



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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Agenda Item
5

DATE: 5 June, 2008
MEMO TO: Members of the International Public Sector Accounting Standards Board
FROM: Barry Naik
SUBJECT: Entity Combinations

ACTION REQUIRED

Review the attached materials and be prepared to discuss:

- the conclusions reached in the rules of the road analysis – namely:
 - to modify IFRS 3 *Business Combinations*; and
 - have a separate public sector specific project for those combinations which fall outside of IFRS 3; and
- the issues to be addressed in both projects.

AGENDA MATERIAL

Item

- 5.1 Guidelines for modifying IASB documents analysis (rules of the road)
- 5.2 Issues Paper

BACKGROUND

At the March 2007 meeting in Accra, the IPSASB agreed to initiate a project on entity combinations during 2008. The Board noted that for some combinations in the public sector, the key principles of IFRS 3 *Business Combinations* could possibly be convergent for the public sector.

However, the Board noted that a significant number of combinations in the public sector occur under common control - which are not within the scope of IFRS 3. Further, application of the principles in IFRS 3 might either not be possible or not result in optimal accounting for many public sector combinations.

Therefore the Board directed staff to develop an issues paper which considers accounting issues associated with combinations which would both be within the scope of IFRS 3 as well as those which might not. Further, the Board asked that the paper take into account

fair value considerations and also issues related to combining entities with different accounting policies. To assist in the analysis members agreed to provide examples of combinations from their jurisdiction.

Since the Accra meeting, the IASB has completed the second phase in its project on business combinations culminating in the issuance of revised IFRS 3 *Business Combinations* (January 2008). The primary conclusion from the first phase was that virtually all business combinations are acquisitions. Accordingly, it was decided to require the use of one method of accounting for business combinations—the acquisition method. While this remained unchanged under phase two, the second phase addressed the guidance for applying the method.

The second phase was conducted jointly with the FASB as part of promoting international convergence (the Boards deliberated phase one of the project separately). Revisions on applying the acquisition method represented a more extensive change for the FASB than to the previous version of IFRS 3.

Staff have applied the recently developed rules of the road to IFRS 3 (2008) to determine the most appropriate next steps for the project. An issues paper has also been developed to provide a greater understanding of the issues which will have to be dealt with.

While the working title for the IPSASB project has to date been ‘entity combinations’, as is explained in the attached papers, an entity combination can be viewed as one type of restructuring that can occur in the public sector. As such, these papers use the working term ‘restructurings’ to encompass a broad range of combinations. The term ‘entity combination’ is assigned to a particular type of restructuring in the attached.

Finally, staff gratefully acknowledge the considerable support provided by the staff of the South African Accounting Standards Board for the provision of material which has been very helpful in the development of these papers.

GUIDELINES FOR MODIFYING IASB DOCUMENTS

ENTITY COMBINATIONS

Introduction and Background

In undertaking a project on entity combinations, the starting point for the IPSASB is to first consider the extent to which this project could be conducted as an IFRS convergence project. Therefore staff has done an analysis of IFRS 3, *Business Combinations*, using the Guidelines for Modifying IASB Documents (Rules of the Road) in order to determine how the project would be best approached.

In order to conduct the rules of the road analysis, it is important first that the IPSASB have some context in which to consider the analysis and therefore the following background information is provided. Entity combinations are one type of a large group of transactions called restructurings.

Restructurings in the public sector can be driven by numerous factors – for example:

- Giving greater autonomy and decision-making power to those levels of government or entities who better know how to meet the needs of the constituency that they serve (decentralization);
- Improving the alignment of duties with the outcomes the entity is supposed to achieve or contribute to achieving;
- Responding to demands from the constituency for the way in which services are received; or
- Taking advantage of economies of scale by combining the resources of entities.

Further, restructurings will often (if not always) have one or more of the following characteristics (these are not necessarily all public sector specific):

- Common control- Restructurings in the public sector often involve entities under common control. The restructuring may not be of entities, but instead be the transferring of functions or responsibilities from one entity to another entity. It could result in either a larger version of an entity that already existed pre-restructuring or the creation of an entirely new entity, separate from the entity(ies) from which its component parts were derived;
- No common control - Some restructurings can involve no common control eg: two municipalities under the direction of a state or national government whose control could be considered transitory or temporary;
- Non-exchange - There may be little or no consideration exchanged as part of the restructuring e.g. it could have been brought about by a legislative change or a ministerial order;
- No control obtained – The restructuring may not result in any party gaining overall control of the combined entity;

- Control obtained - The restructuring may result in a party gaining overall control of the combined entity; or
- Involuntary – The restructuring may be involuntary with neither party being combined having any influence over its occurrence.

IFRS 3, *Business Combinations* was developed to account for only a particular type of restructuring - those involving an arms-length exchange transaction in a commercial environment. It requires a business combination to be accounted for only by the acquisition method. Business combinations under common control are scoped out. The primary accounting requirements of IFRS 3 are:

- A party to the combination can always be identified as the acquirer – the one obtaining control of the other business(es) (the acquiree);
- With limited exceptions, each identifiable asset and liability is measured at its acquisition-date fair value; and
- The acquirer must determine any difference between the total fair value of the consideration provided and the fair value of the identifiable assets and liabilities acquired. This will generally be recognised as goodwill, though if a gain (bargain purchase), would be recognised in profit or loss.

(Appendix 1 of agenda item 5.2 provides a fuller overview of IFRS 3 while appendix 2 provides the complete text of IFRS 3).

There could be some restructurings in the public sector for which IFRS 3 is applicable. This paper considers the existence and magnitude of any public sector issues arising from the application of IFRS 3 to those restructurings. For the purposes of this paper, those restructurings are termed ‘entity combinations’.

However, there are even more restructurings to which IFRS 3 would not apply. This paper considers the existence and magnitude of public sector issues for those restructurings separately. For the purposes of this paper, they are termed as ‘transfers of functions’. Transfers of functions would be those restructurings:

- undertaken between entities under common control (either by way of an exchange or non-exchange transaction); and
- undertaken between entities that are not under common control but are non-exchange transactions.

“Rules of the Road” Analysis

RULE 1: ARE THERE PUBLIC SECTOR ISSUES THAT WARRANT DEPARTURE?

In applying the steps in rule 1, public sector issues are assessed to determine if they warrant departure in recognition or measurement or in presentation or disclosure. The four rules to be considered are:

1. where applying the international accounting standards/interpretations would mean the objectives of public sector financial reporting would not be met;
2. where applying the international accounting standards/interpretations would result in a loss of accountability to stakeholders;
3. where applying the international accounting standards/interpretations would mean the qualitative characteristics of public sector financial reporting would not be met; and
4. where the cost of applying the international accounting standards/interpretations exceeds the benefit.

Given the close linkage between steps 1 and 2, they are both considered together.

Rule 1, Steps 1 and 2: Applying the international accounting standards/interpretations would:

- **mean the objectives of public sector financial reporting would not be met; and**
- **result in a loss of accountability to stakeholders.**

IPSAS 1.15 specifies that the objectives of general purpose financial reporting in the public sector should be to provide information useful for decision making, and to demonstrate the accountability of the entity for resources entrusted to it by providing:

- Information about the sources, allocation and uses of financial resources;
- Information about how the entity financed its activities and met its cash requirements;
- Information that is useful in evaluating the entity's ability to finance its activities and to meet its liabilities and commitments;
- Information about the financial condition of the entity and changes in it; and
- Aggregate information useful in evaluating the entity's performance in terms of service costs, efficiency and accomplishments.

