the amounts as employee compensation.

Exchanges of share options or other 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 *Share-based Payment*. [IFRS 3(2008).B56] IFRS 3 uses the term 'market-based measure' to describe the basis of measurement in IFRS 2.

9.3.4.2 Acquirer obliged to replace awards

Where the acquirer is obliged to replace the acquiree awards, either all or a portion of the market-based measure of the acquirer's replacement awards is included in measuring the consideration transferred in the business combination. [IFRS 3(2008).B56] The basis of allocating awards between consideration and post-combination service is described in section 9.3.4.4 below.

The acquirer is considered to be obliged to replace the acquiree awards if the acquiree or its employees have the ability to enforce replacement. For example, for the purposes of applying this requirement, the acquirer is considered to be obliged to replace the acquiree's awards if the replacement is required by:

[IFRS 3(2008).B56]

(a) the terms of the acquisition agreement;

(b) the terms of the acquiree awards; or

(c) applicable laws and regulations.

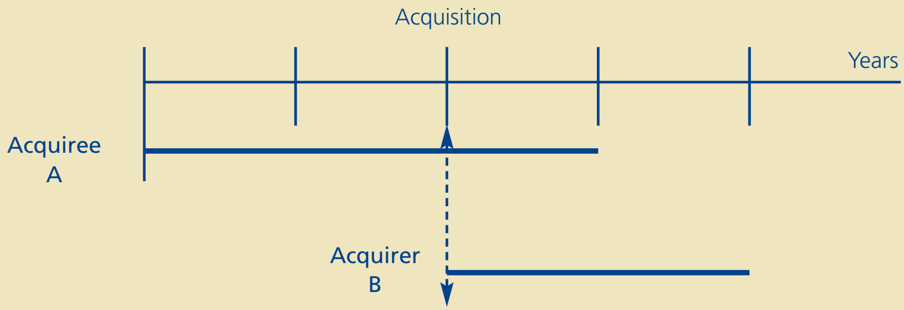
9.3.4.3 Acquirer makes voluntary awards

If the acquiree's awards expire as a consequence of a business combination and the acquirer replaces those awards even though it is not obliged to do so, all of the market-based measure of the replacement awards is recognised as remuneration cost in the post-combination financial statements. This means that none of the market-based measure of those awards is included in measuring the consideration transferred in the business combination. [IFRS 3(2008).B56]

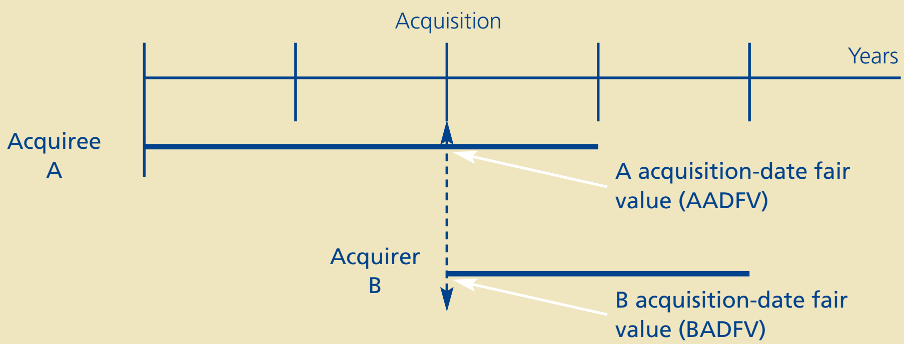
9.3.4.4 Allocating awards to consideration and post-combination service

The requirements of IFRS 3(2008) are best explained by working through an example.

A has awarded share options to its employees, which vest if employees remain in employment for 3 years. A has accounted for the award in accordance with IFRS 2. After 2 years, A is acquired by B. B is obliged to exchange the share options for new share options which vest after two further years of employment.



Step 1 To determine the portion of a replacement award that is part of the consideration transferred for the acquiree and the portion that is remuneration for post-combination service, the acquirer measures both the replacement awards granted by the acquirer and the acquiree awards as of the acquisition date in accordance with IFRS 2. [IFRS 3(2008).B57]

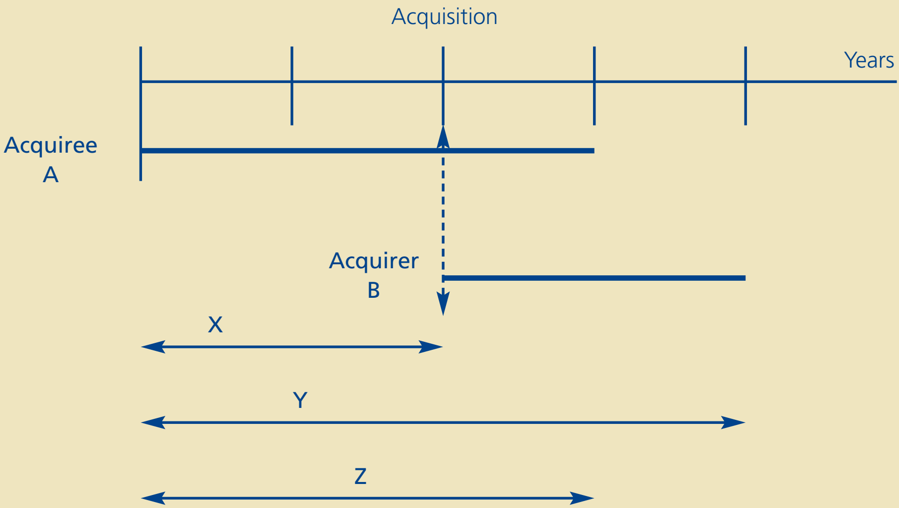


Step 1: B measures the fair value of both A's original share options and the replacement share options at the acquisition date in accordance with IFRS 2.

Step 2 Identify three periods of time:

- the vesting period completed at the date of acquisition;
- the total vesting period; and
- the original vesting period.

The vesting period is the period during which all the specified vesting conditions are to be satisfied (see IFRS 2 for more detailed definitions).



Step 2: B identifies the vesting period completed (X), the total vesting period (Y), and the original vesting period (Z).

Step 3 The portion of the replacement award attributable to pre-combination service (which is the portion that is accounted for as part of the consideration in the business combination) is the 'market-based measure' of the acquiree award multiplied by the ratio of the portion of the vesting period completed to the greater of the total vesting period or the original vesting period of the acquiree award. [IFRS 3(2008).B58]

Step 3: Amount allocated to consideration is:

$$AADFV \times \frac{X}{\text{Higher of } Y \text{ and } Z}$$

Step 4 The amount attributable to post-combination service, and so recognised as remuneration cost in the post-combination financial statements, is determined as the difference between the market-based measure of the acquirer's replacement award and the amount allocated to purchase consideration in Step 3. Therefore, the acquirer attributes any excess of the market-based measure of the replacement award over the market-based measure of the acquiree award to post-combination service and recognises that excess as remuneration cost in the post-combination financial statements. This expense is recognised immediately if there is no further service period. [IFRS 3(2008).B59]

Step 4: Amount allocated to post-combination service is:

BADFV less Amount calculated at step 3

Further requirements:

- the amount allocated to consideration at Step 3 is added to the purchase consideration;
- the amount allocated to post-combination service at Step 4 is recognised as a post-combination expense in accordance with IFRS 2;
- the acquirer attributes a portion of a replacement award to post-combination service if it requires post-combination service, regardless of whether employees had rendered all of the service required for their acquiree awards to vest before the acquisition date [IFRS 3(2008).B59];
- the allocation between purchase consideration and post-combination service should reflect the best estimate of the number of replacement awards that are expected to vest. For example, if the market-based measure of the portion of a replacement award attributed to pre-combination service is CU100 and the acquirer expects that only 95 per cent of the award will vest, the amount included in consideration transferred in the business combination is CU95 [IFRS 3(2008).B60];
- subsequent changes in the estimated number of replacement awards expected to vest are reflected in remuneration cost for the period in which the changes or forfeitures occur and are not adjusted against the initial accounting for the acquisition [IFRS 3(2008).B60];
- the effects of other events, such as modifications or the ultimate outcome of awards with performance conditions, that occur after the acquisition date are accounted for in accordance with IFRS 2 in determining remuneration cost for the period in which an event occurs [IFRS 3(2008).B60];
- the same requirements for determining the portions of a replacement award attributable to pre- and post-combination service apply regardless of whether a replacement award is classified as a liability or as an equity instrument in accordance with IFRS 2. All changes in the market-based measure of awards classified as liabilities after the acquisition date and the related income tax effects are recognised in the acquirer's post-combination financial statements in the period(s) in which the changes occur [IFRS 3(2008).B61]; and

- the income tax effects of replacement awards of share-based payments are recognised in accordance with the requirements of IAS 12 *Income Taxes* [IFRS 3(2008).B62].

The following examples (which assume that all awards are classified as equity) illustrate replacement awards that the acquirer (AC) was obliged to issue in the following circumstances:

		Acquiree awards Has the vesting period been completed before the business combination?	
		Completed	**Not completed**
Replacement awards Are employees required to provide additional service after the acquisition date?	**Not required**	Example 9.3.4.4A	Example 9.3.4.4D
	Required	Example 9.3.4.4B	Example 9.3.4.4C

Example 9.3.4.4A

[IFRS 3(2008).IE62-IE64]

Acquiree awards	*Vesting period completed before the business combination*
Replacement awards	*Additional employee services are not required after the acquisition date*

AC issues replacement awards of CU110 (market-based measure) at the acquisition date for TC awards of CU100 (market-based measure) at the acquisition date. No post-combination services are required for the replacement awards and TC's employees had rendered all of the required service for the acquiree awards as of the acquisition date.

The amount attributable to pre-combination service is the market-based measure of TC's awards (CU100) at the acquisition date; that amount is included in the consideration transferred in the business combination. The amount attributable to post-combination service is CU10, which is the difference between the total value of the replacement awards (CU110) and the portion attributable to pre-combination service (CU100). Because no post-combination service is required for the replacement awards, AC immediately recognises CU10 as remuneration cost in its post-combination financial statements.

Applying the steps outlined earlier:

Step 1: Acquiree acquisition date fair value = CU100
Acquirer acquisition date fair value = CU110

Step 2: Vesting period completed = (say) 3 years
Original vesting period = (say) 3 years
Total vesting period = (say) 3 years

Step 3: Amount allocated to consideration = $100 \times \dfrac{3}{\textit{Higher of 3 and 3}} = 100$

Step 4: Amount allocated to post-combination service = 110-100 = 10

Example 9.3.4.4B

[IFRS 3(2008).IE65-IE67]

Acquiree awards	*Vesting period completed before the business combination*
Replacement awards	*Additional employee services are required after the acquisition date*

AC exchanges replacement awards that require one year of post-combination service for share-based payment awards of TC, for which employees had completed the vesting period before the business combination. The market-based measure of both awards is CU100 at the acquisition date. When originally granted, TC's awards had a vesting period of four years. As of the acquisition date, the TC employees holding unexercised awards had rendered a total of seven years of service since the grant date.

Even though TC employees had already rendered all of the service, AC attributes a portion of the replacement award to post-combination remuneration cost in accordance with paragraph B59 of IFRS 3, because the replacement awards require one year of post-combination service. The total vesting period is five years – the vesting period for the original acquiree award completed before the acquisition date (four years) plus the vesting period for the replacement award (one year).

The portion attributable to pre-combination services equals the market-based measure of the acquiree award (CU100) multiplied by the ratio of the pre-combination vesting period (four years) to the total vesting period (five years). Thus, CU80 (CU100 x 4/5 years) is attributed to the pre-combination vesting period and therefore included in the consideration transferred in the business combination. The remaining CU20 is attributed to the post-combination vesting period and is therefore recognised as remuneration cost in AC's post-combination financial statements in accordance with IFRS 2.

Applying the steps outlined earlier:

Step 1: Acquiree acquisition date fair value = CU100
Acquirer acquisition date fair value = CU100

Step 2: Vesting period completed = 4 years
Original vesting period = 4 years
Total vesting period = 5 years

Step 3: Amount allocated to consideration = $100 \times \dfrac{4}{\textit{Higher of 4 and 5}} = 80$

Step 4: Amount allocated to post-combination service = 100-80 = 20

Example 9.3.4.4C

[IFRS 3(2008).IE68-IE69]

Acquiree awards	*Vesting period not completed before the business combination*
Replacement awards	*Additional employee services are required after the acquisition date*

AC exchanges replacement awards that require one year of post-combination service for share-based payment awards of TC, for which employees had not yet rendered all of the service as of the acquisition date. The market-based measure of both awards is CU100 at the acquisition date. When originally granted, the awards of TC had a vesting period of four years. As of the acquisition date, the TC employees had rendered two years' service, and they would have been required to render two additional years of service after the acquisition date for their awards to vest. Accordingly, only a portion of the TC awards is attributable to pre-combination service.

The replacement awards require only one year of post-combination service. Because employees have already rendered two years of service, the total vesting period is three years. The portion attributable to pre-combination services equals the market-based measure of the acquiree award (CU100) multiplied by the ratio of the pre-combination vesting period (two years) to the greater of the total vesting period (three years) or the original vesting period of TC's award (four years). Thus, CU50 (CU100 x 2/4 years) is attributable to pre-combination service and therefore included in the consideration transferred for the acquiree. The remaining CU50 is attributable to post-combination service and therefore recognised as remuneration cost in AC's post-combination financial statements.

Applying the steps outlined earlier:

Step 1: Acquiree acquisition date fair value = CU100
Acquirer acquisition date fair value = CU100

Step 2: Vesting period completed = 2 years
Original vesting period = 4 years
Total vesting period = 3 years

Step 3: Amount allocated to consideration = $100 \times \dfrac{2}{\textit{Higher of 4 and 3}} = 50$

Step 4: Amount allocated to post-combination service = 100-50 = 50

Example 9.3.4.4D

[IFRS 3(2008).IE70-IE71]

Acquiree awards	*Vesting period not completed before the business combination*
Replacement awards	*Additional employee services are not required after the acquisition date*

Assume the same facts as in example 9.3.4.4C above, except that AC exchanges replacement awards that require no post-combination service for share-based payment awards of TC for which employees had not yet rendered all of the service as of the acquisition date. The terms of the replaced TC awards did not eliminate any remaining vesting period upon a change in control. (If the TC awards had included a provision that eliminated any remaining vesting period upon a change in control, the guidance in example 9.3.4.4A would apply.) The market-based measure of both awards is CU100. Because employees have already rendered two years of service and the replacement awards do not require any post-combination service, the total vesting period is two years.

The portion of the market-based measure of the replacement awards attributable to pre-combination services equals the market-based measure of the acquiree award (CU100) multiplied by the ratio of the pre-combination vesting period (two years) to the greater of the total vesting period (two years) or the original vesting period of TC's award (four years). Thus, CU50 (CU100 x 2/4 years) is attributable to pre-combination service and therefore included in the consideration transferred for the acquiree. The remaining CU50 is attributable to post-combination service. Because no post-combination service is required to vest in the replacement award, AC recognises the entire CU50 immediately as remuneration cost in the post-combination financial statements.

