IFRS 3
Business combinations

1. Objective

IFRS 3 outlines the principles and the requirements relating to accounting for business combinations, and in particular how an entity:

- recognizes and measures in its financial statements, the identifiable assets acquired, and liabilities assumed, in the acquiree;
- recognizes and measures the difference between the cost of investment in the acquirer, and the net amount of the assets acquired and liabilities assumed (this difference is regarded as either the purchased goodwill acquired or the gain from a bargain purchase);
- discloses information in the notes to the financial statements.

This Standard does not apply to transactions involving joint ventures or the combination of entities or businesses under common control or the investments entities defined by IFRS 10 "consolidated financial statements".

2. Scope

2.1 Identifying a business combination

A business combination exists when the acquirer **obtains control** of one or more entities (targets) which constitute business assets or businesses.

The business combination can take several forms:

- the purchase of equity shares;
- the purchase of all or part of the assets and/or liabilities that, together, constitute one or several businesses;
- the issue of financial instruments as part of the purchase consideration;
- the transfer of other types of consideration;
- by execution by contract alone (particularly relevant for special purpose entities).

In most cases, business combinations give rise to the creation of a new entity and a parent company-subsidiary relationship.

2.2 Accounting method

All business combinations within the scope of IFRS 3 must be accounted for by applying the **acquisition method**. This method involves **four main steps**:

- identifying the acquirer;
- determining the date of acquisition;
- recognizing and measuring the identifiable assets acquired, liabilities assumed, and the non-controlling (minority) interests in the acquired business;
- recognizing and measuring goodwill or the gain profit resulting from a bargain purchase.

3. Accounting impact

3.1 Identifying the acquirer

The acquirer is the entity that obtains **control of another entity** (the acquire). The acquirer of an entity is presumed to be the entity which obtains over half of the voting rights of the acquire. However, other criteria may also be used to determine the identity of the acquirer, including:

- power over half of the voting rights, by virtue of an arrangement with other investors;
- the power to govern the financial and operating policies of the entity;
- the power to appoint or dismiss the majority of the members of the governing body (board of directors);
- the power to control the majority of the voting rights during meetings of the governing body (board of directors).

3.2 Determining the acquisition date

The acquisition date corresponds to the date on which the acquirer obtains **control** of the acquiree.

Example 1: On 25 March N, company X acquired 45% of the share capital of company Z. The remainder of the capital is held by two shareholders (A and B), who each hold a 15% stake in the capital, and by a multitude of small shareholders. The share purchase agreement provides for the seller, Mr. Power, to retain his right of veto until 15 May N+3, the date when his son is contracted to leave company Z. On 30 September N+1, Mr. A sells his shares in company Z to company X. What is company Z's acquisition date according to IFRS 3?

With 45% of the voting rights, company X has the majority of votes on 25 March N. Nonetheless, X does not have the ability to control company Z since its former owner, Mr. Power, retains a right of veto until 15 May N+3. Acquiring an additional 15% of the share capital of company Z on 30 September N+1 does not have any impact on the power exerted by company X. The effective acquisition date is therefore 15 May N+3, i.e., the date when Mr. Power's right of veto lapses.

3.3 Recognizing and measuring the identifiable components of the transaction

On acquisition date, the acquirer must recognize, **separately**:

- goodwill;
- the identifiable assets acquired and liabilities assumed;
- non-controlling (minority) interests.

The assets and liabilities recognized in the transaction must **meet the definition of assets and liabilities** in the Conceptual Framework, but also **be part of what is exchanged** between the acquirer and the acquiree. Certain assets that did not initially appear in the separate books of the acquiree because they were developed internally, are recognized on acquisition providing they are **identifiable assets** (for example, brand names, patents, customer relationships). In addition to actual liabilities assumed, a contingent liability assumed in a business combination should be recognized if it is a present obligation arising from past events, and its fair value can be measured reliably.
Assets acquired and liabilities assumed should be **classified** and **designated by the acquirer**, on the basis of **relevant criteria** specific to each entity, including for example: contractual terms, economic conditions, the entity's accounting and financial policies.
The above do not apply to classification of insurance contracts and lease contracts, which should be classified on the basis of the contractual terms and other factors.
The assets acquired and liabilities assumed are **measured at fair value** determined as at acquisition date, in accordance with IFRS 13, apart from a **limited number of exceptions**: contingent liabilities, income taxes, employee benefits, indemnification assets, reacquired rights, share-based payment transactions and assets held for sale.