ENTITY COMBINATIONS

The public sector issues for entity combinations are:

- Non-GBE acquisitions; and
- IFRS 3 guidance for which the IPSASB is still deliberating.

Non-GBE acquisitions

As noted, IFRS 3, *Business Combinations* was developed to account for restructurings involving an arms-length exchange transaction in a commercial environment. In the public sector acquisition of a profit-oriented commercial entity, notably a GBE, would be considered to determine if application of the principles in IFRS 3 is appropriate.

A GBE is defined in the IPSASB Handbook as an entity that has all the following characteristics:

- Is an entity with the power to contract in its own name;
- Has been assigned the financial and operational authority to carry on a business;

- Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;
- Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and
- Is controlled by a public sector entity.

The self-sustaining nature of a GBE, or more particularly that its under-lying assets are used primarily to generate net cash inflows (often described as embodying future economic benefits) as opposed to being employed as a means to deliver goods and services in accordance with an entity's objectives (often described as embodying service potential) would support the application of fair value re-measurement to the acquired identifiable assets and liabilities, though more importantly recognition of any goodwill or bargain purchase.

This would be supported by the definition of goodwill in IFRS 3:

“An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.”

Applying IFRS 3 to acquisition of a GBE should not result in the objectives of public sector financial reporting or accountability to stakeholders not being achieved as the requirements of IFRS 3 are designed to address these types combinations.

However, where the acquisition involves acquiring a non-GBE entity – notably an entity whose under-lying assets predominately embody service potential as opposed to economic benefits, then the goodwill/bargain purchase guidance in IFRS 3 may result in the objectives of public sector financial reporting and accountability to stakeholders being compromised. Recognition, particularly of goodwill, would not be consistent with the under-lying service nature of the assets acquired.

Therefore, in order to meet the objectives of public sector financial reporting and ensure that accountability to stakeholders is maintained, it will be necessary to include guidance on this issue within a new IPSAS.

IFRS 3 guidance for which the IPSASB is still deliberating

There are some finer aspects of IFRS 3 of which the IPSASB should be cognizant. The general issue with these is that IFRS 3 introduces some guidance related to matters on which the IPSASB is currently deliberating/has a project for which final conclusions have not yet been reached. The introduction of some of the requirements in IFRS 3 could be interpreted by constituents as the IPSASB taking a position on unfinished business – notably:

- Intangibles: IFRS 3 allows the recognition of acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship even if the acquiree did not recognize those as assets in its financial statements because they were developed

internally and charged to expense. IAS 38 *Intangible Assets* para 33 – 34 essentially supports this allowance. While staff have no particular concerns on this allowance within IFRS 3, the final outcome of the IPSASB's intangible assets project is not yet known.

- **Financial Instruments:** The stated objective of the IPSASB FI project is to develop IPSASs that converge with IAS 32, *Financial Instruments: Presentation*, IAS 39, *Financial Instruments: Recognition and Measurement* and IFRS 7, *Financial Instruments: Disclosure* - the final outcome of the project is not yet known. As such, the Board should take note that adoption of the provisions within IFRS 3 could (ie: IFRS 3 makes regular direct reference to IAS 39) be interpreted as endorsing and pre-supposing the outcome of the FI project.
- **Contingent Liabilities:** IFRS 3 contains provisions which provide an exception to the recognition principles for contingent liabilities assumed in a business combination – such an exception would be relevant to IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. In brief, in a business combination, an acquirer would recognize a contingent liability assumed based solely on:
 - if it is a present obligation that arises from past events; and
 - its fair value can be measured reliably.

Contrary to IPSAS 19, the acquirer would recognize a contingent liability assumed even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

These provisions stem from the work the IASB was doing which was expected to result in a revised IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The IPSASB does not have a current project specifically on IPSAS 19 though has scheduled as part of its broader improvements project to review IPSAS 19. As such, the IPSASB should be aware of introducing provisions in other standards (IFRS 3) which could create conflict within the IPSASB Handbook.

Finally there are numerous provisions which may not be fully applicable in a public sector context relating to matters such as income taxes, share-based payment awards, reverse acquisitions and exchanging of only equity interests.

While these are all areas the IPSASB will need to remain cognizant of, with appropriate project management it should not be an issue to ensure that the objectives of public sector financial reporting and the accountability to stakeholders are not compromised. Currently there is no concern that rules 1 and 2 would not be met.

Overall, of the issues discussed above, only the non-GBE acquisition is considered significant enough to potentially mean the objectives of public sector financial reporting or accountability to stakeholders could be compromised if it were not addressed in a new IPSAS.

TRANSFER OF FUNCTIONS

The public sector issues for transfer of functions are:

- no international standard; and
- IFRS 3 guidance not appropriate.

No international standard

There is no international standard to address transfer of functions. IFRS 3 is the only business combinations standard available for the foreseeable future.

The IASB website advises the intention to progress a project on business combinations under common control. It notes 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. The project will also consider the accounting for demergers, such as the spin-off of a subsidiary or business.

IASB staff are undertaking preliminary research on the accounting for common control transactions and had planned to present a comprehensive project outline to the Board in June 2008. IPSASB staff discussions with IASB staff highlight that the timeframe for this project has been revised (maybe a comprehensive project outline in late 2008) – a confirmed timeframe is not known.

Considering the IFRS 3 guidance

While no international standard exists, it is necessary to consider if applying IFRS 3 to transfer of functions would mean the objectives of public sector financial reporting would not be met or result in a loss of accountability to stakeholders.

IFRS 3 is developed with the under-pinning notions of value attaching to future cash-flows and earnings potential of the entity(ies) being acquired which are external to the reporting entity. It prescribes the use of fair values for the measurement of identifiable assets and liabilities acquired along with guidance for the recognition of any subsequent goodwill or bargain purchase.

Transfer of functions under common control, at the consolidated reporting level, represent an entity transacting with itself – not an acquisition. The application of IFRS 3 to a transfer under common control (which is arguably not arms length) would appear to raise an inconsistency with the conceptual under-pinning of IFRS 3.

Remeasurement of any identifiable assets and identifiable liabilities of the commonly controlled entities from their former carrying value would appear to ignore the reality that the restructuring has all taken place within the same reporting entity. Equally, recognition of any goodwill (disregarding the service delivery nature of those assets) or

bargain purchase for an entity transacting with itself would also not account for the substance of what has occurred.

Transfer of functions not under common control involving no purchase consideration tend to result from the forced amalgamation of municipalities by a state of national level of government – not a commercial arms-length acquisition as contemplated by IFRS 3.

As such, this type of transfer would appear to also raise a possible inconsistency with the conceptual under-pinning of IFRS 3.

Remeasurement of any identifiable assets and identifiable liabilities of the entities from their former carrying value would appear to ignore the reality that an acquisition has not occurred. Again, recognition of any goodwill (disregarding the service delivery nature of those assets – particularly if the transfer is of municipalities) or bargain purchase where no acquisition or exchange has occurred would also not account for the substance of what has occurred.

While IFRS 3 does have commentary on a business combination achieved without consideration, the circumstances are specific and, arguably, not particularly applicable to public sector circumstances e.g. acquiree purchasing its own shares and lapsing of minority veto rights. Further, in substance, the examples provided in IFRS 3 could be viewed as involving consideration.

Overall, applying the key principles of IFRS 3 to transfers of functions would likely compromise the objectives of general purpose financial reporting in the public sector resulting in providing misleading information not useful for decision making, and would not demonstrate proper accountability of the entity for resources entrusted to it.

Rule 1 Step 3: Applying the international accounting standards/interpretations would mean the qualitative characteristics of public sector financial reporting would not be met.