Applying the steps outlined earlier:

Step 1: Acquiree acquisition date fair value = CU100
Acquirer acquisition date fair value = CU100

Step 2: Vesting period completed = 2 years
Original vesting period = 4 years
Total vesting period = 2 years

Step 3: Amount allocation to consideration = $100 \times \dfrac{2}{\textit{Higher of 4 and 2}} = 50$

Step 4: Amount allocated to post-combination service = 100-50 = 50

9.3.5 A transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs.

Section 9.4 below deals with the treatment of acquisition-related costs as expenses, which represents a significant change from the previous version of IFRS 3. The Basis for Conclusions for IFRS 3(2008) recognises that this change creates the potential for abuse. 'Some constituents, including some respondents to the 2005 Exposure Draft, said that if acquirers could no longer capitalise acquisition-related costs as part of the cost of the business acquired, they might modify transactions to avoid recognising those costs as expenses. For example, some said that a buyer might ask a seller to make payments to the buyer's vendors on its behalf. To facilitate the negotiations and sale of the business, the seller might agree to make those payments if the total amount to be paid to it upon closing of the business combination is sufficient to reimburse the seller for payments it made on the buyer's behalf. If the disguised reimbursements were treated as part of the consideration transferred for the business, the acquirer might not recognise those expenses. Rather, the measure of the fair value of the business and the amount of goodwill recognised for that business might be overstated.' [IFRS 3(2008).BC370]

To mitigate such concerns, IFRS 3(2008) includes in its list of examples of transactions that should be separated from the business combination '.. a transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs'. [IFRS 3(2008).52(c)] It follows that where such a transaction is identified, that element is deducted from the consideration used to calculate goodwill, and is expensed by the acquirer.

9.4 Acquisition-related costs

Acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. Under IFRS 3(2008), the acquirer is required to recognise 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 are recognised in accordance with IAS 32 (for equity) and IAS 39 (for debt). [IFRS 3(2008).53]

This requirement is a change from IFRS 3(2004) where direct costs were included in the acquisition cost, but indirect costs were excluded. In explaining this change, the Basis for Conclusions notes: 'The boards concluded that acquisition-related costs are not part of the fair value exchange between the buyer and seller for the business. Rather, they are separate transactions in which the buyer pays for the fair value of services received. The boards also observed that those costs, whether for services performed by external parties or internal staff of the acquirer, do not generally represent assets of the acquirer at the acquisition date because the benefits obtained are consumed as the services are received.' [IFRS 3(2008).BC366]

The Board rejected arguments that certain costs are unavoidable, or are taken into account by the buyer in deciding what it is willing to pay for the acquiree. The Board noted that the amount that a seller is willing to accept as consideration for its business does not vary with the costs incurred by different potential buyers. Also, the recoverability of costs is considered to be a matter that is separate from 'the fair value measurement objective in the revised standards'. [IFRS 3(2008).BC368]

It has been pointed out that this change results in the treatment of acquisition-related costs in a business combination transaction being inconsistent with the treatment of direct incremental costs incurred in acquiring, for example, property, plant and equipment (capitalised in accordance with IAS 16 *Property, Plant and Equipment*), or inventory (capitalised in accordance with IAS 2 *Inventories*) The Board notes, in the 'Feedback Statement' issued with the new Standards, that it does not see this as a reason to delay change in the treatment of business combination costs.

It is suggested that, since the Board has introduced the requirement to expense acquisition costs within IFRS 3(2008), it only applies to financial statements in which a business combination is accounted for under IFRS 3(2008). It follows that this requirement does not extend to the individual financial statements of the investing or parent entity.

The Board has also identified a potential for abuse, whereby the acquirer might arrange for the seller to pay certain acquisition-related costs on its behalf in return for increased purchase consideration for the business combination. This is considered in section 9.3.5 above.

10. Recognising and measuring goodwill or a gain from a bargain purchase

10.1 Measuring goodwill or a gain from a bargain purchase

Goodwill arising from a business combination is determined as:

[IFRS 3(2008).32]

Consideration transferred	→ Generally acquisition-date fair value – see chapter 9
plus	
The amount of any non-controlling interest	→ See section 8.3
plus	
The fair value of any previously-held equity interest in the acquiree	→ See chapter 12
less	
The fair value of the identifiable net assets of the acquiree	→ See chapter 8

Under IFRS 3(2004) the calculation of goodwill compared just two numbers, being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. In a business combination achieved in stages, goodwill was determined as the sum of goodwill arising at each stage (or 'step') of the acquisition.

The revised treatment has expanded the calculation to involve potentially four numbers.

- As noted in section 8.3, under IFRS 3(2008), non-controlling interests can be measured on two bases – by reference to their share of the identifiable net assets of the acquiree or the fair value of the non-controlling interests. The latter measure results in the recognition of the non-controlling interest's share of goodwill. Because non-controlling interests can be measured by alternative methods, it is necessary to include the non-controlling interests within the calculation of goodwill, and also to deduct the entire identifiable acquiree net assets (rather than only the acquirer's share of those net assets). Example 10.1 below provides an illustration.

- As discussed in detail in section 2.2 of this guide, under IFRS 3(2008) a business combination occurs only at the date when an acquirer obtains control of an acquiree. Accounting for a business combination therefore reflects the fair value of any previously-held equity interests in the acquiree. Under IFRS 3(2004), goodwill was calculated separately for each stage of a step acquisition. Business combinations achieved in stages are discussed in further detail in chapter 12.

Example 10.1

Calculation of goodwill

P acquired Q in two stages.

- In 20X1, P acquired a 30% equity interest for cash consideration of CU32,000 when the fair value of Q's identifiable net assets was CU100,000.

- In 20X5, P acquired a further 50% equity interest for cash consideration of CU75,000. On the acquisition date, the fair value of Q's identifiable net assets was CU120,000. The fair value of P's original 30% holding was CU40,000 and the fair value of the 20% non-controlling interest is assessed as CU28,000.

Goodwill is calculated, on the alternative bases that P records non-controlling interests (NCI) at their share of net assets, or at fair value, as follows:

	NCI @ % of net assets	**NCI @ fair value**
Fair value of consideration	75,000	75,000
Non-controlling interests	24,000	28,000
Previously-held interest	40,000	40,000
	139,000	143,000
Fair value of identifiable net assets	120,000	120,000
Goodwill	19,000	23,000

The implications of the choice between the alternatives for measuring non-controlling interests are discussed in section 8.3.2.

10.2 Special situations

10.2.1 Share-for-share exchanges

In a business combination in which the acquirer and the acquiree (or its former owners) exchange only equity interests, the fair value of the acquiree's equity interests may be more reliably measurable than the fair value of the acquirer's equity interests. If so, the acquirer should determine the amount of goodwill by using the fair value of the acquiree's equity interests rather than the fair value of the equity interests transferred. [IFRS 3(2008).33]

Use of the fair value of the acquiree's equity interests in this situation, as an alternative to measuring the fair value of consideration transferred by the acquirer, is on grounds of reliable measurement only.

Example 10.2.1

Consideration measured using acquiree's equity

An unlisted private equity entity acquires a listed entity through an exchange of equity instruments. The published price of the quoted equity instruments of the acquiree at the date of exchange is likely to provide a more reliable indicator of fair value than the valuation methods used to measure the fair value of the private acquirer's equity instruments.

10.2.2 Business combinations with no consideration

Paragraph 33 of IFRS 3(2008) also deals with the situation of a business combination in which no consideration is transferred. This could occur where the acquiree repurchases equity interests from other investors such that the acquirer's unchanged equity interest becomes a controlling interest, or a business combination achieved by contract alone.

In a business combination achieved without the transfer of consideration, goodwill is determined by using the acquisition-date fair value of the acquirer's interest in the acquiree (measured using a valuation technique) rather than the acquisition-date fair value of the consideration transferred. [IFRS 3(2008).33]

The acquirer measures the fair value of its interest in the acquiree using one or more valuation techniques that are appropriate in the circumstances and for which sufficient data is available. If more than one valuation technique is used, the acquirer should evaluate the results of the techniques, considering the relevance and reliability of the inputs used and the extent of the available data. [IFRS 3(2008).B46]

Business combinations with no transfer of consideration are considered in more detail in chapter 13.

10.2.3 Mutual entities

Earlier sections of this guide dealt with the change to include combinations involving mutual entities within the scope of IFRS 3(2008) (section 4.2.3), and the identification of the acquirer in such circumstances (section 6.3.2). This section deals with measurement issues.

When two mutual entities combine, the entity identified as the acquirer gives member interests in itself in exchange for the member interests in the acquiree. Thus consideration is paid, but its fair value is not readily determinable by reference to a market. IFRS 3(2008) recognises that it may be easier to fair value the entire member interest of the acquiree, rather than the incremental member interests given by the acquirer.

10.2.3.1 Consideration given

Accordingly, IFRS 3(2008) provides that where the fair value of the equity or member interests in the acquiree (or the fair value of the acquiree) is more reliably measurable than the fair value of the member interests transferred by the acquirer, the acquirer should determine the amount of goodwill by using the acquisition-date fair value of the acquiree's equity interests instead of the acquisition-date fair value of the acquirer's equity interests transferred as consideration. [IFRS 3(2008).B47]

This is an example of IFRS 3(2008) using the fair value of the acquiree to measure consideration as it is more reliably measurable than consideration given by the acquirer.

10.2.3.2 Basis of valuation

Although they are similar in many ways to other businesses, mutual entities have distinct characteristics that arise primarily because their members are both customers and owners. Members of mutual entities generally expect to receive benefits for their membership, often in the form of reduced fees charged for goods and services or patronage dividends. The portion of patronage dividends allocated to each member is often based on the amount of business the member did with the mutual entity during the year. [IFRS 3(2008).B48]

A fair value measurement of a mutual entity should include the assumptions that market participants would make about future member benefits as well as any other relevant assumptions market participants would make about the mutual entity. For example, an estimated cash flow model may be used to determine the fair value of a mutual entity. The cash flows used as inputs to the model should be based on the expected cash flows of the mutual entity, which are likely to reflect reductions for member benefits, such as reduced fees charged for goods and services. [IFRS 3(2008).B49]

10.2.3.3 Identifiable net assets acquired

The acquirer in a combination of mutual entities recognises the acquiree's net assets as a direct addition to capital or equity in its statement of financial position, not as an addition to retained earnings, which is consistent with the way in which other types of entities apply the acquisition method. [IFRS 3(2008).B47]

Member interests given by the acquirer will be recognised directly in equity. IFRSs do not usually prescribe where within equity such items are classified. In this case, however, IFRS 3(2008) is specific that the amount recognised (equal to the acquiree's identifiable net assets) should not be added to retained earnings.

Example 10.2.3.3

Combination of mutual entities

X and Y are co-operative institutions owned by their customers who receive dividends in proportion to the amount of goods purchased. They combine, with X identified as the acquirer. Members of Y become members of X.

A valuation of Y as an entity indicates a fair value of CU500,000. The fair value of Y's identifiable net assets is CU400,000.

X records its acquisition of Y in its consolidated financial statements as follows:

	CU	CU
Dr Identifiable net assets acquired	400,000	
Dr Goodwill	100,000	
Cr Member interests issued		500,000

The classification of member interests as either equity or a financial liability is determined by applying IAS 32.

10.3 Bargain purchases

A bargain purchase is a business combination in which the net fair value of the identifiable assets acquired and liabilities assumed exceeds the aggregate of the consideration transferred, the non-controlling interests and the fair value of any previously-held equity interest in the acquiree.

A bargain purchase might happen, for example, in a business combination that is a forced sale in which the seller is acting under compulsion. However, the recognition and measurement exceptions for particular items, as discussed in chapter 8, might also lead to the recognition of a gain (or a change in the amount of a recognised gain) on a bargain purchase. [IFRS 3(2008).35]

10.3.1 Accounting for a bargain purchase gain

If, after applying the requirements in section 10.3.2 below, it is determined that the acquisition is a bargain purchase, the acquirer recognises the resulting gain in profit or loss on the acquisition date. The gain is attributed to the acquirer. [IFRS 3(2008).34]

10.3.2 Reassessment required prior to recognising a bargain purchase gain

An acquirer's initial calculations under IFRS 3(2008).32 (see section 10.1) may indicate that the acquisition has resulted in a bargain purchase. Before recognising any gain, the Standard requires that the acquirer should reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed. The acquirer should recognise any additional assets or liabilities that are identified in that review. [IFRS 3(2008).36]

The acquirer is then required to review the procedures used to measure the amounts that IFRS 3(2008) requires to be recognised at the acquisition date for all of the following:

[IFRS 3(2008).36]

(a) the identifiable assets acquired and liabilities assumed;

(b) the non-controlling interest in the acquiree, if any;

(c) for a business combination achieved in stages, the acquirer's previously-held equity interest in the acquiree; and

(d) the consideration transferred.

The objective of the review is to ensure that the measurements appropriately reflect consideration of all available information as of the acquisition date. [IFRS 3(2008).36]

Example 10.3.2

Gain on a bargain purchase

[IFRS 3(2008).IE46-IE49]

On 1 January 20X5 AC acquires 80 per cent of the equity interests of TC, a private entity, in exchange for cash of CU150. Because the former owners of TC needed to dispose of their investments in TC by a specified date, they did not have sufficient time to market TC to multiple potential buyers. The management of AC initially measures the separately recognisable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirements of IFRS 3. The identifiable assets are measured at CU250 and the liabilities assumed are measured at CU50. AC engages an independent consultant, who determines that the fair value of the 20 per cent non-controlling interest in TC is CU42.

The amount of TC's identifiable net assets (CU200, calculated as CU250 – CU50) exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in TC. Therefore, AC reviews the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non-controlling interest in TC and the consideration transferred. After that review, AC decides that the procedures and resulting measures were appropriate.

AC measures the gain on its purchase of the 80 per cent interest as follows:

	CU	CU
Amount of the identifiable net assets acquired (CU250 – CU50)		200
Less: Fair value of the consideration transferred for AC's 80 per cent interest in TC; plus	150	
Fair value of non-controlling interest in TC	42	192
Gain on bargain purchase of 80 per cent interest		8

AC would record its acquisition of TC in its consolidated financial statements as follows:

	CU	CU
Dr Identifiable assets acquired	250	
Cr Cash		150
Cr Liabilities assumed		50
Cr Gain on the bargain purchase		8
Cr Equity – non-controlling interest in TC		42

If the acquirer chose to measure the non-controlling interest in TC on the basis of its proportionate interest in the identifiable net assets of the acquiree, the recognised amount of the non-controlling interest would be CU40 (CU200 x 0.20). The gain on the bargain purchase then would be CU10 (CU200 – (CU150 + CU40)).

11. Post-combination accounting

11.1 General guidance on subsequent measurement and accounting

In general, assets acquired, liabilities assumed or incurred, and equity instruments issued in a business combination are subsequently measured and accounted for in accordance with other applicable IFRSs, according to their nature. [IFRS 3(2008).54]

Examples of other IFRSs that provide guidance on subsequently measuring and accounting for assets acquired and liabilities assumed or incurred in a business combination include:

[IFRS 3(2008).B63]

- IAS 38 *Intangible Assets* prescribes the accounting for identifiable intangible assets acquired in a business combination. The acquirer measures goodwill at the amount recognised at the acquisition date less any accumulated impairment losses;
- IAS 36 *Impairment of Assets* prescribes the accounting for impairment losses;
- IFRS 4 *Insurance Contracts* provides guidance on the subsequent accounting for an insurance contract acquired in a business combination;
- IAS 12 *Income Taxes* prescribes the subsequent accounting for deferred tax assets (including unrecognised deferred tax assets) and liabilities acquired in a business combination;
- IFRS 2 *Share-based Payment* provides guidance on subsequent measurement and accounting for the portion of replacement share-based payment awards issued by an acquirer that is attributable to employees' future services; and
- IAS 27 *Consolidated and Separate Financial Statements* (as amended in 2008) provides guidance on accounting for changes in a parent's ownership interest in a subsidiary after control is obtained.