The components of **non-controlling (minority) interests** are measured as follows:

- Components that represent current ownership rights and which entitle their holders to a proportionate share of the net assets of the acquired entity: either at the fair value of the interest, or at the proportionate share of the identifiable net assets of the acquired entity measured at fair value;
- For other components of minority interests, fair value at acquisition date.

3.4 Recognizing and measuring goodwill or a gain resulting from a bargain purchase

At the end of the reporting period in which the business combination took place, goodwill is calculated as follows:

+ The purchase consideration transferred
+ Non-controlling (minority) interests
+ the fair value (measured at acquisition date) of the proportionate share of any interest previously held by the acquirer
-/+ the net amount of the identifiable assets acquired and liabilities assumed

Example 2: What are the components of the purchase price of the acquired entity?

Liquid assets acquired	YES
Other assets acquired	YES
Equity instruments issued	YES
Subsequent adjustments to purchase consideration	YES
Liabilities assumed	YES
Potential assets	NO

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Example 3: Company W acquires all of the shares in company X at a cost of 15,000 including acquisition expenses. At the date of the transaction, company X's financial position is summarized as follows:

Non-current assets	1,500	Equity	4,000
Other tangible assets	2,000	Long-term debts	500
Inventories	1,000	Accounts payable	2,000
Accounts receivable	2,500	Employee-related liabilities	800
Other current assets	500	Other liabilities	200
TOTAL	7,500		7,500

An audit showed that the value of company X had included the following items for company W: the non-current assets with an unrealized and unrecorded gain of 3,000 and unrecorded employee-related liabilities in the amount of 300.

In its consolidated financial statements, company W must report the acquisition of company X at the fair value of the acquired assets and liabilities assumed, namely:

Fair value of the long-term assets adjusted for the unrealized gain	4,500
Other tangible assets	2,000
Inventories	1,000
Accounts receivable	2,500
Other current assets	500
Total value of the assets	10,500
Long-term debts	500
Accounts payable	2,000
Employee-related liabilities, including unrealized obligations	1,100
Other liabilities	200
Total liabilities assumed	3,800
The fair value of the assets and liabilities of company X would therefore amount to	6,700

The difference between the purchase consideration and the fair value of the assets acquired and liabilities assumed of the acquired company therefore equals: 15,000 – 6,700 = 8,300.

This amount corresponds to the excess value over that of net identifiable assets acquired that company W paid in order to take control of company X. This is purchased goodwill which should be classified under non-amortisable intangible assets. The purchased goodwill must at least annually undergo an impairment test.

Where the above calculation results initially in a **negative difference**, the calculations should be reviewed and verified for completeness, particularly with regard to the measurement of the components acquired or assumed. Following this, the resulting gain (referred to as a "bargain purchase") should be **recognized in the profit or loss of the acquirer.**

Example 4: Company Y purchased a 50% stake in the share capital of company Z, which in the particular circumstances gave control, for a cost of 2,600. Z's equity at the date of the transaction was 8,000, and required a provision of 400 in respect of a receivable. For the parties to the transaction, the discounted price is justified by the expenditure which will need to be undertaken to re-establish company Z's profitability.

The difference between the price paid	2,600
and the share of interest acquired in the fair value	
of company Z's assets less liabilities [(8,000 – 400) × 50%]	3,800
The bargain purchase amounting to	1,200
must be recorded in full in the profit of the current reporting period during which the transaction occurred.	

The initial accounting for the acquisition may be subsequently modified according following further information relating to items for which the accounting was incomplete and where provisional amounts were used to determine goodwill:

- Within twelve months of the acquisition date: the provisionally determined amounts may be revised, with a corresponding adjustment to the goodwill figure;
- After more than twelve months from the acquisition date: any adjustment will impact on profit or loss (except in the event that an error is corrected).

The goodwill is tested for impairment in accordance with IAS 36.

4. Disclosure

In general terms, an acquirer must provide information which will enable the users of the financial statements to assess the nature and the financial effect of the business combinations occurring during the reporting period or after the end of the period. Information to be disclosed includes:

- the names of the entities or activities being acquired;
- their description;
- the acquisition date;
- the percentage of voting equity acquired;
- the cost of the business combination and its main components;
- information related to goodwill.