IPSAS 1 states that qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

ENTITY COMBINATIONS

When involving the acquisition of a profit-oriented commercial entity, notably a GBE, application of the principles in IFRS 3 should mean that the qualitative characteristics of public sector financial reporting would be met. This is because the acquisition of a GBE is very similar to the type of acquisition contemplated within IFRS 3.

However, where the acquisition involves acquiring a non-GBE entity then the goodwill/bargain purchase guidance in IFRS 3 may not result in the qualitative characteristics of public sector financial reporting being met – notably:

- Reliability, in particular the recognition of goodwill/bargain purchase may not faithfully represent or report the substance of the nature of the entity acquired (underlying assets essentially embodying service potential); and
- Relevance as the information will not be useful to assist in the evaluation of past, present or future events or in confirming, or correcting, past evaluations.

TRANSFER OF FUNCTIONS

The financial reporting issues examined above lead staff to the conclusion that the qualitative characteristics of public sector financial reporting are not met if applying IFRS 3 to transfer of functions.

Rule 1 Step 4: The cost of applying the international accounting standards/interpretations exceeds the benefit

ENTITY COMBINATIONS

When involving the acquisition of a profit-oriented commercial entity, notably a GBE, application of the principles in IFRS 3 should mean that the benefits at least equal the costs. The IASB has gone through its own due process in developing IFRS 3 and given they also apply the cost-benefit constraint as part of the due process, gives IPSASB staff comfort. IPSASB staff do not see why the benefits, but more importantly the costs would necessarily be materially any different in a public sector context vs a private sector context.

If the acquisition involves acquiring a non-GBE entity the issue relating to the recognition of goodwill/bargain purchase negatively impacts the assessment for the benefits of applying IFRS 3.

TRANSFER OF FUNCTIONS

The financial reporting issues examined above negate the existence of any benefits.

CONCLUSION ON RULE 1

ENTITY COMBINATIONS

The acquisition of non-GBEs in the public sector is a unique public sector issue which warrants some departure from IFRS. As noted in the issues paper, the acquisition of a non-GBE forms an important part of the guidance of at least one public sector national standard setter (Canada). As such, the issue should be addressed and additional guidance developed.

TRANSFER OF FUNCTIONS

For transfers of functions, staff consider that there are public sector issues that warrant departure.

Since the analysis on step 1 indicates that there are public sector differences, the next step is to consider whether those issues are so significant that a public sector specific project should be initiated or whether the issues can be addressed within an IPSAS that is substantially converged with the related IFRS with some modification.

RULE 2: ARE THE DEPARTURES SO SIGNIFICANT THAT A PUBLIC SECTOR SPECIFIC PROJECT SHOULD BE INITIATED?

Key to making this assessment is the nature of the public sector issue identified and its significance in the public sector in particular in comparison with the private sector.

ENTITY COMBINATIONS

As noted above, the acquisition of non-GBEs in the public sector is a unique public sector issue which warrants some departure from IFRS. While it is a unique issue it is not expected to be a significant issue and therefore it is likely to be able to be addressed with some additional guidance added to the related IFRS. This is an example of a public sector issue not addressed in the IFRS but which is not major in the context of the standard as a whole.

TRANSFER OF FUNCTIONS

For transfer of functions, the situation regarding significance is somewhat different.

In analyzing these transactions, the following factors were taken into consideration:

- The significance of transfer of functions (in particular, under common control) in the public sector;
- The absence of any international standard to address transfer of functions;
- The extent to which the application of IFRS 3 to transfer of functions will compromise the objectives of public sector financial reporting, accountability to stakeholders, the qualitative characteristics of financial reporting and not create any benefits; and
- The fact that there is no evidence that the IASB will under-take a project to address transfer of functions (in particular common control) in the very near future.

Based on these factors, staff consider that a public sector specific project should be initiated to deal with transfer of functions.

**RULE 3: PARAMETERS ON THE MODIFICATIONS THAT WOULD BE MADE TO
AN IASB DOCUMENT TO ADDRESS PUBLIC SECTOR DIFFERENCES**

For entity combinations it will be necessary to consider the modifications that will be required to IFRS 3 to be able to address the non-GBE acquisition issue.

Rule 3 ‘Modify IASB documents’, step iv) provides the necessary scope to allow additional guidance to be inserted into the IAS to provide a public sector context. As such, staff consider that IFRS 3 should be modified under rule 3 to take into consideration non-GBE acquisitions.

Rule 3, step vi) will also allow, if needed, the insertion of a public sector specific example.

Overall Conclusions For Rules of the Road Analysis

After conducting an analysis of public sector issues related to entity combinations and other restructurings, staff has come to the conclusions that there should be two projects. The first will be an IFRS convergence project which will address entity combinations in a manner similar to IFRS 3 but which will include additional guidance to address the issue of non-GBE acquisitions.

In addition, staff is proposing that a new public sector specific project be initiated to deal with transfer of functions since these have not been specifically addressed yet by the IASB. It is noted that this proposed approach is broadly similar to that being proposed for financial instruments. It would allow work on entity combinations to be conducted fairly quickly. It would also ensure that unique public sector issues are addressed in a separate IPSAS.

Staff Recommendation:

Develop 2 IPSASs related to restructurings:

- entity combinations –an IFRS converged standard which includes guidance on non GBE acquisitions; and
- transfers of functions - a new IPSAS that addresses public sector specific issues.

ISSUES PAPER – ENTITY COMBINATIONS

The IPSASB approved a project on entity combinations for the public sector in March 2007 to commence in 2008. In undertaking this project, it is appropriate first to recognize that entity combinations are simply one component of a large group of transactions called restructurings. Agenda item 5.1 discusses the many attributes that restructurings in the public sector can possess.

In terms of accounting standards internationally, only the IASB's IFRS 3 Business Combinations provides guidance on any type of restructuring arrangement. IFRS 3 addresses a particular type of restructuring - those involving a commercial arms-length exchange transaction. It requires one business to be identified as an acquirer (gaining control) of another business(es) (the acquiree). It then only allows the application of the acquisition method of accounting. The rules of the road note that there could be some restructurings in the public sector for which IFRS 3 is applicable. Those restructurings are termed 'entity combinations'.

This means that there are a number of types of restructuring arrangements that have not been addressed in the accounting literature. These need to be considered in the public sector context to determine how they should be dealt with. These other restructurings to which IFRS 3 would not apply are termed 'transfers of functions'. Transfers of functions would be those restructurings:

- undertaken between entities under common control (either by way of an exchange or non-exchange transaction); and
- undertaken between entities that are not under common control but are non-exchange transactions.

The key outcomes and conclusions from the rules of the road in relation to entity combinations and transfer of functions are as follows:

- Entity Combinations - When involving the acquisition of a profit-oriented commercial entity, notably a GBE, application of the principles in IFRS 3 should not result in the objectives of public sector financial reporting or accountability to stakeholders not being achieved as the requirements of IFRS 3 are essentially designed to address these types combinations.

The self-sustaining nature of a GBE, or more particularly that its under-lying assets are used primarily to generate net cash inflows (often described as embodying future economic benefits) as opposed to being employed as a means to deliver goods and services in accordance with an entity's objectives (often described as embodying service potential) would support the application of fair value re-measurement to the acquired identifiable assets and liabilities, though more importantly recognition of any goodwill or bargain purchase.

However, where the acquisition involves acquiring a non-GBE entity – notably an entity whose under-lying assets predominately embody service potential as opposed to economic benefits, then the goodwill/bargain purchase guidance in IFRS 3 may not be appropriate. Recognition particularly of goodwill would not be consistent with the under-lying service potential of the assets acquired.