11.2 Specific guidance

IFRS 3(2008) provides specific guidance in relation to the following assets acquired, liabilities assumed or incurred, and equity instruments issued in a business combination:

- reacquired rights (see section 8.5.2);
- contingent liabilities (see section 8.5.1);
- indemnification assets (see section 8.5.7); and
- contingent consideration (see section 9.2).

11.3 Adjustments to provisional values

IFRS 3(2008) permits adjustments to items recognised in the original accounting for a business combination, for a maximum of one year after the acquisition date, where new information about facts and circumstances existing at the acquisition date is obtained. Any such adjustments are made retrospectively as if those adjustments had been made at the acquisition date.

11.3.1 Use of provisional values

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the financial statements should be prepared using provisional amounts for the items for which the accounting is incomplete. [IFRS 3(2008).45]

11.3.2 The measurement period

The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination. [IFRS 3(2008).46] The measurement period begins at the acquisition date and ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period cannot exceed one year from the acquisition date. [IFRS 3(2008).45]

11.3.3 What can be adjusted?

Adjustments may be made in the measurement period to the following components:

[IFRS 3(2008).46]

(a) the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree;

(b) the consideration transferred for the acquiree (or the other amount used in measuring goodwill);

(c) in a business combination achieved in stages, the equity interest in the acquiree previously held by the acquirer; and

(d) the resulting goodwill or gain on a bargain purchase.

11.3.4 Retrospective adjustments

The adjustments to provisional amounts should be recognised as if the accounting for the business combination had been completed at the acquisition date. Therefore, comparative information for prior periods presented in the financial statements is revised as required, including making any change in depreciation, amortisation or other income effects recognised in completing the initial accounting. [IFRS 3(2008).49]

Adjustments to recognised items During the measurement period, the acquirer retrospectively adjusts the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognised as of that date. [IFRS 3(2008).45]

Adjustments to unrecognised items During the measurement period, the acquirer also recognises additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have resulted in the recognition of those assets and liabilities as of that date. [IFRS 3(2008).45]

Information to be considered The acquirer is required to consider all pertinent factors in determining whether information obtained after the acquisition date should result in an adjustment to the provisional amounts recognised or whether that information results from events that occurred after the acquisition date. Pertinent factors include the date when additional information is obtained and whether the acquirer can identify a reason for a change to provisional amounts. Information that is obtained shortly after the acquisition date is more likely to reflect circumstances that existed at the acquisition date than is information obtained several months later. For example, unless an intervening event that changed its fair value can be identified, the sale of an asset to a third party shortly after the acquisition date for an amount that differs significantly from its provisional fair value determined at that date is likely to indicate an error in the provisional amount. [IFRS 3(2008).47]

Revising goodwill The acquirer recognises an increase (decrease) in the provisional amount recognised for an identifiable asset (liability) by means of a decrease (increase) in goodwill. However, new information obtained during the measurement period may sometimes result in an adjustment to the provisional amount of more than one asset or liability. For example, the acquirer might have assumed a liability to pay damages related to an accident in one of the acquiree's facilities, part or all of which are covered by the acquiree's liability insurance policy. If the acquirer obtains new information during the measurement period about the acquisition-date fair value of that liability, the adjustment to goodwill resulting from a change to the provisional amount recognised for the liability would be offset (in whole or in part) by a corresponding adjustment to goodwill resulting from a change to the provisional amount recognised for the claim receivable from the insurer. [IFRS 3(2008).48]

Example 11.3.4

Measurement period

[IFRS 3(2008).IE51-53]

Suppose that AC acquires TC on 30 September 20X7. AC seeks an independent valuation for an item of property, plant and equipment acquired in the combination, and the valuation was not complete by the time AC authorised for issue its financial statements for the year ended 31 December 20X7. In its 20X7 annual financial statements, AC recognised a provisional fair value for the asset of CU30,000. At the acquisition date, the item of property, plant and equipment had a remaining useful life of five years. Five months after the acquisition date, AC received the independent valuation, which estimated the asset's acquisition-date fair value as CU40,000.

In its financial statements for the year ended 31 December 20X8, AC retrospectively adjusts the 20X7 prior year information as follows:

(a) the carrying amount of property, plant and equipment as of 31 December 20X7 is increased by CU9,500. That adjustment is measured as the fair value adjustment at the acquisition date of CU10,000 less the additional depreciation that would have been recognised if the asset's fair value at the acquisition date had been recognised from that date (CU500 for three months' depreciation);

(b) the carrying amount of goodwill as of 31 December 20X7 is decreased by CU10,000; and

(c) depreciation expense for 20X7 is increased by CU500.

In accordance with paragraph B67 of IFRS 3, AC discloses:

(a) in its 20X7 financial statements, that the initial accounting for the business combination has not been completed because the valuation of property, plant and equipment has not yet been received;

(b) in its 20X8 financial statements, the amounts and explanations of the adjustments to the provisional values recognised during the current reporting period. Therefore, AC discloses that the 20X7 comparative information is adjusted retrospectively to increase the fair value of the item of property, plant and equipment at the acquisition date by CU9,500, offset by a decrease to goodwill of CU10,000 and an increase in depreciation expense of CU500.

11.3.5 Adjustments after the measurement period.

After the measurement period ends, the accounting for a business combination can be amended only to correct an error in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. [IFRS 3(2008).50]

11.3.6 Deferred tax arising from a business combination

The requirements of IFRS 3(2008) have resulted in amendments to IAS 12 *Income Taxes*. In addition to consequential changes in terminology, a more significant change is made in respect of the post-combination recognition of deferred tax assets acquired in a business combination as follows:

[IAS 12.68 (as amended by IFRS 3(2008).C4)]

- acquired deferred tax benefits recognised within the measurement period that result from new information about facts and circumstances that existed at the acquisition date reduce the carrying amount of any goodwill related to that acquisition. If the carrying amount of that goodwill is zero, any remaining deferred tax benefits are recognised in profit or loss; and

- all other acquired deferred tax benefits realised are recognised in profit or loss (or outside profit or loss if otherwise required by IAS 12).

Prior to this amendment, under IAS 12, the subsequent realisation of all deferred tax assets acquired in a business combination reduced the carrying amount of goodwill to the amount that would have been recognised if the deferred tax asset had been recognised as an identifiable asset from the acquisition date, regardless of the date of realisation.

See section 15.3.3 for specific transitional provisions regarding this change.

12. Step acquisitions and partial disposals

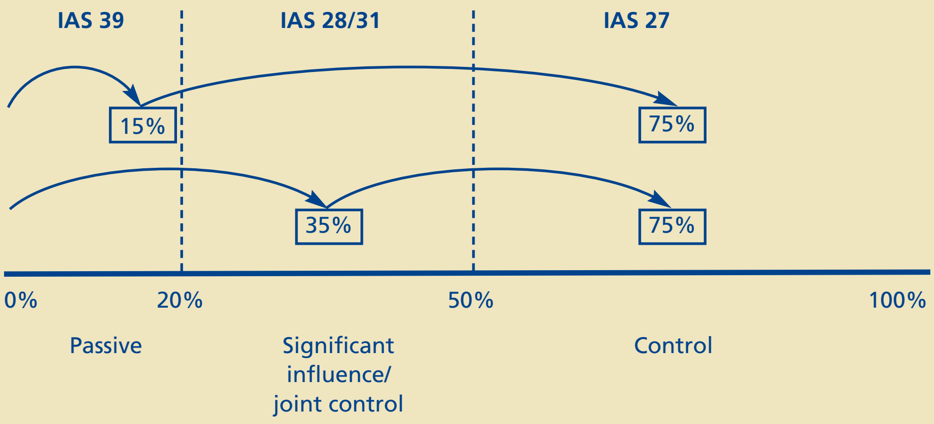
This chapter deals not only with business combinations where control is achieved through two or more separate transactions (referred to as 'business combinations achieved in stages' or 'step acquisitions'), but also with other partial acquisition and disposal situations.

These types of transactions are significantly affected by the 2008 revisions to IFRS 3 and IAS 27. The underlying principles are explained in chapter 2 of this guide.

12.1 Control achieved in two or more transactions

This section applies where an equity investment in one of the following categories is increased to become a controlling interest: a financial asset under IAS 39, an associate under IAS 28 or a jointly controlled entity under IAS 31.

Transactions where control is achieved through two transactions



The principles to be applied are:

- a business combination occurs only in respect of the transaction that gives one entity control of another [IFRS 3(2008)(Appendix A)];
- the identifiable net assets of the acquiree are remeasured to their fair value on the date of acquisition (i.e. the date that control passes) [IFRS 3(2008).18];
- non-controlling interests are measured on the date of acquisition under one of the two options permitted by IFRS 3(2008) [IFRS 3(2008).19];

- an equity interest previously held in the acquiree which qualified as a financial asset under IAS 39 is treated as if it were disposed of and reacquired at fair value on the acquisition date. Accordingly, it is remeasured to its acquisition-date fair value and any resulting gain or loss is recognised in profit or loss. Consistent with the treatment as if it were a direct disposal, any changes in value of the equity interest that were previously recognised in other comprehensive income (e.g. because the investment was classified as available-for-sale) are reclassified from equity to profit or loss [IFRS 3(2008).42];

- an equity interest previously held in the acquiree which qualified as an associate under IAS 28 or a jointly controlled entity under IAS 31 is similarly treated as if it were disposed of and reacquired at fair value on the acquisition date. Accordingly, it is remeasured to its acquisition-date fair value, and any resulting gain or loss compared to its carrying amount under IAS 28 or IAS 31 is recognised in profit or loss. Any amount that has previously been recognised in other comprehensive income, and that would be reclassified to profit or loss following a disposal, is similarly reclassified to profit or loss [IFRS 3(2008).42]; and

- goodwill (or a gain from a bargain purchase) is measured as: [IFRS 3(2008).32]

Consideration transferred to obtain control

plus

Amount of non-controlling interest (using either option)

plus

Fair value of previously-held equity interest

less

Fair value of the identifiable net assets of the acquiree (100%)

Example 12.1A

Financial asset under IAS 39 becomes a subsidiary

A acquired a 75% controlling interest in B in two stages.

- In 20X1, A acquired a 15% equity interest for cash consideration of CU10,000. A classified the interest as available-for-sale under IAS 39. From 20X1 to the end of 20X5, A reported fair value increases of CU2,000 in other comprehensive income (OCI).

- In 20X6, A acquired a further 60% equity interest for cash consideration of CU60,000. A identified net assets of B with a fair value of CU80,000. 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 CU12,500.

	CU
In 20X6, A will include CU2,500 in profit or loss, being:	
Gain on 'disposal' of 15% investment (CU12,500 – CU12,000)	500
Gain previously reported in OCI (CU12,000 – CU10,000)	2,000
Total	2,500
In 20X6, A will measure goodwill as follows:	
Fair value of consideration given for controlling interest	60,000
Non-controlling interest (25% x CU80,000)	20,000
Fair value of previously-held interest	12,500
	92,500
Less: fair value of net assets of acquiree	(80,000)
Goodwill	12,500

Example 12.1B

Associate becomes a subsidiary

C acquired a 75% controlling interest in D in two stages.

- In 20X1, C acquired a 40% equity interest for cash consideration of CU40,000. C classified the interest as an associate under IAS 28. At the date that C acquired its interest, the fair value of D's identifiable net assets was CU80,000. From 20X1 to 20X6, C equity accounted for its share of undistributed profits totalling CU5,000, and included its share of an IAS 16 revaluation gain of CU3,000 in other comprehensive income (OCI). Therefore, in 20X6, the carrying amount of C's interest in D was CU48,000.
- In 20X6, C acquired a further 35% equity interest for cash consideration of CU55,000. C identified net assets of D with a fair value of CU110,000. C elected to measure non-controlling interests at fair value of CU30,000. On the date of acquisition, the previously-held 40% interest had a fair value of CU50,000.

In 20X6 (ignoring any profits earned prior to the acquisition), C will include CU2,000 in profit or loss, being:

	CU
Fair value of previously-held interest	50,000
Less: carrying amount under IAS 28	48,000
Total	2,000

The revaluation gain of CU3,000 previously recognised in OCI is not reclassified to profit or loss because it would not be reclassified if the interest in D were disposed of.

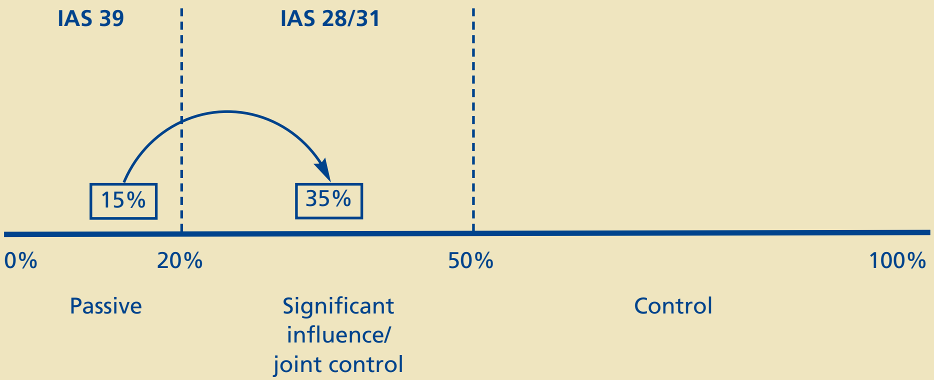
In 20X6, C will measure goodwill as follows:

Fair value of consideration given for controlling interest	55,000
Non-controlling interest (fair value)	30,000
Fair value of previously-held interest	50,000
Sub-total	135,000
Less: fair value of net assets of acquiree	(110,000)
Goodwill	25,000

12.2 Financial asset becomes an associate or a jointly controlled entity

While consequential amendments were made to IAS 28 and IAS 31 to require remeasurement of a residual interest to fair value following a disposal, no amendment was made to deal with the situation of an equity investment which is classified as a financial asset under IAS 39 being increased to become either an associate under IAS 28 or a jointly controlled entity under IAS 31.

Financial asset becomes an associate or a jointly controlled entity



When control is lost and an investment in an associate/jointly controlled entity is retained, IAS 27(2008) requires measurement of the investment retained at fair value and for that fair value to be used as deemed cost for subsequent accounting. IAS 27(2008).37 states that 'the fair value of any investment retained in the former subsidiary at the date when control is lost shall be regarded as … the cost on initial recognition of an investment in an associate or jointly controlled entity'.

The question arises as to whether the principles applied to partial disposals and control achieved in stages should also be applied to an equity-accounted or proportionately-consolidated interest achieved in stages. IAS 28.20 states that: 'Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures described in IAS 27. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate.'

Against this, it is noted that IAS 28.11 has not been amended and states 'Under the equity method, the investment in an associate is initially recognised at cost…', which may be read as requiring any remeasurement under IAS 39 to be reversed in the initial equity accounting.

In developing IFRS 3(2008), the IASB considered this issue, but did not provide any answer.

12.3 Transactions between parent and non-controlling interests

Once control has been achieved, further transactions whereby the parent entity acquires further equity interests from non-controlling interests, or disposes of equity interests but without losing control, are accounted for as equity transactions (i.e. transactions with owners in their capacity as owners). [IAS 27(2008).30] It follows that:

[IAS 27(2008).31]

- the carrying amounts of the controlling and non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiary;
- any difference between the amount by which the non-controlling interests is adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the parent; and
- there is no consequential adjustment to the carrying amount of goodwill, and no gain or loss is recognised in profit or loss.

The option available to measure non-controlling interests either at fair value or at a proportionate share of the acquiree's identifiable net assets in IFRS 3(2008).19 is described as being available 'in a business combination'.

