IFRS 3 BUSINESS COMBINATIONS

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Scope

Objectives: IFRS 3 improve the relevance, reliability comparability of information about a business combination and its effects

Scope

IFRS 3 applies to all entities entering business combinations except

- Entities accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself. (Transaction dealt by IFRS 11)
- Acquisition of asset or group of assets of an entity that do not qualify the definition of business.
- A combination of entities or businesses under common control

Definitions

Business:
Integrated set of inputs and processes that creates or has ability to generate revenue

Business Combination:
Transaction or event in which acquirer obtains control over a business by way of Acquiring shares, net assets, reverse merger etc.

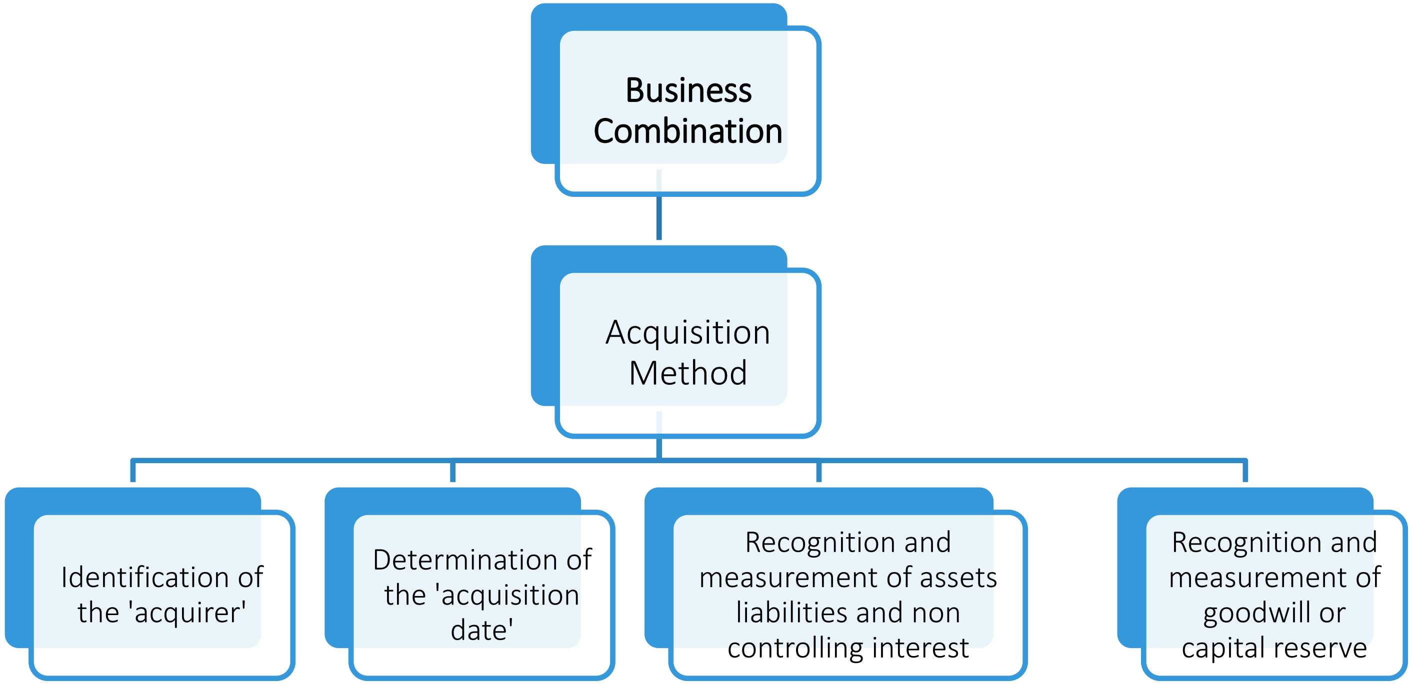
Acquisition date
The date on which the Acquirer obtains control of the Acquiree

Acquirer
The entity that obtains control of the Acquiree

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

Determining whether a transaction is a business combination

- Business combination can be done in many ways such as in cash, in equity shares or by issuing no consideration at all (i.e. by way of contract of arrangement)
- Business combinations can be structured in various ways to satisfy legal, taxation or other objectives, including one entity becoming a subsidiary of another, the transfer of net assets from one entity to another or to a new entity
- The business combination must involve the acquisition of a business, which generally has three elements:
  - Inputs – an economic resource (e.g. non-current assets, intellectual property) that creates an ability to generate revenue
  - Process – a system, standard, protocol, convention or rule that when applied to an input or inputs, creates outputs (Workforce that are directly related to the Activities of business, Administration staff not included)
  - Output – the result of inputs and processes applied to those inputs also it includes dividend and other economic benefits for investor member or financers)



Step 1: Identifying an Acquirer

IFRS 10 states that the entity that obtains control of the Acquire is an Acquirer
IFRS 3 provides additional guidance which is then considered:
The Acquirer is usually the entity that transfers cash or other assets like equity instruments in the transaction of business combination
However the entity also considers other pertinent facts and circumstances including

- relative voting rights in the combined entity after the business combination
- the existence of any large minority interest if no other owner or group of owners has a significant voting interest
- the composition of the governing body and senior management of the combined entity the terms on which equity interests are exchanged
- The Acquirer is usually the entity with the largest relative size (assets, revenues or profit)