As such, **Rule 3** ‘Modify IASB documents’, step iv) provides the necessary scope to allow additional guidance to be inserted into the IAS to provide a public sector context. Staff consider that IFRS 3 could be modified under rule 3 to take into consideration non-GBE acquisitions.

- Transfer of Functions - Given the following factors:
 - significance of transfer of functions (in particular, under common control) in the public sector;
 - absence of any international standard to address transfer of functions;
 - the extent to which the application of IFRS 3 to transfer of functions will compromise the objectives of public sector financial reporting, accountability to stakeholders, the qualitative characteristics of financial reporting and not create any benefits; and
 - no evidence that the IASB will under-take a project to address transfer of functions (in particular common control) in the very near future;

staff recommended based on the analysis performed that a public sector specific project be initiated.

This paper considers further the matters that will need to be addressed based on the issues identified in the rules of the road. The analysis is presented separately for each of entity combinations and transfer of functions.

In addition to IFRS 3, approaches applicable to accounting for restructurings in the public sector which are either being considered or have been adopted by national standard setters with public sector responsibility were also reviewed and considered.

Appendix 1 to this paper provides an overview of the national standard setter material reviewed (and summarized below) while appendix 2 provides the complete text of IFRS 3. Finally, appendix 3 provides extracts of the relevant sections for some of the national standard setters below.

Overview of Pronouncements Reviewed

- IASB – IFRS 3 *Business Combinations*, unless under common control, requires a business combination to be accounted for only by the acquisition method. A party to the combination can always be identified as the acquirer – the one obtaining control of the other business (the acquiree).

With limited exceptions, each identifiable asset and liability is measured at its acquisition-date fair value with any non-controlling interest in an acquiree measured at fair value or as the non-controlling interest's proportionate share of the acquiree's net identifiable assets.

The acquirer must determine any difference between the total fair value of the consideration provided (taking into account any non-controlling interest or previously held equity in the acquiree) and the net identifiable assets acquired. This will generally be recognised as goodwill, though if a gain (bargain purchase), should be recognised in profit or loss.

- New Zealand – existing guidance is the same as IFRS 3 in all material respects. There is currently no additional New Zealand financial reporting standard which supplements IFRS 3 for those entity combinations beyond its scope.
- Canada - Public Sector Accounting Standards Board (PSAB)
 - Section PS 2510 *Additional Areas of Consolidation* - guidance for acquisition of a governmental unit (an organization controlled by the government, other than a government business enterprise). Requires the 'purchase method' with no recognition of goodwill or bargain purchase.
 - PS 3070 *Investments in Government Business Enterprises* – guidance for acquisition of a GBE. Requires the 'purchase method' with recognition of purchase premium but is silent on bargain purchases.
- Australia – existing guidance based on IFRS 3 (AASB 3) except for a scoping exclusion for arrangements called 'restructure of administrative arrangements' – with guidance in AASB 1004 *Contributions*. AASB 1004 has limited applicability. Where applicable AASB 1004 essentially requires that "transfers of resources resulting from such restructures are to be treated as movements in owner's equity by government controlled not-for-profit entities and for-profit government departments that are transferees or transferors."
- United Kingdom - FRS 6 *Acquisitions and Mergers*. An 'acquisition' is considered a business combination which is not a merger. Where an acquisition has occurred, requires an acquisition approach with either positive or negative goodwill recognised. Acquisition accounting is required to be applied to all business combinations unless it's a merger – for which 5 criteria are provided for determining if the definition of a merger has been met. For mergers, the carrying value of the asset and liabilities of the parties to the combination are not required to be adjusted to fair value on consolidation.
- South Africa - has issued a discussion paper *Transfer of Functions* – comment deadline of April 30. The paper focuses on guidance for transfers of functions that are undertaken between entities that are:

- commonly controlled - whether or not a purchase price is paid;
- not commonly controlled and no purchase consideration is paid; and
- mergers.

Overall the ASB favors the use of carrying value as a measurement basis for assets and liabilities acquired or assumed as part of a transfer of functions between entities under common control. For transfers not under common control and no purchase consideration paid, the ASB favors the recipient measuring the assets and liabilities at fair value. Comments are being sought on the measurement basis for the transferor. If a merger, the most notable proposal is the application of the pooling of interests method.

PART 1 – ENTITY COMBINATIONS

Non-GBE Acquisitions

From the rules of the road analysis, staff has concluded that for entity combinations an IPSAS that is substantially converged with IFRS 3 could be developed with some additional guidance to address public sector issues. In order to develop this IPSAS, rule 3 of the Guidelines to Modify IASB Documents (rules of the road) needs to be applied to IFRS 3 to take into consideration the public sector specific circumstance of the acquisition of a non-GBE entity – notably an entity whose under-lying assets predominately embody service potential as opposed to economic benefits.

The acquisition of such an entity creates an issue as to the appropriateness of the recognition of goodwill/bargain purchase since the definition of goodwill would arguably not be consistent with the service potential aspect of assets within non-GBE entities.

Because of the predominance of the acquisition approach in existing business combination standards, the most common approach to goodwill or purchase premium is recognition/ amortization.

The Canadian Public Sector Accounting Standard Board Sections PS 2510 *Additional Areas of Consolidation* PS 3070 *Investments in Government Business Enterprises* treat goodwill/purchase premium dependent upon the nature of the entity acquired.

PS 2510 provides guidance for when an acquisition of a governmental unit (an organization controlled by the government, other than a government business enterprise) occurs, requiring:

- Any excess of the purchase cost over the government's interest in identifiable assets acquired and liabilities assumed, based on their fair values, be accounted for as a purchase premium and expensed;
- Where the government's interest in the amounts assigned to identifiable assets acquired and liabilities assumed exceeds the purchase cost, it will be necessary to adjust such amounts to eliminate this excess.

However, if acquiring a GBE, the guidance in Section PS 3070 states that any excess of the purchase cost over the government's interest in the amounts assigned to identifiable assets acquired less liabilities assumed would be considered to be a purchase premium which would be recognised.

Staff are of the view that the Canadian approach is worthy of further consideration in modifying IFRS 3 for entity combinations involving non-GBE entities.

Definitions/Terminology

As noted in the rules of the road analysis, staff consider it necessary to review some key definitions within IFRS 3 to ensure they properly reflect the public sector context.

These would include for example:

- Definition of a business -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.
- Definition of a business combination - 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.

In particular the service provision aspect of public sector entities needs to be better reflected in these definitions – particularly if they are to recognize acquisitions of non-GBE entities. The South African discussion paper proposes the following definition of a function which is useful:

- A function is an integrated set of activities conducted and managed for the purpose of achieving an entity’s objectives. A function consists of inputs, processes to be applied to those inputs, and resulting outputs that may be used to:
 - provide a return to owners;
 - generate revenue;
 - reduce costs or improve efficiencies in the way in which resources are used; or
 - deliver goods and services.

Further, the paper also proposes a definition of an entity combination which is also helpful.

- Entity combinations are the bringing together of separate entities or functions into one reporting entity.

These will be given further consideration as the project progresses.

Action requested:

Do you agree that for restructurings that are entity combinations an IPSAS could be developed that is substantially converged with IFRS 3 but which includes additional guidance to address public sector specific issues?

PART 2 – TRANSFER OF FUNCTIONS

As noted, staff are proposing that restructurings other than entity combinations be addressed in a public sector specific project. This is based primarily on the following two issues:

- The lack of international standard; and
- The fact that IFRS 3 guidance is not appropriate.