For a transaction between the parent and non-controlling interests, IAS 27(2008) does not give detailed guidance as to how to measure the amount to be allocated to the parent and non-controlling interest to reflect a change in their relative interests in the subsidiary. More than one approach may be possible. In most cases, however, the best approach may be to recognise any difference between the fair value of the consideration paid and the non-controlling interest, in terms of existing carrying amount, directly in equity attributable to the parent.

IAS 32.35 requires that the transaction costs of any equity transaction be recognised in equity. Therefore, the costs associated with a transaction between a parent and non-controlling interests are recognised in equity.

A schedule is required to be disclosed that shows the effects on the equity attributable to owners of the parent of any changes in a parent's ownership interest in a subsidiary that do not result in a loss of control. [IAS 27(2008).41(e)]

12.3.1 Implications of the measurement basis of non-controlling interests

The adjustment to the carrying amount of non-controlling interests and the consequential adjustment to equity following a transaction with the parent will be affected by the choice of measurement basis for the non-controlling interest at acquisition date. The Board explains the difference as follows:

'The third difference [due to the choice of measurement basis for non-controlling interests] arises if the acquirer subsequently purchases some (or all) of the shares held by the non-controlling shareholders. If the non-controlling interests are acquired, presumably at fair value, the equity of the group is reduced by the non-controlling interests' share of any unrecognised changes in the fair value of the net assets of the business, including goodwill. If the non-controlling interest is measured initially as a proportionate share of the acquiree's identifiable net assets, rather than at fair value, that reduction in the reported equity attributable to the acquirer is likely to be larger. This matter was considered further in the IASB's deliberations on the proposed amendments to IAS 27.'
[IFRS 3(2008).BC218]

The difference is highlighted in the following examples.

Example 12.3.1A

Parent acquires non-controlling interest

In 20X1, A acquired a 75% equity interest in B for cash consideration of CU90,000. B's identifiable net assets at fair value were CU100,000. The fair value of the 25% non-controlling equity interest (NCI) was CU28,000. Goodwill, on the two alternative bases for measuring non-controlling interests at acquisition, is calculated as follows:

	NCI @ % of net assets	**NCI @ fair value**
	CU	**CU**
Fair value of consideration	90,000	90,000
Non-controlling interests	25,000	28,000
	115,000	118,000
Fair value of net assets	100,000	100,000
Goodwill	15,000	18,000

In the subsequent years, B increased net assets by CU20,000 to CU120,000. This is reflected in the carrying amount within equity attributed to non-controlling interests as follows:

	NCI @ % of net assets	**NCI @ fair value**
	CU	**CU**
Non-controlling interests at acquisition	25,000	28,000
Increase (25% x CU20,000)	5,000	5,000
Carrying amount	30,000	33,000

In 20X6, A then acquired the 25% equity interest held by non-controlling interests for cash consideration of CU35,000. The adjustment to equity will be:

	NCI @ % of net assets	**NCI @ fair value**
	CU	**CU**
Fair value of consideration	35,000	35,000
Carrying amount of non-controlling interests	30,000	33,000
Negative movement in parent equity	5,000	2,000

As indicated in BC218, the reduction in equity is greater where the option was taken to measure non-controlling interests at acquisition date as a proportionate share of the acquiree's identifiable net assets. The treatment has the effect of including the non-controlling interest's share of goodwill directly in equity. This outcome will always occur where the fair value basis is greater than the net asset basis at acquisition date.

Example 12.3.1B

Parent acquires part of a non-controlling interest

The facts are as in example 12.3.1A above except that, rather than acquire the entire non-controlling interest, A acquires an additional 15% equity interest held by non-controlling interests for cash consideration of CU21,000. The adjustment to the carrying amount of non-controlling interests will be:

	NCI @ % of net assets	NCI @ fair value
	CU	CU
Balance as in example 12.3.1A	30,000	33,000
Transfer to parent (15/25ths)*	18,000	19,800
10% interest carried forward	12,000	13,200
The adjustment to equity will be:		
Fair value of consideration	21,000	21,000
Change to non-controlling interests (as above)	18,000	19,800
Negative movement	3,000	1,200

* It is assumed that non-controlling interests are reduced proportionately. Under the tair value option, the closing balance represents 10/25th of the acquisition date fair value (11,200) plus 10% of the change in net assets since acquisition (2,000).

Example 12.3.1C

Parent disposes of part of its interest to non-controlling interests

In 20X1, A acquired a 100% equity interest in B for cash consideration of CU125,000. B's identifiable net assets at fair value were CU100,000. Goodwill of CU25,000 was identified and recognised.

In the subsequent years, B increased net assets by CU20,000 to CU120,000. This is reflected in equity attributable to the parent.

A then disposed of 30% of its equity interest to non-controlling interests for CU40,000. The adjustment to equity will be:

	CU
Fair value of consideration received	40,000
Amount recognised as non-controlling interests (30% x 120,000)	36,000
Positive movement in parent equity	4,000

Note that there is no adjustment to the carrying amount of goodwill of CU25,000 because control has been retained.

12.4 Disposal of a controlling interest but retaining a non-controlling residual interest

12.4.1 Adjustments on loss of control

IAS 27 details the adjustments made when a parent loses control of a subsidiary, based on the date when control is lost:

[IAS 27(2008).34]

- derecognise the carrying amount of assets (including goodwill), liabilities and non-controlling interests;
- recognise the fair value of consideration received;
- recognise any distribution of shares to owners;
- recognise the fair value of any residual interest;
- reclassify to profit or loss any amounts (i.e. the entire amount, not a proportion) relating to the subsidiary's assets and liabilities previously recognised in other comprehensive income as if the assets and liabilities had been disposed of directly; and
- recognise any resulting difference as a gain or loss in profit or loss attributable to the parent.

Example 12.4.1

Parent disposes of its controlling interest but retains an associate interest

In 20X1, A acquired a 100% equity interest in B for cash consideration of CU125,000.
B's identifiable net assets at fair value were CU100,000. Goodwill of CU25,000 was identified and recognised.

In the subsequent years, B increased net assets by CU20,000 to CU120,000. Of this, CU15,000 was reported in profit or loss and CU5,000, relating to fair value movements on an available-for-sale financial asset, was reported within other comprehensive income.

A then disposed of 75% of its equity interest for cash consideration of CU115,000.
The resulting 25% equity interest is classified as an associate under IAS 28 and has a fair value of CU38,000.

The gain recognised in profit or loss on disposal of the 75% equity interest is:

	CU
Fair value of consideration received	115,000
Fair value of residual interest	38,000
Gain previously reported in other comprehensive income	5,000
	158,000
Less: net assets and goodwill derecognised	145,000
Gain	13,000

Subsequent accounting under IAS 28 on an equity-accounting basis will require an exercise to assess the fair value of B's identifiable net assets on the date that control is lost. Goodwill will be identified by comparing the initial fair value of the interest of CU38,000 with the residual share (25%) of identifiable net assets at fair value.

IAS 27(2008).41(f) requires disclosure of 'the portion of that gain or loss attributable to recognising any investment retained in the former subsidiary at its fair value at the date when control is lost'. The amount would be determined as follows:

	CU
Fair value of residual interest	38,000
25% of net assets and goodwill derecognised (25% x CU145,000)	36,250
Portion of gain	1,750

12.4.2 Subsequent accounting for a residual interest

The fair value of any residual interest on the date that control is lost becomes the fair value on initial recognition of the resulting financial asset under IAS 39, associate under IAS 28, or jointly controlled entity under IAS 31. [IAS 27(2008).36 – 37]

12.4.3 Interaction with IFRS 5

Where a parent is committed to a plan to dispose of a controlling interest in a subsidiary, and meets the other requirements of IFRS 5, **all** the assets and liabilities of that subsidiary are classified as held for sale, regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale. [IFRS 5.8A]

12.5 Disposal of an associate or a jointly controlled entity but retaining a financial asset

The principle adopted in IAS 27 that a change in accounting basis is recognised as a disposal and re-acquisition at fair value is extended by consequential amendments in IAS 27 to two other Standards:

- IAS 28 is amended such that on the loss of significant influence, the investor measures at fair value any investment the investor retains in the former associate [IAS 27(2008).A7]; and
- IAS 31 is amended such that when an investor ceases to have joint control, the investor measures at fair value any investment the investor retains in the former jointly controlled entity [IAS 27(2008).A8].

This reflects the Board's view that the loss of control, loss of significant influence and loss of joint control are economically similar events which should be accounted for similarly.
[IAS 27(2008).BCA2 – BCA30]

In each case, the fair value of any retained interest becomes the initial carrying amount for the retained asset as a financial asset, associate or jointly controlled entity under the appropriate Standard.

12.6 Accounting in the investing entity (where separate financial statements are prepared)

Because the Board introduced the requirement to remeasure pre-existing and residual equity interests within IFRS 3(2008) (which is a Standard dealing only with accounting for business combinations), it appears that the requirement only applies to financial statements in which a business combination is accounted for under IFRS 3(2008). It follows that this requirement would not extend to the individual financial statements of the investing or parent entity.

13. Business combinations with no transfer of consideration

13.1 Accounting requirement and examples

An acquirer may obtain control of an acquiree without transferring consideration. In such cases, IFRS 3 requires an acquirer to be identified, and the acquisition method to be applied. Examples of such circumstances include:

[IFRS 3(2008).43]

(a) the acquiree repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control;

(b) minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights; and

(c) a combination by contract alone (see section 13.2).

13.2 Combinations by contract alone

In a business combination achieved by contract alone, two entities enter into a contractual arrangement which covers, for example, operation under a single management and equalisation of voting power and earnings attributable to both entities' equity investors. Such structures may involve a 'stapling' or formation of a dual listed corporation.

13.2.1 Example of a dual listed structure

BHP Billiton Annual Report 2007

Merger terms

On 29 June 2001, BHP Billiton Plc (previously known as Billiton Plc), a UK listed company, and BHP Billiton Limited (previously known as BHP Limited), an Australian listed company, entered into a Dual Listed Companies' (DLC) merger. This was effected by contractual arrangements between the Companies and amendments to their constitutional documents.

The effect of the DLC merger is that BHP Billiton Plc and its subsidiaries (the BHP Billiton Plc Group) and BHP Billiton Limited and its subsidiaries (the BHP Billiton Limited Group) operate together as a single economic entity (the BHP Billiton Group).

Under the arrangements:

- the shareholders of BHP Billiton Plc and BHP Billiton Limited have a common economic interest in both Groups.
- the shareholders of BHP Billiton Plc and BHP Billiton Limited take key decisions, including the election of Directors, through a joint electoral procedure under which the shareholders of the two Companies effectively vote on a joint basis.
- BHP Billiton Plc and BHP Billiton Limited have a common Board of Directors, a unified management structure and joint objectives.
- dividends and capital distributions made by the two Companies are equalised.
- BHP Billiton Plc and BHP Billiton Limited each executed a deed poll guarantee, guaranteeing (subject to certain exceptions) the contractual obligations (whether actual or contingent, primary or secondary) of the other incurred after 29 June 2001 together with specified obligations existing at that date.

If either BHP Billiton Plc or BHP Billiton Limited proposes to pay a dividend to its shareholders, then the other Company must pay a matching cash dividend of an equivalent amount per share to its shareholders. If either Company is prohibited by law or is otherwise unable to declare, pay or otherwise make all or any portion of such a matching dividend, then BHP Billiton Plc or BHP Billiton Limited will, so far as it is practicable to do so, enter into such transactions with each other as the Boards agree to be necessary or desirable so as to enable both Companies to pay dividends as nearly as practicable at the same time.

The DLC merger did not involve the change of legal ownership of any assets of BHP Billiton Plc or BHP Billiton Limited, any change of ownership of any existing shares or securities of BHP Billiton Plc or BHP Billiton Limited, the issue of any shares or securities or any payment by way of consideration, save for the issue by each Company of one special voting share to a trustee company which is the means by which the joint electoral procedure is operated. In addition, to achieve a position where the economic and voting interests of one share in BHP Billiton Plc and one share in BHP Billiton Limited were identical, BHP Billiton Limited made a bonus issue of ordinary shares to the holders of its ordinary shares.

13.2.2 Accounting for a combination by contract

IFRS 3 requires one of the combining entities to be identified as the acquirer, and one to be identified as the acquiree – see chapter 6 for guidance. In reaching the conclusion that combinations achieved by contract alone should not be excluded from the scope of IFRS 3, the Board noted that:

[IFRS 3(2008).BC79]

- such business combinations do not involve the payment of readily measurable consideration and, in rare circumstances, it might be difficult to identify the acquirer;

- difficulties in identifying the acquirer are not a sufficient reason to justify a different accounting treatment, and no further guidance is necessary for identifying the acquirer; and
- the acquisition method is already being applied for such combinations in the United States and insurmountable issues have not been encountered.

Under IFRS 3(2004), combinations achieved by contract alone were outside the scope of the Standard. Accordingly, they were often accounted for as poolings of interests.

13.3 Application of the acquisition method to a combination in which no consideration is transferred

13.3.1 Deemed consideration

In a business combination achieved without the transfer of consideration, the acquirer substitutes the acquisition-date fair value of its interest in the acquiree for the acquisition-date fair value of the consideration transferred to measure goodwill or a gain on a bargain purchase. [IFRS 3(2008).33 & B46]

The acquirer measures the fair value of its interest in the acquiree using one or more valuation techniques that are appropriate in the circumstances and for which sufficient data is available. If more than one valuation technique is used, the acquirer should evaluate the results of the techniques considering the relevance and reliability of the inputs used and the extent of the available data. [IFRS 3(2008).B46]

The acquirer's interest in the acquiree may be limited to its right to equalisation payments. In practice, the fair value may be negligible.

13.3.2 Amount attributed to non-controlling interests

The amount attributed to non-controlling interests in a business combination achieved by contract alone is dealt with in IFRS 3(2008).44, which states as follows: 'In a business combination achieved by contract alone, the acquirer shall attribute to the owners of the acquiree the amount of the acquiree's net assets recognised in accordance with this IFRS. In other words, the equity interests in the acquiree held by parties other than the acquirer are a non-controlling interest in the acquirer's post-combination financial statements even if the result is that all of the equity interests in the acquiree are attributed to the non-controlling interest.' [IFRS 3(2008).44]

14. Reverse acquisitions

14.1 Identifying a reverse acquisition

14.1.1 Meaning of reverse acquisition

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes on the basis of the guidance in chapter 6. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. [IFRS 3(2008).B19]

Example 14.1.1

Private entity reversing into a public entity

[IFRS 3(2008).B19]

Reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for equity interests of the public entity. In this example, the public entity is the legal acquirer because it issued its equity interests, and the private entity is the legal acquiree because its equity interests were acquired. However, application of the guidance in chapter 6 results in identifying:

(a) the listed entity as the *acquiree* for accounting purposes (the accounting acquiree); and

(b) the private entity as the *acquirer* for accounting purposes (the accounting acquirer).

14.1.2 Acquiree must meet the definition of a business

IFRS 3(2008) limits business combinations to circumstances where the acquiree is a business. [IFRS 3(2008).3] It follows, for reverse acquisitions, that the accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition. [IFRS 3(2008).B19]

This restriction appears to exclude from the scope of IFRS 3(2008) two circumstances that, in the past, were identified as reverse acquisitions:

- a private entity reversing into a publicly-listed ‘cash shell’ (i.e. an entity with a public listing but with no ongoing business activities; and
- a new entity becoming the new parent of an existing group through an exchange of equity instruments.

