



# Alerte de votre conseiller – IFRS

## Aperçu d'IFRS 3 – coup d'œil sur la méthode de l'acquisition

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### Résumé

L'équipe IFRS de Grant Thornton International a publié le document *Insights into IFRS 3 – The acquisition method at a glance* (en anglais seulement).

### Aperçu

Les fusions et acquisitions (regroupements d'entreprises) peuvent avoir une incidence fondamentale sur les activités, les ressources et les stratégies de l'acquéreur. Pour la plupart des entités, ces transactions sont rares et chacune d'entre elles est unique. La norme IFRS 3 *Regroupements d'entreprises* présente les exigences relatives à ces transactions, exigences qui sont difficiles à appliquer. La norme même est en place depuis plus de dix ans maintenant et a fait l'objet d'un examen post-mise en œuvre par l'IASB. Il s'agit d'une des normes les plus souvent citées parmi les normes en vigueur à l'heure actuelle.

La série *Insights into IFRS 3* résume les domaines clés de la norme en soulignant les aspects les plus difficiles à interpréter et en examinant les caractéristiques les plus pertinentes et susceptibles d'avoir des répercussions sur votre entreprise.

La publication *Insights into IFRS 3 – The acquisition method at a glance* fournit un aperçu général d'IFRS 3 et explique les étapes clés de la comptabilisation d'un regroupement d'entreprises conformément à cette norme. Elle met également en évidence certaines difficultés d'ordre pratique posées par l'application de la norme, notamment sur les sujets suivants :

- Les modalités de l'entente et leurs répercussions possibles sur la comptabilisation d'un regroupement d'entreprises;
- La manière d'éviter des répercussions comptables non voulues lors du regroupement de deux entreprises.

### Ressource

La publication *Insights into IFRS 3 - The acquisition method at a glance* est jointe au présent bulletin *Alerte de votre conseiller – IFRS*.



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# Insights into IFRS 3

## The acquisition method at a glance

Mergers and acquisitions (business combinations) can have a fundamental impact on the acquirer's operations, resources and strategies. For most entities such transactions are infrequent, and each is unique. IFRS 3 'Business Combinations' contains the requirements for these transactions, which are challenging in practice. The Standard itself has been in place for more than ten years now and has undergone a post implementation review by the IASB. It is one of the most referred to Standards currently issued.

Our 'Insights into IFRS 3' series summarises the key areas of the Standard, highlighting aspects that are more difficult to interpret and revisiting the most relevant features that could impact your business.

This article provides a high-level overview of IFRS 3 and explains the key steps in accounting for business combinations in accordance with this Standard. It also highlights some practical application issues dealing with:

- deal terms and what effect they can have on accounting for business combinations and
- how to avoid unintended accounting consequences when bringing two businesses together.



## The acquisition method

IFRS 3 establishes the accounting and reporting requirements (known as 'the acquisition method') for the acquirer in a business combination. The key steps in applying the acquisition method are summarised below:

<b>Step 1</b>	<b>Identifying a business combination</b>	<p>Most traditional acquisitions, such as the purchase of a controlling interest in an unrelated operating entity, are business combinations within the scope of IFRS 3. However, many transactions or other events involving the purchase of another entity or groups of assets require further analysis to determine whether:</p> <ul style="list-style-type: none"><li>• what was acquired constitutes a business</li><li>• control as defined by IFRS 10 has been obtained</li><li>• the combination is within the scope of IFRS 3.</li></ul>
<b>Step 2</b>	<b>Identifying the acquirer</b>	<p>The party identified as the accounting acquirer will most often be the legal owner (the accounting acquirer is usually the entity that transfers the consideration ie cash or other assets). However, IFRS 3 requires an in-substance approach to identify the party that obtained control (ie the acquirer). This approach looks beyond the legal form of the transaction and considers the rights of the combining entities and their former owners.</p>
<b>Step 3</b>	<b>Determining the acquisition date</b>	<p>The acquisition date is the date the acquirer obtains control of the acquiree, usually the specified closing or completion date of the business combination.</p>
<b>Step 4</b>	<b>Recognising and measuring identifiable assets acquired and liabilities assumed</b>	<p>This is typically the most complex and time-consuming step which requires the acquirer to:</p> <ul style="list-style-type: none"><li>• recognise identifiable assets acquired and liabilities assumed at the acquisition date, including some intangible assets that may not have been previously recognised in the acquiree's financial statements</li><li>• measure identifiable assets acquired and liabilities assumed at fair value, with a few exceptions</li><li>• determine the applicability of some specific recognition and measurement provisions</li><li>• classify or designate the assets acquired and liabilities assumed.</li></ul>

**Step 5****Recognising and measuring any non-controlling interest (NCI)**

The acquirer has a choice to measure present ownership-type NCI at either fair value or the proportionate interest in the acquiree's recognised identifiable net assets. When making the choice, a number of factors should be considered. Decisions made at the time of the business combination cannot be revisited. The measurement of NCI affects the amount of goodwill that can be recognised and it can also impact post-combination reported results.