In the development of public sector specific guidance, there are a number of issues that will need to be considered. These include:

- Recognition principles;
- Measurement principles;
- Disclosures;
- Terminology/definitions; and
- Presentation within the IPSASB Handbook.

IFRS 3 focuses on the accounting for the acquirer only. Guidance for transfers of functions will need to apply to more than just the receiving entity in the restructuring - it will be necessary that the guidance result in all parties accounting for their involvement so that they not only record the substance of the transaction, but also that the accounting ideally complements that of the other parties to the transfer.

ISSUE 1: RECOGNITION

The project will need to consider options for appropriate recognition guidance for the parties involved in the transfer of functions. In particular, there will need to determine recognition and de-recognition guidance for the assets and liabilities transferred. The recognition approach should reflect the substance of the transfer that has occurred and take into consideration transferors, recipients and any interposing entity (where applicable).

Related to recognition guidance is the need to consider guidance for determining:

- The date at which recognition of the transfer of function should be recorded by the transferor and recipient;
- The identification of the transferors and recipients; and
- What assets and liabilities should be recognized.

I. Recognition and de-recognition guidance for the assets and liabilities to be transferred

Common Control - Exchange or Non-Exchange Transaction

Existing guidance (eg: AASB 1004 *Contributions*, IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*) and the nature of the transfer – in

particular the involvement of an interposing controlling body, highlight two methods which should be considered for the recognition and de-recognition in the transfer:

- contributions from/distributions to owners; and
- revenues and expenses.

The IPSAS 1 *Presentation of Financial Statements* defines contributions from and distributions to owners as:

Contributions from owners means future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:

- (a) Conveys entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or
- (b) Can be sold, exchanged, transferred or redeemed.

Distributions to owners means future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.

Further, the IPSASB Handbook defines revenue and expenses as:

Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.

Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrence of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owners.

Arguments exist in support of either treatment – as noted in the South African discussion paper:

- The transfer of assets and liabilities to an entity as part of a transfer of a function can be seen in the same light as appropriations made to entities in cash, i.e. resources have been provided to an entity to fulfill its objectives. The fact that it may be paid in cash or other assets, and may include certain liabilities, is irrelevant. Those that favour this argument believe that the nature of transfers of functions is in fact revenue and expenditure, because, in the absence of evidence to the contrary, the nature of the transaction is no different to the receipt of appropriations.

- An alternative view is that one entity had its mandate reduced, while another had its mandate expanded. As a result, government's investment in one entity reduces, and it increases in another. Those that favour this view believe that transfers of functions are capital in nature and should be treated as contributions from and distributions to owners. Only subsequent appropriations received from the fiscus provide funding for the fulfilment of the ongoing activities of the entity and should be treated as revenue.

IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* provides some assistance noting that:

A contribution from owners may be evidenced by, for example:

- (a) A formal designation of the transfer (or a class of such transfers) by the contributor or a controlling entity of the contributor as forming part of the recipient's contributed net assets/equity, either before the contribution occurs or at the time of the contribution;
- (b) A formal agreement, in relation to the contribution, establishing or increasing an existing financial interest in the net assets/equity of the recipient which can be sold, transferred or redeemed; or
- (c) The issuance, in relation to the contribution, of equity instruments which can be sold, transferred or redeemed.

Australian Accounting Standards Board 1004 *Contributions* provides guidance which also should be considered. For those transactions constituting a 'restructure of administrative arrangements' (applicable only to government controlled not-for-profit entities and for-profit government departments)), 1004, in brief, notes that they are in the nature of transactions with owners in their capacity as owner;

- 54. In relation to a restructure of administrative arrangements, a government controlled not-for-profit transferor entity or a for-profit government department transferor entity shall recognise distributions to owners and a government controlled not-for-profit transferee entity or a for-profit government department transferee entity shall recognise contributions by owners in respect of assets transferred.
- 55. In relation to a restructure of administrative arrangements, a government controlled not-for-profit transferor entity or a for-profit government department transferor entity shall recognise contributions by owners and a government controlled not-for-profit transferee entity or a for-profit government department transferee entity shall recognise distributions to owners in respect of liabilities transferred.
- 56. When both assets and liabilities are transferred as a consequence of a restructure of administrative arrangements, a government controlled not-for-profit transferor entity or a for-profit government department transferor entity and a government controlled not-for-profit transferee entity or a for-profit government department transferee entity shall recognise a net contribution by owners or distribution to owners, as applicable.

Staff have the preliminary view that when under common control, such transfers have more the characteristics of contributions from and distributions to owners – the guidance in IPSAS 23 is particularly relevant in forming this view, in particular (b):

- (b) A formal agreement, in relation to the contribution, establishing or increasing an existing financial interest in the net assets/equity of the recipient which can be sold, transferred or redeemed

Further, transfers of functions generally commence or are based upon a legislative approval or formal binding agreement resulting in a re-organization of the owner's financial interest in the net assets/equity of the recipient. The nature of the transfer (ie: a function vs only assets) differs to the regular receipt of appropriations (assets) and is not in support of the regular operations of the recipient but instead, amends the mandate of those operations at the reduction of the mandate of the transferor(s).

This view is to be further considered as the project progresses. Where it could be shown that the transfer would clearly not constitute contributions from and distributions to owners, then the possibility of revenue and expense will also need to be explored.

Not Under Common Control – Non-Exchange Transactions

The absence of common control appears to significantly change the dynamics as to how transfers of functions should be recognized. As such, staff are of the preliminary view that the application of the definitions of revenue and expense may be more relevant in this context – this is to be further considered as the project progresses.

i) Date Of The Transfer Of Function And Identification Of The Transferors And Recipients

All Transfers of Functions

The date upon which the restructuring occurs, and from which the respective recognition of the transfer of functions between those entities involved should be recorded, needs consideration.

IFRS 3 requires that the date of the acquisition is the date at which the acquirer gains control of the acquiree. Further, IFRS 3 advises 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 might obtain control 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. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.”

Transfers of functions occur in the public sector predominately as the result of a legislative approval or agreement. The enabling agreement or legislation should be helpful in providing a date for the transfer and identifying the parties to it.

However, as contemplated in IFRS 3, staff consider that an alternative approach may also need to be taken into consideration beyond reliance on the dates or terms and conditions stated in the legislative approval or agreement. This is because there could be circumstances where the legal date for the transfer does not agree with the substance of the relationship that the transferor(s) and recipients have with the assets and liabilities subject to the transfer. IPSAS 23 gives support to using control as the basis to assist in determining the dates of recognition:

Control of an asset arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or otherwise regulate the access of others to that benefit.

As such, consideration of whether control should be a central tenet in determining the date of the transfer is needed. Further, determining who has and gained and relinquished control will also be useful to determining who the parties are to the transfer.

Where the transfer would result in no one party gaining control, it will be necessary for the project to provide guidance for an alternative basis for determining the date of the event and the respective parties to it. As will often be the case with restructurings for which a test of control could be usefully applied, reference back to the enabling legislation for the arrangement may be the primary guidance in determining the date of the transfer and the parties to it.

ii) What assets and liabilities should be recognized

IFRS 3 contains the following recognition principle:

“As of the acquisition date, the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree....

...The acquirer’s application of the recognition principle and conditions may result in recognising some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its financial statements. For example, the acquirer recognises the acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.”

Common Control - Exchange or Non-Exchange Transaction

For transfer of functions under common control, the substance of the arrangement is that the entity is transacting with itself. As such, conceptually it would not appear appropriate to recognize assets or liabilities in addition to what existed before the transfer.