Under IFRS 3(2008), such transactions should not be described as reverse acquisitions. An appropriate accounting policy may describe them as 'capital restructurings' or 'reverse asset acquisitions'. Such an accounting policy may result in consolidated financial statements that are similar to those produced under reverse acquisition accounting.

14.1.3 More complex cases

The guidance on identifying the acquirer in chapter 6 is relevant in a reverse acquisition transaction. Beyond this, IFRS 3(2008) does not provide detailed guidance for more complex arrangements (e.g. where the accounting acquirer had a previously-held interest in the accounting acquiree). It is suggested that the two primary factors that might lead to the conclusion that the transaction involves a reverse acquisition are:

- the former shareholders of the entity whose shares are acquired own the majority of shares, and control the majority of votes, in the combined entity; and
- the management of the combined entity is drawn predominantly from the entity whose shares are acquired.

14.2 Accounting for a reverse acquisition

There are no substantive differences between the accounting treatment prescribed for reverse acquisitions under IFRS 3(2004) and under IFRS 3(2008). Both versions of IFRS 3 aim to achieve an accounting outcome that reflects the consolidated financial statements as if the accounting acquirer had legally acquired the accounting acquiree. In other words, the legal form of the business combination should not impact the accounting for the substance of the business combination.

14.2.1 Accounting periods

Consolidated financial statements prepared following a reverse acquisition are issued under the name of the legal parent (accounting acquiree) but described in the notes as a continuation of the financial statements of the legal subsidiary (accounting acquirer), with one adjustment, which is to adjust retroactively the accounting acquirer's legal capital to reflect the legal capital of the accounting acquiree. That adjustment is required to reflect the capital of the legal parent (the accounting acquiree). Comparative information presented in those consolidated financial statements also is retroactively adjusted to reflect the legal capital of the legal parent (accounting acquiree). [IFRS 3(2008).B21]

Separate entity financial statements for the legal parent, if required, would be prepared on a stand-alone basis. Where the entity was formed shortly before the combination, its entity financial statements would cover only its actual accounting period.

14.2.2 Detailed accounting entries

IFRS 3(2008).B19 – B27 contains detailed guidance on the preparation of consolidated financial statements for a reverse acquisition. For understanding, this guidance is set out below as a comparison with a 'conventional acquisition' (i.e. a business combination where the accounting acquirer and the legal acquirer are the same entity). The terminology used for a reverse acquisition is that the accounting acquirer is the legal subsidiary, and the accounting acquiree is the legal parent.

	Conventional acquisition	**Reverse acquisition** [IFRS 3(2008).B19 – B27]
Consolidated financial statements issued	In the name of the legal parent.	In the name of the legal parent (with disclosure in the notes that they are a continuation of the financial statements of the legal subsidiary).
Consideration transferred	Fair value of consideration given by legal parent.	Fair value of the notional number of equity instruments that the legal subsidiary would have had to issue to the legal parent to give the owners of the legal parent the same percentage ownership in the combined entity.
Net assets of legal subsidiary (accounting acquirer)	Recognised and measured in accordance with IFRS 3(2008) – generally restated to fair value.	Not restated from pre-combination carrying amounts.
Net assets of legal parent (accounting acquiree)	Not restated from pre-combination carrying amounts.	Recognised and measured in accordance with the requirements for acquirees under IFRS 3(2008) – generally restated to fair value.
Goodwill/gain on bargain purchase	Consideration transferred less identified net assets of legal subsidiary.	Consideration transferred less identified net assets of legal parent.
Consolidated retained earnings and other equity balances at date of combination	Legal parent only.	Legal subsidiary only.

	Conventional acquisition	**Reverse acquisition** [IFRS 3(2008).B19 – B27]
Consolidated equity instruments	Equity instruments of legal parent.	Issued equity instruments of legal subsidiary outstanding before the business combination plus the fair value of the legal parent.
Non-controlling interests in legal subsidiary	Non-controlling interest's proportionate share of legal subsidiary net assets, or at fair value.	Non-controlling interest's proportionate share of legal subsidiary net assets at pre-combination carrying amounts. No fair value option.
Comparative information	Legal parent only.	Legal subsidiary only, but retroactively adjusted to reflect the legal capital of the legal parent.
Earnings per share of current period	Earnings based on consolidated earnings. Weighted average number of shares reflects actual shares issued for legal subsidiary from date of acquisition. Earnings based on consolidated earnings.	Weighted average number of shares reflects legal subsidiary's weighted average pre-combination ordinary shares multiplied by the exchange ratio established in the acquisition, and the weighted average total actual shares of the legal parent in issue after the date of acquisition.
Earnings per share of comparative period	Acquirer only.	Earnings of legal subsidiary. Legal subsidiary's weighted average ordinary shares multiplied by exchange ratio established at acquisition.
Separate financial statements of legal parent	Legal parent.	Legal parent.

14.2.3 Presentation of equity and comparative information

Pre-combination net income and net assets are those of the legal subsidiary (accounting acquirer), and present no particular problems.

Pre-combination equity is, in theory, the pre-combination equity of the legal subsidiary but adjusted retroactively to reflect the legal capital of the legal parent. IFRS 3(2008) describes the position at the date of combination as follows:

[IFRS 3(2008).B22(c) & (d)]

- the consolidated financial statements reflect the retained earnings and other equity balances of the legal subsidiary (accounting acquirer) before the business combination; and
- the amount recognised as issued equity interests in the consolidated financial statements is determined by adding the issued equity interest of the legal subsidiary (the accounting acquirer) outstanding immediately before the business combination to the fair value of the legal parent (accounting acquiree) determined in accordance with the requirements of IFRS 3(2008). However, the equity structure (i.e. the number and type of equity interests issued) reflects the equity structure of the legal parent (the accounting acquiree), including the equity interests the legal parent issued to effect the combination. Accordingly, the equity structure of the legal subsidiary (the accounting acquirer) is restated using the exchange ratio established in the acquisition agreement to reflect the number of shares of the legal parent (the accounting acquiree) issued in the reverse acquisition.

Applying this guidance to periods before the combination:

- the total amount shown as equity is the total shown as equity in the legal subsidiary; and
- the amount shown as equity instruments (i.e. share capital) is the amount shown in the legal subsidiary adjusted by the exchange ratio. In the case of share capital with a fixed nominal value, the result may be higher or lower than the legal subsidiary's actual share capital pre-combination. The resulting adjustment is reflected as a reduction in, or addition to, equity.

Example 14.2.3

Presentation of equity for an entity with share capital

The statements of financial position of Company A and Company B include the following amounts.

	Company A	Company B
	CU	CU
Share capital – CU1 nominal shares	100	300
Retained earnings	200	500
Net assets at carrying amount	300	800
Net assets at fair value	500	2,000
Fair value of whole business	5,000	25,000

On the date that the statements of financial position were drawn up, Company A issued 500 new shares in exchange for the entire share capital of Company B.

Since the equity holders of Company B obtain a 5/6ths share of the equity of Company A, Company B is identified as the acquirer. Since Company A issued 500 shares in itself in exchange for 300 shares in Company B, the exchange ratio is 5/3rds

The consideration transferred would be CU5,000. This equals the fair value of 60 new shares in Company B, being the notional number that Company B would issue to give the shareholders of Company A 1/6th of the combined entity. It also represents the fair value of Company A as an entity.

	Date of combination	Pre-combination comparative
	CU	CU
Share capital – CU1 nominal	600	500
Other reserves	4,700	(200)
Issued equity instruments	5,300	300
Retained earnings	500	500
Total equity	5,800	800

Share capital at the date of combination is 600, being the actual Company A shares in issue. Share capital pre-combination is CU500, being the issued shares of Company B (CU300) adjusted for the exchange ratio.

Issued equity instruments at the date of combination is the issued equity instruments of Company B (CU300) plus the consideration transferred (CU5,000). Issued equity instruments pre-combination are those of Company B (CU300).

Retained earnings at the date of combination, and pre-combination, are those of Company B (CU500).

The balance of other reserves pre-combination (CU200 debit) represents the capitalisation of reserves into share capital (500 shares in Company A issued in exchange for 300 shares in Company B).

Earnings per share would be based on the consolidated earnings (pre-combination earnings of Company B, and post-combination earnings of Company A + Company B). The weighted average number of shares would be based on 500 shares pre-combination (being the number of shares in Company A issued to shareholders of Company B) and 600 shares post-combination.

14.2.4 Worked example of a reverse acquisition

Example 14.2.4
Reverse acquisition

[IFRS 3(2008).IE1-IE15]

This example illustrates the accounting for a reverse acquisition in which Entity B, the legal subsidiary, acquires Entity A, the entity issuing equity instruments and therefore the legal parent, in a reverse acquisition on 30 September 20X6. This example ignores the accounting for any income tax effects.

The statements of financial position of Entity A and Entity B immediately before the business combination are:

	Entity A (legal parent, accounting acquiree)	Entity B (legal subsidiary, accounting acquirer)
	CU	CU
Current assets	500	700
Non-current assets	1,300	3,000
Total assets	1,800	3,700

	Entity A (legal parent, accounting acquiree)	Entity B (legal subsidiary, accounting acquirer)
	CU	CU
Current liabilities	300	600
Non-current liabilities	400	1,100
Total liabilities	700	1,700
Shareholders' equity		
Retained earnings	800	1,400
Issued equity		
100 ordinary shares	300	–
60 ordinary shares	–	600
Total shareholders' equity	1,100	2,000
Total liabilities and shareholders' equity	1,800	3,700

This example also uses the following information:

(a) On 30 September 20X6 Entity A issues 2.5 shares in exchange for each ordinary share of Entity B. All of Entity B's shareholders exchange their shares in Entity B. Therefore, Entity A issues 150 ordinary shares in exchange for all 60 ordinary shares of Entity B.

(b) The fair value of each ordinary share of Entity B at 30 September 20X6 is CU40. The quoted market price of Entity A's ordinary shares at that date is CU16.

(c) The fair values of Entity A's identifiable assets and liabilities at 30 September 20X6 are the same as their carrying amounts, except that the fair value of Entity A's non-current assets at 30 September 20X6 is CU1,500.

Calculating the fair value of the consideration transferred

As a result of Entity A (legal parent, accounting acquiree) issuing 150 ordinary shares, Entity B's shareholders own 60 per cent of the issued shares of the combined entity (i.e. 150 of 250 issued shares). The remaining 40 per cent are owned by Entity A's shareholders. If the business combination had taken the form of Entity B issuing additional ordinary shares to Entity A's shareholders in exchange for their ordinary shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholders would then own 60 of the 100 issued shares of Entity B – 60 per cent of the combined entity. As a result, the fair value of the consideration effectively transferred by Entity B and the group's interest in Entity A is CU1,600 (40 shares with a fair value per share of CU40).

The fair value of the consideration effectively transferred should be based on the most reliable measure. In this example, the quoted market price of Entity A's shares provides a more reliable basis for measuring the consideration effectively transferred than the estimated fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's shares – 100 shares with a fair value per share of CU16.

Measuring goodwill

Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in Entity A) over the net amount of Entity A's recognised identifiable assets and liabilities, as follows:

	CU	CU
Consideration effectively transferred		1,600
Net recognised values of Entity A's identifiable assets and liabilities		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	(400)	(1,300)
Goodwill		300

Consolidated statement of financial position at 30 September 20X6

The consolidated statement of financial position immediately after the business combination is:

	CU
Current assets [CU700 + CU500]	1,200
Non-current assets [CU3,000 + CU1,500]	4,500
Goodwill	300
Total assets	6,000
Current liabilities [CU600 + CU300]	900
Non-current liabilities [CU1,100 + CU400]	1,500
Total liabilities	2,400
Shareholders' equity	
Retained earnings	1,400
Issued equity	
250 ordinary shares [CU600 + CU1,600]	2,200
Total shareholders' equity	3,600
Total liabilities and shareholders' equity	6,000

The amount recognised as issued equity interests in the consolidated financial statements (CU2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination (CU600) and the fair value of the consideration effectively transferred (CU1,600). However, the equity structure appearing in the consolidated financial statements (i.e. the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to effect the combination.

Earnings per share

Assume that Entity B's earnings for the annual period ended 31 December 20X5 were CU600 and that the consolidated earnings for the annual period ended 31 December 20X6 were CU800. Assume also that there was no change in the number of ordinary shares issued by Entity B during the annual period ended 31 December 20X5 and during the period from 1 January 20X6 to the date of the reverse acquisition on 30 September 20X6. Earnings per share for the annual period ended 31 December 20X6 is calculated as follows:

Number of shares deemed to be outstanding for the period from 1 January 20X6 to the acquisition date (i.e. the number of ordinary shares issued by Entity A (legal parent, accounting acquiree) in the reverse acquisition)	150
Number of shares outstanding from the acquisition date to 31 December 20X6	250
Weighted average number of ordinary shares outstanding [(150 x 9/12) + (250 x 3/12]	175
Earnings per share [800/175]	CU4.57

Restated earnings per share for the annual period ended 31 December 20X5 is CU4.00 (calculated as the earnings of Entity B of 600 divided by the number of ordinary shares Entity A issued in the reverse acquisition (150)).

15. Effective date and transition

15.1 IFRS 3(2008) - effective date

15.1.1 Mandatory application

IFRS 3(2008) is applicable to business combinations for which the acquisition date is in annual reporting periods beginning on or after 1 July 2009. [IFRS 3(2008).64]. With certain exceptions, the requirements of IFRS 3(2008) apply prospectively, meaning that there is no amendment to the accounting for earlier business combinations.

Specific transitional provisions override the requirements of IFRS 3(2008) in relation to deferred taxes, meaning that no goodwill adjustments can be recognised where deferred taxes arising in a pre-transition business combination are recognised for the first time after the beginning of the annual reporting period in which the IFRS 3(2008) is applied (see 15.3.3). [IFRS 3(2008)(67)]

There are also specific transitional provisions in relation to entities (such as mutual entities) that have not yet applied IFRS 3(2004) and had one or more business combinations that were accounted for using the purchase method (see 15.3.2). [IFRS 3(2008)(67)]

15.1.2 Early adoption

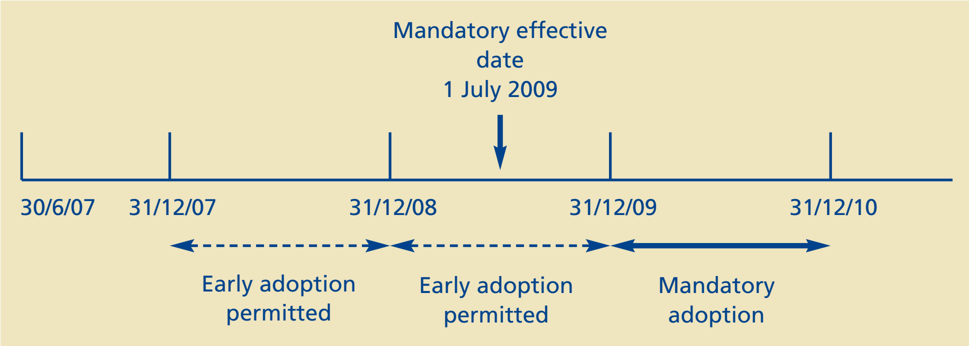
The Standard may be adopted early, but only for annual reporting periods beginning on or after 30 June 2007. If an entity chooses to adopt IFRS 3(2008) before 1 July 2009:

- it must disclose that fact; and
- it must apply the 2008 amendments to IAS 27 at the same time.

15.1.3 Effect on a calendar-year entity

For an entity with a calendar-year accounting period:

- application for IFRS 3(2008) is mandatory for the year ended 31 December 2010; and
- early adoption is allowed from the year ended 31 December 2008. (i.e. applied in accounting for business combinations occurring after 1 January 2008).