STEP 4: RECOGNITION AND MEASUREMENT OF GOODWILL OR A BARGAIN PURCHASE

Goodwill = Consideration transferred + Amount of non-controlling interests + Fair value of previous equity interests − Net assets recognised

Goodwill
If the difference above is negative, the resulting gain is a bargain purchase and transferred to profit or loss
Goodwill can be grossed up to include the amounts attributable to NCI that is the case when NCI is measured at their Acquisition date fair value.
Contingent consideration is either classified as a liability or an equity instrument (IFRS 32)
Contingent consideration that is if as per IFRS 9 - classified as a financial liability needs to be remeasured at fair value at the reporting date with changes reported in profit or loss.
The Acquirer should consider if the consideration includes amounts attributable to other transactions within the contract (pre-existing relationship, arrangements that remunerate employees etc.)

Step 2 : Acquisition date

The date at which the acquirer obtains control over the acquiree. This may be the date earlier or later than closing date.

Step 3: Recognition and Measurement of assets, liabilities and non-controlling interests (NCI)

Recognition:
Identifiable assets Acquired, liabilities assumed, and non-controlling interests in the Acquiree, are recognised separately from goodwill
Measurement:
All assets Acquired and liabilities assumed in a business combination are measured at Acquisition-date fair value.
<u>Exceptions to recognition and measurement</u>
Some exceptions to the recognition and/or measurement principles which cover contingent liabilities, income taxes, employee benefits, indemnification assets, required rights, share-based payments and assets held for sale.

Related transactions and subsequent Accounting

General principles

transactions that are not part of what the Acquirer and Acquiree exchanged in the business combination are identified and Accounted for separately from business combination

the recognition and measurement of assets and liabilities arising in a business combination after the initial Accounting for the business combination is dealt with under other relevant standards

For determining whether a particular item is part of the exchange or whether it is separate from the business combination, an Acquirer considers the reason for the transaction, who initiated the transaction and the timing of the transaction.

Indemnification assets

Indemnification assets recognised at the Acquisition date (under the exceptions to the general recognition and measurement principles noted above) are subsequently measured on the same basis of the indemnified liability or asset, subject to contractual impacts and collectability. Indemnification assets are only derecognized when collected, sold or when rights to it are lost.

Disclosure

- Name and a description of the Acquiree
- Acquisition date
- percentage of voting equity interests Acquired
- primary reasons for the business combination and a description of how the Acquirer obtained control of the Acquiree
- description of the factors that make up the goodwill recognised
- qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations, intangible assets that do not qualify for separate recognition
- Acquisition-date fair value of the total consideration transferred and the Acquisition-date fair value of the major class of consideration
- details of contingent consideration arrangements and indemnification assets
- details of Acquired receivables
- the amounts recognised as of the Acquisition date for the major class of assets Acquired and liabilities assumed
- details of contingent liabilities recognised
- total amount of goodwill that is expected to be deductible for tax purposes
- details about any transactions that are recognised separately from the Acquisition of assets and assumption of liabilities in the business combination
- information about a bargain purchase
- information about the measurement of non-controlling interests
- details about a business combination Achieved in stages
- information about the Acquiree's revenue and profit or loss
- information about a business combination whose Acquisition date is after the end of the reporting period but before the financial statements are authorized for issue

Disclosure

An Acquirer is required to disclose information that enables users of its financial statements to evaluate the financial effects of adjustments

Among the disclosures required to meet the foregoing objective are the following:

details when the initial Accounting for a business combination is incomplete for particular assets, liabilities, non-controlling interests or items of consideration (and the amounts recognised in the financial statements for the business combination thus have been determined only provisionally)

follow-up information on contingent consideration

follow-up information about contingent liabilities recognised in a business combination

a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period, with various details shown separately

the amount and an explanation of any gain or loss recognised in the current reporting period that both:

- 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

Illustrative disclosure

On 1 June 20X9 A Acquired 15 per cent of the outstanding ordinary shares of ABC. On 30 June 2012 A Acquired 60 per cent of the outstanding ordinary shares of ABC and obtained control. ABC is a provider of data networking products and services in USA and UAE. As a result of the Acquisition, A 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.

The goodwill of AED 2,500 arising from the Acquisition consists largely of the synergies and economies of scale expected from combining the operations of A and ABC.

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

The following table summarizes the consideration paid for ABC and the amounts of the assets Acquired and liabilities assumed recognised at the Acquisition date, as well as the fair value at the Acquisition date of the non-controlling interest in ABC.

At 30 June 20X2

Consideration	**AED**	
Cash		5,000
Equity instruments (100,000 ordinary shares of A)		4,000
Contingent consideration arrangement		1,000
Total consideration transferred		10,000
Fair value of A's equity interest in ABC held before the business combination		2,000
12,000		

A acquisition-related costs (included in selling, general and administrative expenses in A's statement of comprehensive income for the year ended 31 December 20X9)
1,250

Recognised amounts of identifiable assets Acquired and liabilities assumed	
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
Non-controlling interest in ABC	(3,300)
Goodwill	2,500
	12,000