Not Under Common Control – Non-Exchange Transaction

When not under common control and an exchange transaction, the recognition principle under IFRS 3 may result in recognising some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its financial statements.

For the transfer of functions not under common control, arguably a similar principle may seem more applicable as the entity is not transacting with itself. However, the transfer can often be an imposed arrangement with no purchase consideration compared with a voluntary acquisition by the acquirer using a purchase consideration to acquire a bundle of assets and liabilities.

As such, the public sector circumstances are not completely similar to those under IFRS 3 and therefore the recognition principle may not be equally applicable.

Staff are of the preliminary view therefore that the application of the IFRS 3 recognition principle should be further reviewed in a public sector context though given the differences between the two scenarios consider that there should probably not be recognition of assets or liabilities in addition to what existed before the transfer.

ISSUE 2: MEASUREMENT OF ASSETS AND LIABILITIES

A further issue that needs consideration is determining the appropriate measurement basis of assets and liabilities which are the subject of transfer of functions.

Business combination under IFRS 3 require fair value measurement for all identifiable assets and identifiable liabilities identified as part of that combination and assumed by the acquirer.

Common control or in the absence of common control, terms and conditions which do not enable a transferor and recipient to be determined (for example, a merger) and/or the existence of no purchase consideration raises the need to consider measurement approaches in order to determine which best reflects the substance of what has occurred.

Common Control - Exchange or Non-Exchange Transaction

Existing guidance of national standard setters tends to give greater focus to valuation based within the context of an acquisition method - like IFRS 3, focusing on fair value measurement (UK (except for mergers), Canada) . Australian Accounting Standards Board 1004 *Contributions* does not provide measurement requirements with respect to restructure of administrative arrangements.

As such, there is not a great deal of existing guidance for measurement approaches to be applied for restructurings outside of an acquisition scenario, in particular, under common control.

Under common control, the use of fair values, where in substance, the entity, at a consolidated level has transacted itself, would not appear to fit with the non-acquisition nature of the transaction. Given the entity has transacted with itself, this arguably gives support for the continued use of the existing value of those assets and liabilities at the time the transfer of function was entered into – carrying value. This would certainly seem to be the case where the common control restructuring has involved no exchange of purchase consideration.

The project will need to consider the appropriateness of measurement approaches other than fair value – the preliminary view of staff is that carrying values provide a better reflection of the substance of the transaction. As discussed in the South African discussion paper, the use of carrying values as a measurement basis for assets and liabilities acquired as part of a transfer of functions is also appropriate for a number of practical reasons, such as, when:

- no gain or loss is recognised by either the recipient or transferor in remeasuring those assets and liabilities to fair value;
- no artificial gains and losses are recognised as the economic entity is merely transacting with itself;
- costs relating to the valuation of those assets and liabilities are saved, particularly where the assets and liabilities are of such a nature that expert valuers may be required; or
- adjustments are not required to be made on consolidation of the controlled entities with their controlling entity.

If there was to be a circumstance for the use of fair value for transfers of functions under common control, a more likely scenario would be when it involves an exchange transaction. Exchange of consideration could arguably be viewed as giving the transaction more of a commercial acquisition substance and as such, measurement principles such as in IFRS 3, or the Canadian Public Sector Accounting Standard PS 3070 may be more appropriate.

However, staff are of the initial view that, as with those common control transactions where there is no exchange of consideration, the exchanging of consideration to effect a common control transfer of function is still in substance, at the consolidated entity level, an entity transacting with itself. Therefore this would seem to support measurement principles reflecting that in substance there has been no acquisition of a new entity into the reporting entity and carrying values would seem to be more appropriate. The four points raised above from the South African discussion paper would seem equally applicable in this circumstance. This will be considered further as the project progresses.

Where a purchase consideration is paid by the recipient, there may arise amounts which are in excess or shortfall of the net assets received – akin to goodwill/purchase premium or bargain purchase under IFRS 3 and other standard setters. An issue will be to determine how these amounts could be treated.

When such an excess or shortfall exists with respect to the purchase consideration compared to the fair values of the identifiable assets and identifiable liabilities received by the acquirer, IFRS 3 would require recognition of such goodwill or if a bargain purchase, immediate recognition in the P&L.

Canadian Public Sector Accounting Standard 2510 applies a slightly different approach requiring, upon the acquisition of a governmental unit:

- Any excess of the purchase cost over the government's interest in identifiable assets acquired and liabilities assumed, based on their fair values, to be accounted for as a purchase premium and expensed;
- Where the government's interest in the amounts assigned to identifiable assets acquired and liabilities assumed exceeds the purchase cost, it will be necessary to adjust such amounts to eliminate this excess.

However, if the acquisition of a GBE, Canadian PS 3070 *Investments in Government Business Enterprises* would require any excess of the purchase cost over the government's interest in the fair value amounts assigned to identifiable assets acquired less liabilities to be a purchase premium and amortized. 3070 is silent on the treatment of bargain purchase amounts.

Alternatively, the UK ASB FRS 6 *Acquisitions and Mergers* requires the difference between the fair value of the net identifiable assets acquired and the fair value of the purchase consideration be recognized as goodwill, positive or negative.

The existing approaches above do not reflect a restructuring occurring within a reporting entity and as such do not take into consideration that the entity is in substance contracting with itself – which in itself would arguably make the recognition of any goodwill or bargain purchase artificial. Further, if the assets underlying the transferring functions predominantly embody service potential as opposed to future economic benefits, then the recognition of goodwill would also be seemingly be inconsistent with at least the IFRS 3 definition of goodwill:

“An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.”

Approaches as is suggested in PS 2510 of eliminating the bargain purchase excess by adjustment of the values of the related assets and liabilities would negate the principle of using carrying value only, which staff has supported above.

As such it appears that the substance of the transaction is best reflected with the elimination of any goodwill or bargain purchase through the statement of financial performance. This is the approach being considered by the South African discussion paper which proposes:

- Any excess of the purchase price paid over the carrying values of the assets acquired or liabilities incurred or assumed should be treated as a purchase premium and recognised as an expense in the year of acquisition.
- Any excess of the carrying values of assets acquired or liabilities incurred or assumed over the purchase price paid should be recognised in surplus or deficit.

Not Under Common Control – Non-Exchange Transaction

The issue of the most appropriate measurement basis involving transfers of functions when there is no common control requires a little further consideration. From a public sector perspective, these most often occur as a result of one entity (state or national government) imposing a transitory or temporary control over other entities to effect the restructuring.

Achievement of this type of transfer of function could potentially occur in a number of ways – most common would appear to be in the form of an amalgamation or merger, or, alternatively a transferor and recipient can be identified.

Mergers

To give context as to the nature of a merger, the following definition appears in UK ASB FRS 6:

Mergers are considered a form of business combinations that results in the creation of a new reporting entity formed from the combining parties, in which the shareholders of the combining entities come together in a partnership for the mutual sharing of the risks and benefits of the combined entity, and in which no party to the combination in substance obtains control over any other, or is otherwise seen to be dominant, whether by virtue of the proportion of its shareholders' rights in the combined entity, the influence of its directors or otherwise. (underline added)

IFRS 3 requires the identification of an acquirer – one who gains control. Since a key under-pinning of a merger is that no one party gains control (no party is being acquired), this makes the application of the principles of IFRS 3 difficult, though does not necessarily disqualify the use of fair value principles. Two alternative approaches with related measurement attributes can also be considered, notably:

- pooling of interest method; and
- fresh start accounting.