15.1.4 Summary table for various reporting periods

The table below shows the mandatory application date of IFRS 3(2008) and the earliest business combination that could be accounted for under IFRS 3(2008) if the Standard is adopted early.

End of annual reporting period	First mandatory application date in annual reporting periods ending	Date of earliest acquisition date for a business combination to which IFRS 3(2008) could be applied if early adopted
January	31 January 2011	1 February 2008
February	28 February 2011	1 March 2008
March	31 March 2011	1 April 2008
April	30 April 2011	1 May 2008
May	31 May 2011	1 June 2008
June	30 June 2010	1 July 2007
July	31 July 2010	1 August 2007
August	31 August 2010	1 September 2007
September	30 September 2010	1 October 2007
October	31 October 2010	1 November 2007
November	30 November 2010	1 December 2007
December	31 December 2010	1 January 2008

Note: Different dates will apply where an entity changes its annual reporting date during the transitional period.

15.2 IAS 27(2008) – effective date

The effective date for the 2008 amendments to IAS 27 is for annual accounting periods beginning on or after 1 July 2009. [IAS 27(2008).45] This is the same date as IFRS 3(2008). The amendments can also be applied early, but only if IFRS 3(2008) is adopted early, and disclosure of early adoption is made. Because the early adoption of IAS 27(2008) is linked to the adoption of IFRS 3(2008), this effectively limits early adoption of IAS 27(2008) to the beginning of an annual reporting period that begins on or after 30 June 2007.

The requirements of IAS 27(2008) are required to be applied retrospectively with the following exceptions (which are to be applied prospectively):

[IAS 27(2008).45]

- attribution of total comprehensive income to the parent and non-controlling interests even if this results in the non-controlling interests having a deficit balance (the amendment to paragraph 28 of the Standard). Therefore, entities are not permitted to restate the allocation of profit or loss between the parent and the non-controlling interests for reporting periods before the amendment is applied;
- accounting for changes in ownership interests in a subsidiary after control is obtained (requirements of paragraphs 30 and 31 of the Standard – see section 12.3). Therefore, these requirements should not be applied to changes in ownership interests that occurred before the amendments are applied; and
- accounting for loss of control (requirements of paragraphs 34 – 37 of the Standard – see section 12.4). Entities are not permitted to restate the carrying amount of an investment in a former subsidiary, nor to recalculate any gain or loss on the loss of control of a subsidiary, if control was lost before the amendments are applied.

15.3 Transition

15.3.1 General principles

Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of the Standard are not adjusted upon application of IFRS 3(2008). [IFRS 3(2008).65] Similarly, many of the changes introduced in IAS 27(2008) only apply on a prospective basis, and the accounting adopted for transactions that occurred prior to the beginning of the first annual reporting period in which IAS 27(2008) is applied is not adjusted. [IAS 27(2008).45]

The acquisition date in a business combination, combined with the relevant annual reporting period to which IFRS 3(2008) is first applied, determines which version of IFRS 3 to apply when accounting for a particular business combination.

Acquisition date after IFRS 3(2008) is applied Where the acquisition date is on or after the beginning of the annual reporting period during which the IFRS 3(2008) is first applied, then IFRS 3(2008) must be applied in full to the transaction.

Acquisition date before IFRS 3(2008) is applied Where the acquisition date is before the beginning of the annual reporting period during which the IFRS 3(2008) is first applied, IFRS 3(2004) is applied when accounting for the business combination. Therefore:

- the initial accounting for the business combinations is in accordance with IFRS 3(2004);
- the initial accounting for the business combination (e.g. capitalised acquisition costs, initial measurement of non-controlling interests, adjustments to goodwill for the different method of accounting for step acquisitions, and so on) is not restated to reflect the new or revised requirements in IFRS 3(2008) when the revised Standard is adopted;
- contingent consideration adjustments that arise in respect of the business combination are adjusted against the initial accounting for the business combination in accordance with IFRS 3(2004), resulting in an adjustment to goodwill; and
- comparative information is not adjusted.

However, the new requirements in IFRS 3(2008) and IAS 27(2008) are applied to:

- changes in ownership interests in a subsidiary occurring after the beginning of the annual reporting period in which IFRS 3(2008) and IAS 27(2008) are first applied, regardless of whether or not the subsidiary was acquired in a business combination that occurred prior to initial application of IFRS 3(2008) and IAS 27(2008); and
- deferred tax adjustments occurring after the beginning of the annual reporting period in which IFRS 3(2008) and IAS 27(2008) are first applied – see section 15.3.3 below.

Contingent consideration The intent of the Board appears to be that contingent consideration arising on business combinations occurring before IFRS 3(2008) is applied continues to be accounted for under IFRS 3(2004). Consequently, any adjustments continue to be made against goodwill. However, the interaction of this requirement in IFRS 3(2008) and the consequential amendment to IAS 39 is currently the subject of debate. As a consequence of IFRS 3(2008), paragraph 2(f) of IAS 39 is deleted with the effect that contracts for contingent consideration in a business combination are no longer excluded from the scope of IAS 39. The amendment to IAS 39 does not provide any transitional relief for contingent consideration relating to business combinations occurring before the implementation of IFRS 3(2008) with the effect that IAS 39 would apply to such ‘brought forward’ contingent consideration. On the basis that the US version of this requirement provides such transitional relief, it is suggested that the Board’s drafting does not reflect their intent.

15.3.2 Entities previously outside the scope of IFRS 3

Mutual entities and combinations by contract alone were previously outside the scope of IFRS 3. IFRS 3(2008) will apply to those entities prospectively, as described above. For business combinations occurring in earlier periods:

[IFRS 3(2008).B68 – B69]

- classification – earlier business combinations continue to be classified in accordance with the entity's previous accounting policy;
- previously-recognised goodwill – elimination of any amortisation accumulated under the entity's previous accounting policy, but no change to net carrying amount;
- goodwill previously recognised as a deduction from equity – not recognised as an asset. Nor is the goodwill recognised in profit or loss when the business to which it relates is disposed of or when the relevant cash-generating unit is determined to be impaired;
- subsequent accounting for goodwill – discontinue amortisation (if any) and test for impairment; and
- previously-recognised negative goodwill – derecognise any amount carried as a deferred credit and adjust retained earnings.

15.3.3 Deferred tax assets arising in a business combination

Paragraph 68 of IAS 12 *Income Taxes*, which deals with changes in the measurement of deferred tax assets arising in business combinations, has been amended by IFRS 3(2008) (see section 11.3.6). These amendments are to be applied prospectively to the recognition of deferred tax assets acquired in business combinations from the effective date of IFRS 3(2008). [IAS 12.93]

Therefore, following the adoption of IFRS 3(2008), the rules of the revised Standard as regards subsequent recognition or remeasurement of deferred tax assets arising in business combinations apply both to business combinations occurring after the adoption of IFRS 3(2008), and prospectively to the recognition or remeasurement of deferred tax assets acquired in business combinations occurring before the adoption of IFRS 3(2008). Therefore, following the adoption of IFRS 3(2008), irrespective of the date of the original acquisition, the impact of the recognition or remeasurement of such deferred tax assets is recognised in profit or loss unless the benefits are recognised within the measurement period and those adjustments result from new information about facts and circumstances that existed at the acquisition date. [IAS 12.94]

Example 15.3.3A

Deferred tax assets determined provisionally

Company M has an annual reporting period that ends in December. On 15 November 2009, Company M acquires a 100% controlling interest in Company N and the business combination is accounted for in accordance with IFRS 3(2004). At the acquisition date, Company N has certain carry-forward tax benefits. It is not clear that Company N will be able to carry forward those tax benefits following its acquisition – the position requires detailed assessment under the relevant tax law of the jurisdiction in which Company N operates.

Company M engages tax advisors to assess whether the tax benefits will be available to Company N after the acquisition. At 31 December 2009, this assessment has not been completed and, based on preliminary assessment of the application of the relevant laws, a deferred tax asset is not recognised in the initial accounting for the business combination in accordance with IFRS 3(2004). Accounting for the acquired deferred tax benefits is identified as an item determined only provisionally in the 31 December 2009 financial statements.

Company M first applies IFRS 3(2008) in the accounting period ending 31 December 2010. On 30 April 2010, Company M's tax advisers conclude that 50 per cent of Company N's tax benefits can be carried forward. Accordingly, the deferred tax asset arising from 50 per cent of the tax benefits is recognised and an adjustment is made to the goodwill arising in the initial accounting for the business combination (which is sufficient to absorb the adjustment).

In February 2011, when the case comes for final ruling by the taxation authorities, it is determined that all of the tax benefits are available for carry-forward. Under the requirements of IFRS 3(2008), because this adjustment arises after the end of the measurement period, the benefit is not adjusted against goodwill but is recognised in profit or loss. The requirements of IFRS 3(2008 are applied even though the acquisition of Company N was originally accounted for under IFRS 3(2004).

Example 15.3.3B

Favourable change in tax law during the measurement period

Assume the same facts as in example 15.3.3A except that, in making their assessment in April 2010, the tax advisers make reference to a favourable change in the tax law that is substantively enacted in February 2010. Without this change in tax law, the tax benefits could not have been carried forward by Company N.

In this case, the recognition of the deferred tax asset is a direct result of the change in tax law that occurs in February 2010 and, therefore, it does not result from new information about facts and circumstances that existed at the acquisition date. Accordingly, the recognition of the deferred tax asset in April 2010 is recognised in profit or loss, even though it is recognised during the measurement period.

15.3.4 Amendments to IAS 28 and IAS 31

IAS 27(2008) effects consequential amendments to IAS 28 and IAS 31 to introduce accounting requirements for the loss of significant influence over an associate or joint control over a jointly controlled entity (see section 12.5). These requirements are required to be applied to annual reporting periods beginning on after 1 July 2009, or such earlier period to which IFRS 3(2008) and IAS 27(2008) has been applied by the entity.

The amendments to IAS 28 and IAS 31 are not expressed as applying on a prospective or retrospective basis, and do not have transitional provisions equivalent to those under IAS 27 to prohibit the restatement of prior transactions that result in a loss of significant influence or joint control. However, it is suggested that it would be appropriate to apply these changes on a basis that is consistent with the transitional provisions in IAS 27, i.e. only apply the new requirements to transactions occurring after the beginning of the annual reporting period beginning after initial application of IFRS 3(2008) and IAS 27(2008).

15.3.5 Amendments to other IFRSs

IFRS 3(2008) and IAS 27(2008) introduce a number of consequential amendments to various other IFRSs. These amendments are required to be applied to annual reporting periods beginning on after 1 July 2009 or such earlier period to which IFRS 3(2008) and IAS 27(2008) has been applied by the entity. Although not specifically stated, the effect of these amendments is effectively applied on a prospective basis due to their nature.

16. Disclosure

16.1 Business combinations in the current period or after the reporting period

IFRS 3(2008) requires that the acquirer should disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:

[IFRS 3(2008).59]

- during the current reporting period; or
- after the end of the reporting period but before the financial statements are authorised for issue.

Detailed guidance as to the disclosures required to meet the objectives of IFRS 3(2008).59 is set out in Appendix B to the Standard. These requirements are set out below, accompanied by extracts from the Illustrative Examples issued with IFRS 3(2008) which illustrate some (but not all) of the requirements.

If the specific disclosures set out below and those required by other IFRSs do not meet the objectives set out in IFRS 3(2008).59, the acquirer should disclose whatever additional information is necessary to meet those objectives. [IFRS 3(2008).63]

The disclosures are generally required for each business combination that occurs during the reporting period and after the end of the reporting period (see section 16.1.12 below). However, for individually immaterial business combinations occurring during the reporting period that are material collectively, the disclosures may be made in aggregate. [IFRS 3(2008).B65]

For the purposes of the illustrative examples, AC (the acquirer) is assumed to be a listed entity and TC (the acquiree) is an unlisted entity.

16.1.1 Details of the business combination

The acquirer is required to disclose:

[IFRS 3(2008).64(a) – (d)]

- the name and a description of the acquiree;
- the acquisition date;
- the percentage of voting equity interests acquired; and
- the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.

Example 16.1.1

[IFRS 3(2008).IE72]

On 30 June 20X0 AC acquired 15 per cent of the outstanding ordinary shares of TC. On 30 June 20X2 AC acquired 60 per cent of the outstanding ordinary shares of TC and obtained control of TC. TC is a provider of data networking products and services in Canada and Mexico. As a result of the acquisition, AC is expected to be the leading provider of data networking products and services in those markets. It also expects to reduce costs through economies of scale.

16.1.2 Goodwill

The acquirer is required to provide a 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. [IFRS 3(2008).B64(e)]

The acquirer is also required to disclose the total amount of goodwill that is expected to be deductible for tax purposes. [IFRS 3(2008).B64(k)]

Example 16.1.2

[IFRS 3(2008).IE72]

The goodwill of CU2,500 arising from the acquisition consists largely of the synergies and economies of scale expected from combining the operations of AC and TC.

None of the goodwill recognised is expected to be deductible for income tax purposes.

16.1.3 Fair value of consideration and details of contingent consideration

The acquirer is required to disclose the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:

[IFRS 3(2008).B64(f)]

- cash;
- other tangible or intangible assets, including a business or subsidiary of the acquirer;
- liabilities incurred (e.g. a liability for contingent consideration); and
- 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.

For contingent consideration arrangements and indemnification assets, the acquirer is required to disclose:

[IFRS 3(2008).B64(g)]

- the amount recognised as of the acquisition date;
- a description of the arrangement and the basis for determining the amount of the payment; and
- an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer should disclose that fact.

Example 16.1.3

[IFRS 3(2008).IE72]

At 30 June 20X2

Consideration	**CU**
Cash	5,000
Equity instruments (100,000 ordinary shares of AC)	4,000
Contingent consideration arrangement	1,000
Total consideration transferred	10,000

The fair value of the 100,000 ordinary shares issued as part of the consideration paid for TC (CU4,000) was determined on the basis of the closing market price of AC's ordinary shares on the acquisition date.

The contingent consideration arrangement requires AC to pay the former owners of TC 5 per cent of the revenues of XC, an unconsolidated equity investment owned by TC, in excess of CU7,500 for 20X3, up to a maximum amount of CU2,500 (undiscounted). The potential undiscounted amount of all future payments that AC could be required to make under the contingent consideration arrangement is between CU0 and CU2,500.

The fair value of the contingent consideration arrangement of CU1,000 was estimated by applying the income approach. The fair value estimates are based on an assumed discount rate range of 20–25 per cent and assumed probability-adjusted revenues in XC of CU10,000–20,000.

16.1.4 Details of acquired receivables

For acquired receivables, the acquirer is required to disclose:

[IFRS 3(2008).B64(h)]

- the fair value of the receivables;
- the gross contractual amounts receivable; and
- the best estimate at the acquisition date of the contractual cash flows not expected to be collected.

These disclosures are required by major class of receivable, such as loans, direct finance leases and any other class of receivables.

Example 16.1.4

[IFRS 3(2008).IE72]

The fair value of the financial assets acquired includes receivables under finance leases of data networking equipment with a fair value of CU2,375. The gross amount due under the contracts is CU3,100, of which CU450 is expected to be uncollectible.