**Step 6****Determining the consideration transferred**

Consideration transferred can include cash and other assets transferred, liabilities incurred and equity interests issued by the acquirer. Some consideration may be deferred or be contingent on future events. In addition, consideration transferred in exchange for the acquired business may be different from the contractual purchase price if the overall transaction includes elements that are not part of the business combination exchange. For example, the following must be accounted for separately from the business combination:

- acquisition-related costs, including:
  - reimbursement of those incurred by the acquiree or the former owners
  - those paid directly to third parties
- the effective settlement of a pre-existing relationship between the acquirer and acquiree.

**Step 7****Recognising and measuring goodwill or a gain from a bargain purchase**

Goodwill or gain from a bargain purchase is measured as a residual amount.

## Effect of deal terms on the accounting for business combinations

The terms and structures of sales and purchase agreements vary extensively, and they will determine how a business combination should be accounted for. It is important that management is aware of the financial reporting consequences of putting in place certain terms and conditions into sale and purchase agreements. The following table summarises some common deal terms and their related effects on the financial reporting for business combinations.

Deal terms or structure	Financial reporting effects
<p><b>Structure of the purchase price</b></p>	<p>The purchase price may include contingent consideration arrangements, such as variations to the ultimate price depending on the future performance of the acquired business.</p> <ul style="list-style-type: none"> <li>• recognition of the contingent consideration on the acquisition date at fair value has an immediate effect on the statement of financial position (ie directly impacts goodwill and reported amounts of liability or equity depending on the nature of the contingent consideration to be transferred)</li> <li>• subsequent changes in the fair value of any contingent consideration liability will usually affect post-combination earnings of the group. Whereas contingent consideration initially recognised as equity will not impact the post-acquisition performance of the group.</li> </ul> <p>It also could include contingent payment arrangements with selling employee-shareholders who remain employees of the acquired business (eg earn-out agreements).</p> <ul style="list-style-type: none"> <li>• accounted for based on their substance and may need to be treated (wholly or partly) as compensation for future services and accounted for using the guidance in either IFRS 2 'Share-based Payment' or IAS 19 'Employee Benefits' rather than as a payment for the business acquired</li> <li>• arrangements for which payments are automatically forfeited if employment of the selling shareholders is terminated, should be accounted for as remuneration for post-acquisition services.</li> </ul> <p>The parties may agree to transfer some of the acquirer's assets.</p> <ul style="list-style-type: none"> <li>• the assets transferred should be remeasured to their fair value on the acquisition date and form part of consideration transferred</li> <li>• any remeasurement gain or loss is recognised immediately in profit or loss.</li> </ul>
<p><b>Arrangements for the payment of acquisition costs</b></p>	<p>The parties may arrange that transaction costs are paid by the vendor which may or may not be reimbursed by the acquirer.</p> <ul style="list-style-type: none"> <li>• reimbursement of acquisition costs should be recognised as an immediate expense</li> <li>• if costs paid by the vendor are not reimbursed directly by the acquirer, a portion of the contractual price should be treated as in-substance reimbursement and excluded from consideration transferred.</li> </ul>
<p><b>Pre-existing relationship between the acquirer and the acquiree</b></p>	<p>The parties may have an existing:</p> <ul style="list-style-type: none"> <li>• contractual arrangement (eg supplier and customer relationship or a licensor and licensee relationship)</li> <li>• non-contractual relationship (eg litigation).</li> </ul> <ul style="list-style-type: none"> <li>• if the business combination has the effect of settling a pre-existing relationship, that settlement should be accounted for as a separate transaction from the business combination</li> <li>• the amount deemed to relate to the settlement of the pre-existing relationship is excluded from the consideration transferred for the business acquired</li> <li>• any gain or loss arising from the settlement of such an arrangement should be recognised immediately in profit or loss.</li> </ul>

Deal terms or structure	Financial reporting effects
<p><b>Replacement or continuation of an acquiree's share-based payment awards</b></p>	<p>The acquirer may replace the acquiree's share-based payment awards or alternatively continue the acquiree's share based payment awards without changes.</p> <p>Replacement awards:</p> <ul style="list-style-type: none"> <li>• need to assess the portion of the consideration transferred that represents the value of the replacement awards attributable to pre-combination service</li> <li>• amount relating to post-combination service should be recognised as compensation expense over the remaining vesting period.</li> </ul> <p>Existing award schemes not replaced:</p> <ul style="list-style-type: none"> <li>• the fair value of any vested awards is recognised as part of NCI with a consequent effect on goodwill</li> <li>• NCI is increased by the value of unvested awards attributable to pre-combination service</li> <li>• amount relating to post-combination service is recognised as compensation expense over the vesting period on the basis of the market-based measurement of that award at the acquisition date.</li> </ul>
<p><b>Contracts to acquire shares from non-selling shareholders at a later date</b></p>	<p>These contracts may be negotiated at or around the same time as the business combination.</p> <ul style="list-style-type: none"> <li>• a contract that in substance represents the purchase, at the date of acquisition, of the remaining acquiree shares is accounted for as part of the business combination, as a deferred or contingent consideration arrangement. As the remaining shares held by NCI are considered to have been acquired at the date of acquisition, the acquirer is considered having already acquired 100% of the acquiree shares and as such, no NCI should be recognised</li> <li>• contracts that are in substance arrangements to purchase NCI shares at a future date after the acquiring entity gains control of the subsidiary (also referred to as put options over NCI) should be accounted for as a separate transaction. It should not be considered part of the business combination.</li> </ul>