The UK ASB FRS 6 provides direct guidance in relation to mergers (pooling of interests), though is very detailed when such guidance can be applied – requiring the satisfaction of 5 key criteria to ensure that its definition of a merger has been met – the 5 criteria focus on the importance of there being no acquirer in the merger – the criteria are:

1. No party to the combination is portrayed as either acquirer or acquired, either by its own board or management or by that of another party to the combination.
2. All parties to the combination, as represented by the boards of directors or their appointees, participate in establishing the management structure for the combined entity and in selecting the management personnel, and such decisions are made on the basis of a consensus between the parties to the combination rather than purely by exercise of voting rights.
3. The relative sizes of the combining entities are not so disparate that one party dominates the combined entity by virtue of its relative size.
4. Under the terms of the combination or related arrangements, the consideration received by equity shareholders of each party to the combination, in relation to their equity shareholding, comprises primarily equity shares in the combined entity; and
5. any non-equity consideration, or equity shares carrying substantially reduced voting or distribution rights, represents an immaterial proportion of the fair value of the consideration received by the equity shareholders of that party.

Where one of the combining entities has, within the period of two years before the combination, acquired equity shares in another of the combining entities, the consideration for this acquisition should be taken into account in determining whether this criterion has been met.

For the purpose of criterion 4, the consideration should not be taken to include the distribution to shareholders of

- (a) an interest in a peripheral part of the business of the entity in which they were shareholders and which does not form part of the combined entity; or
- (b) the proceeds of the sale of such a business, or loan stock representing such proceeds.

A peripheral part of the business is one that can be disposed of without having a material effect on the nature and focus of the entity's operations. No equity shareholders of any of the combining entities retain any material interest in the future performance of only part of the combined entity.

For the purposes of criterion 1 - 5 above any convertible share or loan stock should be regarded as equity to the extent that it is converted into equity as a result of the business combination.

If the definition of a merger is satisfied, FRS 6's key proposals are:

- the carrying values of the assets and liabilities of the parties to the combination are not required to be adjusted to fair value on consolidation, although appropriate adjustments should be made to achieve uniformity of accounting policies in the combining entities;

- the results and cash flows of all the combining entities should be brought into the financial statements of the combined entity from the beginning of the financial year in which the combination occurred, adjusted so as to achieve uniformity of accounting policies. The corresponding figures should be restated by including the results for all the combining entities for the previous period and their balance sheets for the previous balance sheet date, adjusted as necessary to achieve uniformity of accounting policies.

The FRS 6 approach is essentially a pooling of interests approach recognizing that there has been no acquisition with no-one party gaining control. Therefore, it does not advocate re-measuring the carrying values of the assets and liabilities affected.

The IASB's consideration of the pooling of interest approach, particularly with respect to mergers provides some interesting arguments both for and against. Though the arguments are more within a private sector context, the spirit of some of the arguments seem applicable in a public sector context – to differing degrees. Some respondents argued the pooling method is appropriate for a merger because;

- ownership interests are continued (either completely or substantially);
- no new capital is invested and no assets are distributed;
- post-combination ownership interests are proportional to those before the combination;
- the intention is to unite commercial strategies; and
- unlike acquisitions in which only the acquirer survives the combination, all of the combining entities effectively survive a merger.

IASB deliberations as to the appropriateness of pooling of interests and in particular with respect to mergers, view the combination as an exchange transaction – notably that it is undertaken based on a decision between the two or more entities to be merged. In a public sector context, this is usually not the case – it would more often be simply an aggregation of entities brought about by a higher level of government who has the necessary authority to action the merger.

An alternative to the pooling of interests is the fresh start method. As discussed in the basis of conclusions for IFRS 3:

“In the fresh start method, none of the combining entities is viewed as having survived the combination as an independent reporting entity. Rather, the combination is viewed as the transfer of the net assets of the combining entities to a new entity that assumes control over them. The history of that new entity, by definition, begins with the combination.

In the first part of their respective business combinations projects, both the IASB and the FASB acknowledged that a case could be made for using the fresh start method to account for the relatively rare business combination that does not clearly qualify as an acquisition. Such a combination might be defined either as one in which an acquirer cannot be identified or as one in which the acquirer is substantially modified by the

transaction. However, the boards observed that those transactions have been accounted for by the acquisition method and they decided not to change that practice.

As detailed in the South African discussion paper, in February 1999, the G4 +1 issued a discussion document *Methods of Accounting for Business Combinations: Recommendations of the G4+1 for achieving convergence* which outlines various methods used worldwide to account for business combinations in the private sector. The G4 + 1 document critically analyses the use of the purchase method, the pooling of interests method and the fresh start method, as methods used to account for business combinations.

As further discussed in the South African paper, the key differences between the pooling of interests method and the fresh start method are as follows:

- Under the pooling of interests method, the entities are deemed to continue just within a new entity, i.e. the legal form of the entities may have changed, but the economic substance has not, while under the fresh start method a new entity is deemed to be formed, i.e. there is a change in substance as well as the legal form.
- As the entities are deemed to continue under the pooling of interests method, merely the carrying values of the assets and liabilities of the existing entities are used in the new entity. As a new entity is established in the fresh start method, the new entity should identify assets and liabilities of the new entity and measure them at fair value.

Unfortunately, while the broad principles of the fresh start method seem reasonably well understood, the finer details of its do not appear to be as well commonly agreed upon. The IASB notes in its basis for conclusion for IFRS 3, “Neither the IASB nor the FASB has on its agenda a project to consider the fresh start method. However, both boards have expressed interest in considering whether joint venture formations and some formations of new entities in multi-party business combinations should be accounted for by the fresh start method. Depending on the relative priorities of that topic and other topics competing for their agendas when time becomes available, the boards might undertake a joint project to consider those issues at some future date.

From a pragmatic perspective, the absence of comprehensive guidance on the detailed application of a fresh start approach in and of itself might be sufficient to give greater credence to the pooling of interest approach which is well understood. As indicated in the South African discussion paper – pooling of interests is ‘well tested’.

As such, overall, staff has a preliminary view that a pooling of interest approach seems the more realistic method with which to progress the project in terms of accounting for mergers in the public sector which do not occur under common control and for which there is no exchange transaction.

Transferor and recipient can be identified

Alternatively, instead of a merger, a transferor and recipient could be identified. In these types of circumstances, in particular given the absence of common control, there could be a need for special measurement considerations.

For exchange business combinations not under common control, IFRS 3 requires the identifiable assets and liabilities of the acquiree to be measured at fair value. Similarly, the existing guidance from the national standard setters reviewed also tends to support the use of fair value for the acquirer for an exchange transaction combination not under common control.

Further, IPSAS 23 notes that for an asset acquired through a non-exchange transaction it shall initially be measured at its fair value as at the date of acquisition.

Arguably, for those transfers of functions which do not occur under common control, the approach under IFRS 3 and IPSAS 23 could be relevant. Fair value measurement is also being proposed in the South African discussion paper proposals.

The circumstances surrounding the occurrence of the transfer of functions do differ to those contemplated under IFRS 3 - notably that the transfer can often be an imposed arrangement with no consideration - as such the respective measurement principles may need to be different. However, the absence of common control does appear to give some credit to the application of a measurement bases other than carrying value.

As such, staff are of the preliminary view that the application of fair value could be appropriate and will give this further consideration as the project progresses.

Inconsistent Accounting Policies

A transfer of functions may result in the transferred assets and liabilities having been subject to accounting policies inconsistent with the party receiving those assets and liabilities. As such, staff has the preliminary view that it would be expected that measurements for those items would have to be revised to reflect the accounting policies of the party receiving them.