16.1.5 Details of assets acquired and liabilities assumed

The acquirer is required to disclose the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed. [IFRS 3(2008).B64(i)]

Example 16.1.5

[IFRS 3(2008).IE72]

Recognised amounts of identifiable assets acquired and liabilities assumed	**CU**
Financial assets	3,500
Inventory	1,000
Property, plant and equipment	10,000
Identifiable intangible assets	3,300
Financial liabilities	(4,000)
Contingent liability	(1,000)
Total identifiable net assets	12,800

16.1.6 Details of contingent liabilities recognised

For each contingent liability recognised in accordance with IFRS 3(2008).23 (see section 8.5.1), the acquirer is required to disclose the information required in paragraph 85 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. [IFRS 3(2008).B64(j)]

IAS 37 sets out the general disclosure requirements for provisions recognised under that Standard. The effect of IFRS 3(2008).B64(j) is to require the same disclosures for contingent liabilities recognised in a business combination, as follows:

[IAS 37.85]

- a brief description of the nature of the obligation and the expected timing of any resulting outflow of economic benefits;
- an indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, the acquirer should disclose the major assumptions made concerning future events; and
- the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Example 16.1.6

[IFRS 3(2008).IE72]

A contingent liability of CU1,000 has been recognised for expected warranty claims on products sold by TC during the last three years. We expect that the majority of this expenditure will be incurred in 20X3 and that all will be incurred by the end of 20X4. The potential undiscounted amount of all future payments that AC could be required to make under the warranty arrangements is estimated to be between CU500 and CU1,500.

If a contingent liability is not recognised because its fair value cannot be measured reliably, the acquirer is required to disclose:

[IFRS 3(2008).B64(j)]

- the information required by paragraph 86 of IAS 37; and
- the reasons why the liability cannot be measured reliably.

IAS 37 sets out the general disclosure requirements for contingent liabilities, as follows:

[IAS 37.86]

- a brief description of the nature of the contingent liability; and
- where practicable:
  - an estimate of the financial effect;
  - an indication of the uncertainties relating to the amount or timing of any outflow; and
  - the possibility of any reimbursement.

16.1.7 Details of transactions recognised separately

For transactions that are recognised separately from the acquisition of assets and assumption of liabilities in the business combination in accordance with IFRS 3(2008).51 (see section 9.3 above), the acquirer is required to disclose:

[IFRS 3(2008).B64(l)]

- a description of each transaction;
- how the acquirer accounted for each transaction;
- the amounts recognised for each transaction and the line item in the financial statements in which each amount is recognised; and
- if the transaction is the effective settlement of a pre-existing relationship, the method used to determine the settlement amount.

The disclosure of separately-recognised transactions required by IFRS 3(2008)B64(l) should include the amount of acquisition-related costs and, separately, the amount of those costs recognised as an expense and the line item or items in the statement of comprehensive income in which those expenses are recognised. The amount of any issue costs not recognised as an expense and how they were recognised should also be disclosed. [IFRS 3(2008).B64(m)]

Example 16.1.7

[IFRS 3(2008).IE72]

Acquisition-related costs (included in selling, general and administrative expenses in AC's statement of comprehensive income for the year ended 31 December 20X2) amounted to CU1,250.

16.1.8 Details of bargain purchases

In a bargain purchase (see section 10.3), the acquirer is required to disclose:

[IFRS 3(2008).B64(n)]

- the amount of any gain recognised in accordance with IFRS 3(2008).34 and the line item in the statement of comprehensive income in which the gain is recognised; and
- a description of the reasons why the transaction resulted in a gain.

IFRS 3(2008) does not specify that the amount of the gain recognised must be shown as a separate line item. It could be shown as part of 'other gains and losses'. However, the requirements of IFRS 3(2008).B64(n) ensure that the amount is separately disclosed in the notes.

16.1.9 Details of non-controlling interests

For each business combination in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date, the acquirer is required to disclose:

[IFRS 3(2008).B64(o)]

- the amount of the non-controlling interest in the acquiree recognised at the acquisition date and the measurement basis for that amount; and
- for each non-controlling interest in an acquiree measured at fair value, the valuation techniques and key model inputs used for determining that value.

Example 16.1.9

[IFRS 3(2008).IE72]

The fair value of the non-controlling interest in TC, an unlisted company, was estimated by applying a market approach and an income approach. The fair value estimates are based on:

(a) an assumed discount rate range of 20–25 per cent;

(b) an assumed terminal value based on a range of terminal EBITDA multiples between 3 and 5 times (or, if appropriate, based on long term sustainable growth rates ranging from 3 to 6 per cent);

(c) assumed financial multiples of companies deemed to be similar to TC; and

(d) assumed adjustments because of the lack of control or lack of marketability that market participants would consider when estimating the fair value of the non-controlling interest in TC.

16.1.10 Business combinations achieved in stages

Where a business combination has been achieved in stages, the acquirer is required to disclose:

[IFRS 3(2008).B64(p)]

- the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date; and
- the amount of any gain or loss recognised as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the business combination and the line item in the statement of comprehensive income in which that gain or loss is recognised.

Example 16.1.10

[IFRS 3(2008).IE72]

The fair value of AC's equity interest in TC held before the business combination amounted to CU2,000. AC recognised a gain of CU500 as a result of measuring at fair value its 15 per cent equity interest in TC held before the business combination. The gain is included in other income in AC's statement of comprehensive income for the year ending 31 December 20X2.

16.1.11 Impact of acquiree on amounts reported in the statement of comprehensive income

The acquirer is required to disclose the following information:

[IFRS 3(2008).B64(q)]

- the amounts of revenue and profit or loss of the acquiree since the acquisition date included in the consolidated statement of comprehensive income for the reporting period; and
- the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period.

If disclosure of any of the information required by IFRS 3(2008).B64(q) is impracticable, the acquirer should disclose that fact and explain why the disclosure is impracticable. IFRS 3(2008) uses the term 'impracticable' with the same meaning as in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. [IFRS 3(2008).B64(q)]

Example 16.1.11

[IFRS 3(2008).IE72]

The revenue included in the consolidated statement of comprehensive income since 30 June 20X2 contributed by TC was CU4,090. TC also contributed profit of CU1,710 over the same period. Had TC been consolidated from 1 January 20X2, the consolidated statement of comprehensive income would have included revenue of CU27,670 and profit of CU12,870.

16.1.12 Business combinations after the reporting period

If the acquisition date of a business combination is after the end of the reporting period but before the financial statements are authorised for issue, the disclosures set out in sections 16.1.1 to 16.1.11 are required unless the initial accounting for the business combination is incomplete at the time the financial statements are authorised for issue. [IFRS 3(2008).B66]

In that situation, the acquirer should describe which disclosures could not be made and the reasons why they cannot be made. [IFRS 3(2008).B66]

16.2 Adjustments recognised for business combinations that occurred in the current or previous reporting periods

The acquirer is required to disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the current or previous reporting periods. [IFRS 3(2008).61]

If the specific disclosures set out below and other those required by other IFRSs do not meet the objectives set out in IFRS 3(2008).61, the acquirer should disclose whatever additional information is necessary to meet those objectives. [IFRS 3(2008).63]

The information should be disclosed separately for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively. [IFRS 3(2008).67]

16.2.1 Business combinations for which the initial accounting is incomplete

If the initial accounting for a business combination is incomplete (see section 11.3), and the amounts recognised in the financial statements for the business combination thus have been determined only provisionally, the following information should be disclosed for particular assets, liabilities, non-controlling interests or items of consideration:

[IFRS 3(2008).B67(a)]

- the reasons why the initial accounting for the business combination is incomplete;
- the assets, liabilities, equity interests or items of consideration for which the initial accounting is incomplete; and
- the nature and amount of any measurement period adjustments recognised during the reporting period in accordance with IFRS 3(2008).49 (see section 11.3).

Example 16.2.1

[IFRS 3(2008).IE72]

The fair value of the acquired identifiable intangible assets of CU3,300 is provisional pending receipt of the final valuations for those assets.

16.2.2 Contingent assets and contingent liabilities

For each reporting period after the acquisition date until the entity collects, sells or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires, the acquirer should disclose:

[IFRS 3(2008).B67(b)]

- 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; and
- the valuation techniques and key model inputs used to measure contingent consideration.

For contingent liabilities recognised in a business combination, the acquirer should disclose the information required by IAS 37.84 – 85 for each class of provision. [IFRS 3(2008).B67(c)]

The requirements of IAS 37.85 are set out at section 16.1.6 above. IAS 37.84 requires the following to be disclosed for each class of provision (and, in these circumstances, each class of recognised contingent liability):

- the carrying amount at the beginning and end of the period;
- additional contingent liabilities recognised in the period, included increases to existing contingent liabilities;
- amounts used (i.e. incurred and charged against the contingent liability) during the period;
- unused amounts reversed in the period; and
- the increase during the period in the discounted amount arising from the passage or time and the effect of any change in the discount rate.

16.2.3 Goodwill

The acquirer is required to disclose a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period, showing separately:

[IFRS 3(2008).B67(d)]

- the gross amount and accumulated impairment losses at the beginning of the reporting period;

- additional goodwill recognised during the reporting period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;
- adjustments resulting from the subsequent recognition of deferred tax assets during the reporting period in accordance with IFRS 3(2008).67 (see section 15.3.3) above;
- goodwill included in a disposal group classified as held for sale in accordance with IFRS 5 and goodwill derecognised during the reporting period without having previously been included in a disposal group classified as held for sale;
- impairment losses recognised during the reporting period in accordance with IAS 36. (IAS 36 requires disclosure of information about the recoverable amount and impairment of goodwill in addition to this requirement.);
- net exchange rate differences arising during the reporting period in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*;
- any other changes in the carrying amount during the reporting period; and
- the gross amount and accumulated impairment losses at the end of the reporting period.

16.2.4 Material gains and losses recognised in the period

The acquirer is required to disclose the amount and an explanation of any gain or loss recognised in the current reporting period that both:

[IFRS 3(2008).B67(e)]

- relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period; and
- is of such a size, nature or incidence that disclosure is relevant to understanding the combined entity's financial statements.

16.3 Additional disclosure requirements in IAS 27(2008)

As compared with IAS 27(2003), the following are the additional disclosure requirements in the 2008 version of IAS 27:

[IAS 27(2008).41(e) & (f)]

- the consolidated financial statements should include a schedule that shows the effects on the equity attributable to owners of the parent of any changes in a parent's ownership interest in a subsidiary that do not result in a loss of control; and
- if control of a subsidiary is lost, the parent should disclose the gain or loss, if any, and:
  - the portion of that gain or loss attributable to recognising any investment retained in the former subsidiary at its fair value at the date when control is lost; and
  - the line item(s) in the statement of comprehensive income in which the gain or loss is recognised (if not presented separately in the statement of comprehensive income).

16.4 Disclosure of the impact of adoption of the new Standards and of accounting policies under the Standards

16.4.1 Discussion of revised Standards in advance of adoption

For financial statements issued between January 2008 (date of issue of IFRS 3(2008) and IAS 27(2008)) and the date the entity adopts the revised Standards, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires disclosure of:

[IAS 8.30]

- the fact that the entity has not applied a new IFRS that has been issued but is not yet effective; and
- known or reasonably estimable information relevant to assessing the possible impact that application of the new IFRS will have on the entity's financial statements in the period of initial application.

The entity should consider disclosing:

[IAS 8.31]

- the title of the new IFRS;
- the nature of the impending change or changes in accounting policy;
- the date by which application of the IFRS is required;
- the date at which it plans to apply the IFRS initially; and
- either:
  - a discussion of the impact that initial application of the new IFRS is expected to have on the entity's financial statements; or
  - if that impact is not known or reasonably estimable, a statement to that effect.

Example 16.4.1 illustrates the type of disclosure that may be appropriate (according to the individual circumstances of the entity).

Example 16.4.1

Impact of revised Standards in advance of application

At the date of authorisation of these financial statements, the following Standards and Interpretations (which have not been applied in these financial statements) were in issue but are not effective until annual accounting periods beginning on or after 1 July 2009:

…

IAS 27(2008) *Consolidated and Separate Financial Statements*; and

IFRS 3(2008) *Business Combinations*.

The directors anticipate that they will adopt all of the above Standards and Interpretations in the Group's financial statements for the period commencing 1 January 2009.

Apart from matters of presentation, the principal amendments to IAS 27 that will impact the Group concern the accounting treatment for transactions that result in changes in a parent's interest in a subsidiary. It is likely that these amendments will significantly affect the accounting for such transactions in future accounting periods, but the extent of such impact will depend on the detail of the transactions, which cannot be anticipated. The changes will be adopted prospectively for transactions after the date of adoption of the revised Standard and, therefore, no restatements will be required in respect of transactions prior to the date of adoption.

Similarly, IFRS 3 is concerned with accounting for business combination transactions. The changes to the Standard are significant, but their impact can only be determined once the detail of future business combination transactions is known. The amendments to IFRS 3 will be adopted prospectively for transactions after the date of adoption of the revised Standard and, therefore, no restatements will be required in respect of transactions prior to the date of adoption.

16.4.2 Discussion of impact of revised Standards in the period of adoption

In the year in which IFRS 3(2008) and IAS 27(2008) are first adopted, IAS 8.28 applies. That paragraph requires that when initial application of a Standard has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity should disclose:

[IAS 8.28]

- the title of the Standard;
- when applicable, that the change in accounting policy has been made in accordance with its transitional provisions;
- the nature of the change in accounting policy;
- when applicable, a description of the transitional provisions;

- when applicable, the transitional provisions that might have an effect on future periods;
- for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
  - for each financial statement line item affected; and
  - if IAS 33 *Earnings per Share* applies to the entity, for basic and diluted earnings per share;
- the amount of the adjustment relating to periods before those presented, to the extent practicable; and
- if retrospective application required of the Standard is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

If the Standards are adopted in advance of their effective dates, that fact should be disclosed. [IFRS 3(2008).64 and IAS 27(2008).45]

The following example illustrates how the required disclosures might be made in an accounting period beginning on 1 January 2008. Note that these are intended as an illustration of the type of disclosures that will be required, and they do not illustrate all of the required disclosures in all circumstances.

Example 16.4.2

Impact of revised Standards in year of adoption

The Group has elected to adopt the following Standards in advance of their effective dates:

- IFRS 3 *Business Combinations* (as revised in 2008); and
- IAS 27 *Consolidated and Separate Financial Statements* (as revised in 2008).

The revisions to these Standards have resulted in a number of changes to the Group's accounting policies.

IFRS 3(2008)

In accordance with the transitional provisions of IFRS 3(2008), that Standard has been applied prospectively to business combinations for which the acquisition date is on or after 1 January 2008.

The impact of IFRS 3(2008) *Business Combinations* has been:

- to change the basis of measurement of goodwill recognised in respect of the business combination occurring in the period so that it now reflects the impact of (i) the difference between the fair value of non-controlling interests and their share of the identifiable net assets of the acquiree where the fair value measurement option for non-controlling interests has been adopted, and (ii) the difference between the fair value of previously-held equity interests in the acquiree and their carrying amount;

- to allow a choice on a transaction-by-transaction basis for the measurement of non-controlling interests (previously referred to as 'minority' interests);
- to change the recognition and subsequent accounting requirements for contingent consideration;
- to change the basis for allocating a portion of the purchase consideration in a business combination to replacement share-based payment awards granted at the time of the combination;
- to require that acquisition-related costs be accounted for separately from the business combination, generally leading to those costs being expensed when incurred; and
- for business combinations achieved in stages, to require reclassification from equity to profit or loss at the date of acquisition of amounts related to previously-held interests in the acquiree.