“It is important that management is aware of the financial reporting consequences of putting in place certain terms and conditions into sale and purchase agreements.”

## Reporting business combinations and avoiding surprises

Reporting a business combination is a significant exercise. A considerable amount of time and effort usually needs to be put into gathering, assembling and evaluating all the information required to be reported in the financial statements under IFRS 3. Presented below are some planning considerations and suggestions on how they can be implemented.

	Matters to consider	Implementation hints
<b>During the deal negotiation</b>	<ul style="list-style-type: none"> <li>• understand the accounting effects of the terms set out in the sale and purchase agreement</li> <li>• identify related transactions or other elements that may require separate accounting</li> <li>• identify transactions/agreements or other arrangements that have negotiated at or near the same time to assess whether they should form part of the business combination.</li> </ul>	<ul style="list-style-type: none"> <li>• involve finance/accounting personnel in the early stages of the negotiation to assist in evaluating the accounting effects of the deal terms.</li> </ul>
<b>Applying the acquisition method</b>	<ul style="list-style-type: none"> <li>• identifying intangible assets: these assets are more challenging to identify as they are often not recognised in the acquiree's financial statements.</li> </ul>	<ul style="list-style-type: none"> <li>• consider various sources of information that may provide valuable inputs in detecting intangible assets:               <ul style="list-style-type: none"> <li>– the acquiree's operations</li> <li>– results of due diligence</li> <li>– acquiree's website and other investor-related communication.</li> </ul> </li> </ul>
	<ul style="list-style-type: none"> <li>• identifying contingent liabilities: the acquirer should recognise at the acquisition date a contingent liability assumed in a business combination if it is a present obligation and its fair value can be measured reliably.</li> </ul>	<ul style="list-style-type: none"> <li>• consider various sources of information that may provide valuable inputs in detecting contingent liabilities:               <ul style="list-style-type: none"> <li>– legal correspondence</li> <li>– results of due diligence</li> <li>– documentation and communication with suppliers.</li> </ul> </li> </ul>
	<ul style="list-style-type: none"> <li>• valuation process: fair values of certain items may not be readily available and may require complex estimates.</li> </ul>	<ul style="list-style-type: none"> <li>• implement a robust process in developing fair value estimates</li> <li>• assistance from valuation experts may be required if the acquirer does not have the relevant expertise and experience in valuation.</li> </ul>
	<ul style="list-style-type: none"> <li>• determining consideration transferred: need to consider the effects of transactions that are not part of the business combination under IFRS 3</li> </ul>	<ul style="list-style-type: none"> <li>• consider the commercial reasons for each material element of the transaction, who initiated it and its timing.</li> </ul>
	<ul style="list-style-type: none"> <li>• making an accounting policy choice in certain areas, for example:               <ul style="list-style-type: none"> <li>– measurement of NCI</li> <li>– classification and designation of assets acquired and liabilities assumed.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• assess the implications of the choices available, including the immediate effect on the acquisition date; the relative ease of applying a particular choice; the subsequent accounting requirements; and the related impact on post-combination earnings.</li> </ul>



## Matters to consider

## Implementation hints

### Determining the need for outside experts

- some entities enter into frequent business combination transactions but for others, these are one-time events. The entity may then not have the adequate resources to apply IFRS 3's requirements.

- assess the skills and relevant experience of the finance team to determine whether external consultants are required to assist with the purchase price allocation process that is set out in IFRS 3
- this decision should be made early in the process to ensure the quality of financial information and avoid unnecessary delays.

### Timely completion of the accounting for the business combination

- the accounting for a business combination, including all the required disclosures, should be completed within the measurement period (which should not exceed 12 months after the acquisition date). Depending on the complexity of the business combination, this time frame may be challenging.

- plan early
- identify all the relevant requirements, gather required information and assess the needed resources
- engage external consultants as necessary and agree on scope of work, due dates and deliverables
- implement a project plan and monitor progress of activities regularly
- engage your auditor early!



## How we can help

We hope you find the information in this article helpful in giving you some insight into IFRS 3. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or visit [www.grantthornton.global/locations](http://www.grantthornton.global/locations) to find your local member firm.