In the current period, these changes in policies have affected the accounting for the acquisition of ABC Limited as follows:

Statement of financial position

	CU'000
Excess of the fair value of the non-controlling interests over their share of the identifiable net assets of ABC Limited	4,000
Liability recognised in respect of the fair value of contingent consideration that would not have been required under the previous version of the Standard	500
Portion of share-based payment awards granted at the time of the business combination allocated to post-combination service	(300)
Acquisition-related costs expensed as incurred	(1,500)
Additional goodwill recognised as a result of the adoption of IFRS 3(2008)	2,700

Statement of comprehensive income

Gain arising on recognition of previously-held interest at fair value	2,000
Reclassification from equity to profit or loss of fair value movements on available-for-sale investments held by ABC Limited that were recognised in other comprehensive income when ABC Limited was accounted for as an associate in previous accounting periods	200
Acquisition-related costs expensed as incurred	(1,500)
Cost of share-based payment awards allocated to post-combination service	(300)
Increase in profit for the period as a result of the adoption of IFRS 3(2008)	400

Increase in basic earnings per share as a result of the adoption of IFRS 3(2008)	23 cents
Increase in diluted earnings per share as a result of the adoption of IFRS 3(2008)	19 cents

The revised Standard has also required additional disclosures in respect of the combination (see note xx).

Results in future periods may be affected by future impairment losses in respect of the increased goodwill, and by potential changes in the liability recognised for contingent consideration.

The revised Standard is also expected to affect the accounting for business combinations in future accounting periods, but the impact will only be determined once the detail of future business combination transactions is known.

IAS 27(2008)

IAS 27(2008) has been adopted for periods beginning on of after 1 January 2008. The revised Standard has been applied prospectively in accordance with the relevant transitional provisions.

The revised Standard has resulted in a change in accounting policy regarding increases or decreases in the Group's ownership interests in its subsidiaries. In prior years, in the absence of specific requirements in IFRSs, increases in interests in existing subsidiaries were treated in the same manner as the acquisition of subsidiaries, with goodwill or a bargain purchase gain being recognised where appropriate. The impact of decreases in interests in existing subsidiaries that did not involve loss of control (being the difference between the consideration received and the carrying amount of the share of net assets disposed of) was recognised in profit or loss. Under IAS 27(2008), these treatments are no longer acceptable. All increases or decreases in such interests are dealt with in equity, with no impact on goodwill or profit or loss.

In respect of the disposal during the period of part of the Group's interest in XYZ Limited, the impact of the change in policy has been that the difference of CU3 million between the consideration received and the transfer between the parent's equity and non-controlling interests has been recognised directly in equity. Had the previous accounting policy been applied, this amount would have been recognised in profit or loss. Therefore, the change in accounting policy has resulted in a decrease in the profit for the period of CU3 million, with a consequential decrease in basic earnings per share of CU1.43 and in diluted earnings per share of CU1.28.

16.4.3 Disclosure of accounting policies

Following the adoption of IFRS 3(2008) and IAS 27(2008), the summary of accounting policies should be amended to reflect the revised accounting policies in respect of business combinations and consolidations. The following examples illustrate the type of disclosures that might be appropriate. Note, however, that the examples do not address all of the aspects of the revised Standards and that where other aspects of the Standards are significant to an entity, they should be addressed in the entity's accounting policies.

Example 16.4.3

Extracts from summary of significant accounting policies

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities (including special purpose entities) controlled by the Company (its subsidiaries) made up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. The interest of non-controlling shareholders may be initially measured either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets. The choice of measurement basis is made on an acquisition-by-acquisition basis. Subsequent to acquisition, non-controlling interests consist of the amount attributed to such interests at initial recognition and the non-controlling interest's share of changes in equity since the date of the combination.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

All intragroup transactions, balances, income and expenses are eliminated on consolidation.

Changes in the Group's interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the Group.

Business combinations

Acquisitions of subsidiaries and businesses are accounted for using the acquisition method.

The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree. Acquisition-related costs are recognised in profit or loss as incurred.

Where appropriate, the cost of acquisition includes any asset or liability resulting from a contingent consideration arrangement, measured at its acquisition-date fair value. Subsequent changes in such fair values are adjusted against the cost of acquisition where they qualify as measurement period adjustments (see below). All other subsequent changes in the fair value of contingent consideration classified as an asset or liability are accounting for in accordance with relevant IFRSs. Changes in the fair value of contingent consideration classified as equity are not recognised.

The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3(2008) are recognised at their fair value at the acquisition date, except that:

- deferred tax assets or liabilities and liabilities or assets related to employee benefit arrangements are recognised and measured in accordance with IAS 12 *Income Taxes* and IAS 19 *Employee Benefits* respectively; and
- liabilities or equity instruments related to the replacement by the Group of an acquiree's share-based payment awards are measured in accordance with IFRS 2 *Share-based Payment*; and
- assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* are measured in accordance with that Standard.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (see below), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the amounts recognised as of that date.

The measurement period is the period from the date of acquisition to the date the Group receives complete information about facts and circumstances that existed as of the acquisition date – and is subject to a maximum of one year.

Where a business combination is achieved in stages, the Group's previously-held interests in the acquired entity are remeasured to fair value at the acquisition date (i.e. the date the Group attains control) and the resulting gain or loss, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognised in other comprehensive income are reclassified to profit or loss, where such treatment would be appropriate if that interest were disposed of.

Goodwill

Goodwill arising on the acquisition of a subsidiary is recognised as an asset at the date that control is acquired (the acquisition date). Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously-held equity interest (if any) in the entity over the net fair value of the identifiable net assets recognised.

If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously-held equity interest (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Goodwill is not amortised, but is reviewed for impairment at least annually. Any impairment loss is recognised immediately in profit or loss and is not subsequently reversed.

On disposal of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Appendix 1

Comparison of IFRS 3(2008) and IFRS 3(2004)

Business combinations

Item	IFRS 3(2008)	IFRS 3(2004)
Scope of the Standard		
Mutual entities and business combinations achieved by contract alone	The revised Standard applies to these types of transactions.	Previously, IFRS 3 did not apply to these types of transactions.
Definitions and terminology		
Business combination	'…is a transaction or other event in which an acquirer obtains control of one or more businesses.'	The revised IFRS 3 places more emphasis on control over another business.
Business	'…is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return…'	A set of integrated activities and assets that has not commenced planned principal operation was not treated as a business.
Contingent consideration	• Initially recognised as part of the consideration transferred. • Non-occurrence of a future event (e.g. not meeting earnings target) is not considered to be a measurement period adjustment – therefore not adjusted against goodwill. • Subsequent accounting depends on whether the contingent consideration is initially recognised as equity or as a liability and whether the event is considered a measurement period adjustment. • Disclosure requirements.	• Initially recognised in the cost of the combination only if it meets probability and 'reliably measurable' criteria. • If future event does not occur, then any adjustments to the cost of the business combination are made against goodwill. • Subsequent adjustments to contingent consideration are made against goodwill, except in the case of equity instruments, in which case the adjustment is made against equity. • No disclosure requirements regarding contingent consideration.

Item	IFRS 3(2008)	IFRS 3(2004)
Consideration transferred		
Share-based payment awards	Provides guidance to assist in determining the portion of a replacement award that is part of the consideration transferred for the entity acquired.	No specific guidance.
Costs incurred in a business combination		
Acquisition costs	Costs to effect a business combination are, generally, expensed as incurred.	Costs to effect a business combination are included in the cost of acquisition and therefore impact goodwill.
Recognising and measuring assets acquired and liabilities assumed on initial recognition		
Valuation allowances/ provisions	Prohibits separate valuation allowance at acquisition date for assets measured at fair value but whose future cash flows are uncertain (e.g. doubtful receivables).	No specific guidance.
Assets the acquirer intends to dispose of or use in a different way from other market participants	Requires the acquirer to measure the asset at a 'neutral' fair value.	No specific guidance.
Exceptions to recognition or measurement principles, or both, on initial recognition		
Assets held for sale	Requires measurement in accordance with IFRS 5 *Non-current assets Held for Sale and Discontinued Operations*.	Requires such assets to be measured at fair value less costs to sell.
Contingent liabilities	Requires recognition of 'liabilities' that meet the definition of a liability in the Framework, and only where there is a present obligation that arises from past events and its fair value can be measured reliably.	Requires recognition of possible obligations if their fair value can be measured reliably.

Item	IFRS 3(2008)	IFRS 3(2004)
Employee benefits	Requires recognition and measurement in accordance with IAS 19 *Employee Benefits.*	Limited guidance in Appendix B.
Income taxes	Requires recognition and measurement in accordance with IAS 12 *Income Taxes*.	Limited guidance in Appendix B.
Indemnification assets	Requires recognition and measurement in accordance with other IFRSs.	No specific guidance.
Reacquired rights	Requires measurement based on the remaining term of the related contract.	No specific guidance.
Share-based payment awards	Requires measurement in accordance with IFRS 2 *Share-based Payment*.	No specific guidance.
Acquisition method (referred to as the 'purchase' method in IFRS 3(2004))		
Measuring goodwill/ bargain purchase gain	Difference between: (i) the consideration transferred at acquisition date, plus the amount of any non-controlling interests, plus acquisition-date fair value of any previously-held equity interest in entity acquired; and (ii) the net of acquisition-date fair values of identifiable assets acquired and liabilities assumed. If: (i) > (ii) = difference is goodwill; (i) < (ii) = bargain purchase gain, recognised in profit or loss.	Does not require: (i) measurement of any amount of non-controlling interests in calculating goodwill/ bargain purchase gain; (ii) remeasurement to fair value of any previously-held equity interest in the entity acquired; and (iii) the acquisition date amount of net assets acquired. Instead it considers the portion of the net identifiable assets attributable to the acquirer.

Item	IFRS 3(2008)	IFRS 3(2004)
Non-controlling interests in the acquiree (referred to as 'minority' interests in IFRS 3(2004))	Non-controlling interests are required to be measured when determining the goodwill/ bargain purchase gain. Non-controlling interests can be measured using either: (i) fair value of non-controlling interests; or (ii) proportionate interest in the fair value of net identifiable assets of the entity acquired.	Minority interests are stated at the minority's portion of the fair value of the net assets acquired and (contingent) liabilities assumed.
Business combinations achieved in stages (step acquisitions)	At the date of obtaining control (the acquisiton date), the acquirer remeasures any previously-held equity interest to fair value. Any previous revaluations to equity are treated as if the acquirer had disposed of its previously-held interest.	Each transaction is treated separately by the acquirer. The cost and fair value information at the date of each acquisition is used to determine the related goodwill or bargain purchase gain.

Comparison of IAS 27(2008) and IAS 27(2003)

Consolidated and separate financial statements

Item	IAS 27(2008)	IAS 27(2003)
Increases or decreases in a parent's ownership interest that do not result in a loss of control	Accounted for as equity transactions of the consolidated entity.	Silent on appropriate accounting treatment.
Attribution of subsidiary's losses to non-controlling interests	Losses are allocated to non-controlling interests even if they exceed the non-controlling interest's share of equity in the subsidiary.	Excess losses are allocated to the parent, unless the minority interest has a binding obligation to make good the losses.
Loss of control of a subsidiary	Any retained non-controlling investment at the date control is lost is remeasured to fair value.	The carrying amount at the date the entity ceases to control the subsidiary is regarded as cost for the purposes of subsequent accounting.

Appendix 2

Continuing differences between IFRSs and US GAAP

Following the issue of IFRS 3(2008) and IAS 27(2008) by the IASB, and SFAS 141R *Business Combinations* and SFAS 160 *Noncontrolling Interests in Consolidated Financial Statements* by the FASB, IFRSs and US GAAP are substantially converged in their treatment of business combinations and changes in ownership interests. However, some important differences remain, largely due to differences in related standards that were not addressed by this project, the most significant of which are summarised below.

Issue	Summary of differences
Scope	The IASB and the FASB have different definitions of control. The IASB's definition of control is 'the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities'. The FASB's definition is based on a 'controlling financial interest', which is generally interpreted as an absolute majority of the voting interests. 'Control' is currently the subject of a joint FASB/IASB project.
The definition of fair value	The IASB and the FASB use definitions of 'fair value' from existing Standards. The FASB definition is that in SFAS 157 *Fair Value Measurement* and the IASB uses a definition that is also used in IAS 39 *Financial Instruments: Recognition and Measurement*. The IASB has a continuing project on measurement.
Contingencies	IFRS 3(2008) requires recognition of a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. SFAS 141R requires a contractual liability to be recognised if it is a present obligation without the 'reliably measurable' filter. Non-contractual liabilities must be assessed as to whether it is more likely than not that the contingency gives rise to an asset or liability as defined in FASB Concept Statement 6. If the contingency meets the recognition threshold at acquisition date, it is recognised at its acquisition-date fair value.
Employee benefits	The standards each require liabilities and assets related to the acquired entity's employee benefit arrangements to be recognised and measured in accordance with the appropriate IFRS or US GAAP requirement. As these requirements are different, the amounts recognised will also be different.

Issue	Summary of differences
Measuring non-controlling interests	SFAS 141R requires non-controlling interests to be measured at fair value. IFRS 3(2008) allows a transaction-by-transaction choice for measuring non-controlling interests at either fair value or the proportionate interest in net assets.
Income taxes	The standards each require deferred taxes arising from the assets acquired and liabilities assumed in a business combination to be measured in accordance with IAS 12 *Income Taxes* or SFAS 109 *Accounting for Income Taxes*. These standards can produce different outcomes. In addition, SFAS 141R requires income tax uncertainties of the acquiree to be measured in accordance with FIN 48 *Accounting for Uncertainty in Income Taxes*. There is no equivalent pronouncement under IFRSs.
Loss of joint control or significant influence	IAS 27 effects consequential amendments to IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures* that require a remeasurement to fair value of any retained interest on a loss of significant influence or joint control. The FASB decided that accounting for investments that no longer qualify for equity-method accounting under APB 18 *The Equity Method of Accounting for Investments in Common Stock* was outside the scope of phase II of its business combinations project and decided not to make equivalent adjustments to US GAAP.

Deloitte IFRS resources

In addition to this publication, Deloitte Touche Tohmatsu has a range of tools and publications to assist in implementing and reporting under IFRSs. These include:

www.iasplus.com	Updated daily, iasplus.com is your one-stop shop for information related to IFRSs.
Deloitte's IFRS e-Learning modules	e-Learning IFRS training materials, available without charge at **www.iasplus.com**
IAS Plus newsletter	Quarterly newsletter on recent developments in IFRSs with special editions are issued for important developments. To subscribe, visit **www.iasplus.com**
iGAAP 2007: A guide to IFRS reporting	A comprehensive guide to the requirements of IFRSs.
IFRSs in your Pocket	Published in several languages, this pocket-sized guide includes summaries of all IASB Standards and Interpretations, updates on agenda projects, and other IASB-related information.
IFRSs and US GAAP: A pocket comparison	A summary of the principal differences in pocket-sized format, including a status report as to what is being done about each difference.
Presentation and disclosure checklist	Checklist incorporating all of the presentation and disclosure requirements of IFRSs.
Model financial statements	Model financial statements illustrating the presentation and disclosure requirements of IFRSs.
iGAAP 2008 Financial instruments: IAS 32, IAS 39 and IFRS 7 explained	4th edition (May 2008). Guidance on how to apply these complex Standards, including illustrative examples and interpretations.
First-time adoption: A guide to IFRS 1	Application guidance for the "stable platform" Standards effective in 2005.
Share-based payments: A guide to IFRS 2	Guidance on applying IFRS 2 to many common share-based payment transactions.
Assets held for sale and discontinued operations: A guide to IFRS 5	Detailed summaries and explanations of the requirements of the Standard, including examples of application and discussion of evolving literature.
Interim financial reporting: A guide to IAS 34	3rd edition (June 2007). Guidance on applying the interim reporting Standard, including a model interim financial report and an IAS 34 compliance checklist.

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