In the case of mergers, the policy(ies) to be applied would be based on professional judgment so as to result in financial reporting that provides a true and fair view of the operations of the combined entity.

ISSUE 3: DISCLOSURES

A further issue to be considered in developing guidance will be determining appropriate presentation and disclosure requirements for transfers of functions.

In the explanations accompanying UK ASB FRS 6, it advises, that with respect to mergers and the required disclosures within FRS 6 that “Users, particularly those who have been assessing the parties to the combination as separate businesses, may require

information on the financial performance of the individual parties.” Staff do not consider that this would be significantly different in a public sector context.

Taking this into consideration, there are numerous aspects of the transfers of functions which should be considered in developing disclosures. A review of the existing and proposed disclosure requirements of national standard setters highlight that the key aspects of the transfer for which readers should ideally be informed would include:

- Identification of all parties involved to the transfer;
- Identifying the assets and liabilities recognized/derecognised as a result of the transfer separately from other assets and liabilities of the entities involved;
- Identifying the expenses and income attributable to the transferred activities for the reporting period of the entities involved;
- The nature and amount of significant accounting adjustments made to the net assets of any party to the transfer (eg: to achieve consistency of accounting policies or otherwise);
- Any consideration (and its nature) provided as part of the transfer of function.

In support of the disclosures, staff consider that consideration also be given to disclosures addressing the following:

- Legislation or authority or source of approval for the transfer to occur;
- The rationale or planned objectives which led to the transfer occurring; and
- Explanation as to why the chosen method of transfer (e.g., merger) was most suited to the objectives being sought.

ISSUE 4: TERMINOLOGY/DEFINITIONS

Where applicable, it will be ideal to have consistency with IFRS 3 as well with existing material in the IPSASB Handbook. Developments of the conceptual framework project will also need to be monitored. The IPSASB Handbook and IFRS 3 already provide definitions to some key phrases to be considered in the development of guidance – notably:

IPSAS 23 *Revenue From Non-Exchange Transactions* provides useful definitions to assist in the determination of several aspects of a transfer of function – in particular, identification of parties, when the transfer has occurred (control of an asset):

- *Control of an asset* arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or otherwise regulate the access of others to that benefit.

- *Exchange transactions* are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.
- *Non-exchange transactions* are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.
- IPSAS 23 establishes terminology useful for describing parties to the transfer – *transferor* and *recipient*.

Staff consider these to be appropriate bases for future development.

Important for transfer of functions will be a definition for common control – for which there is no definition in the IPSASB Handbook. The IFRS 3 definition of common control will provide an appropriate basis for future consideration development.

- *Common Control* - A business combination involving entities or businesses under common control 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 business combination, and that control is not transitory.

In addition to the IPSASB Handbook, International/National standard setters also provide some useful existing or proposed terminology and definitions to assist in the development of necessary terminology for the project – notably:

- Defining a transfer of functions;
 - Australian Accounting Standards Board 1004 *Contributions*

Restructure of Administrative Arrangements: The reallocation or reorganisation of assets, liabilities, activities and responsibilities amongst the entities that the government controls that occurs as a consequence of a rearrangement in the way in which activities and responsibilities as prescribed under legislation or other authority are allocated between the government's controlled entities.

- UK Accounting Standards Board FRS 6 *Mergers and Acquisitions*

Business combination : The bringing together of separate entities into one economic entity as a result of one entity uniting with, or obtaining control over the net assets and operations of, another.

Merger: a business combinations that results in the creation of a new reporting entity formed from the combining parties, in which the shareholders of the

combining entities come together in a partnership for the mutual sharing of the risks and benefits of the combined entity, and in which no party to the combination in substance obtains control over any other, or is otherwise seen to be dominant, whether by virtue of the proportion of its shareholders' rights in the combined entity, the influence of its directors or otherwise.

- South African Discussion Paper Proposals:

Transfers of functions: The reallocation of government activities and responsibilities between entities by bringing together separate entities or functions into one reporting entity, or by transferring functions between entities.

- To define what is being transferred – :

- South African Discussion Paper Proposals:

Function: A function is an integrated set of activities conducted and managed for the purpose of achieving an entity's objectives. A function consists of inputs, processes to be applied to those inputs, and resulting outputs that may be used to:

- (a) provide a return to owners;
- (b) generate revenue;
- (c) reduce costs or improve efficiencies in the way in which resources are used; or
- (d) deliver goods and services.

- IFRS 3

Business: 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.

Scoping Provision: This IFRS does not apply to ... (b) the acquisition of an asset or a group of assets that does not constitute a *business*. In such cases the acquirer shall identify and recognise 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. The cost of the group shall be allocated 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.

- To define the parties to the transfer – transferor and recipient:

- South African Discussion Paper Proposals:

The Board proposes to use the terms 'transferors' and 'recipients' for the parties involved in transfers of functions. Transferors are those entities that relinquish

control of an entity or transfer certain of its functions to another entity. The entity gaining control over another entity or function is called the recipient.

ISSUE 5: PLACEMENT WITHIN THE IPSASB HANDBOOK

Though less accounting focused, and more cosmetic in nature, the issue of how to present any public sector restructuring guidance within the IPSASB Handbook will also need to be addressed. Options to explore include:

1. A broader scoped public sector version of IFRS 3 which not only provides guidance for entity combinations, but also transfers of functions;
2. Handbook sections for:
 - a. a public sector version of IFRS 3 *Business Combinations*; and
 - b. transfer of functions.

The rules of the road analysis hints at the structure similar to number two - this would ultimately be at the discretion of the Board.

There are advantages and disadvantages to either approach.

Arguably, having all the guidance for restructurings within one IPSAS would provide a convenient 'one stop shop' for users. However, it may also be unwieldy and less user friendly to work through. Further, having a broader scoped IPSAS may be viewed as negating the IPSASB's convergence policy by having entity combination requirements mixed in with a wide range of other guidance.

Separating out the guidance may prove to be a tidier division of guidance and assist in its user friendliness. However, doing so may reduce user friendliness as users will have more than one place to refer to determine which part of the IPSASB Handbook is the most appropriate section for them to be using.

Staff have some preference for option 2 which would seem to better support the IPSASB's convergence policy.

APPENDIX 1

BREIF OVERVIEW OF EXISTING/PROPOSED ACCOUNTING GUIDANCE FROM NATIONAL STANDARD SETTERS WITH PUBLIC SECTOR RESPONSIBILITY AND THE IASB

IASB – IFRS 3 Business Combinations

To be within the scope of IFRS 3, a business combination must involve a business – defined below. The combining or transferring of assets on their own would not qualify as a business combination.

“... 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.”

A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses. The acquirer is the one who gets the control, and the acquiree is the business(es) whom the acquirer obtains control of. Therefore, it is central to the application of IFRS 3 that an ‘acquirer’ **can always** be identified.

Identical to IPSAS 6 *Consolidated and Separate Financial Statements*, control is defined in IAS 27 *Controlled and Separate Financial Statements* as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In order to identify the acquirer IFRS 3 refers to revised IAS 27 which amongst its requirements, contains guidance to assist in determining when control exists.

- IFRS 27.13 Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity unless, in exceptional circumstances, it can be clearly demonstrated 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: ¹
- (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.

¹ See also SIC-12 *Consolidation—Special Purpose Entities*.

IFRS 3 contains a number of scope exclusions, most notably, a combination between entities or businesses under common control. Common control is explained in the basis for conclusions as where all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory (of a short duration).

For those business combinations to which IFRS 3 applies, the acquisition method **must be applied**. The primary accounting principles for the treatment of those combinations in the acquirer's financial statements are:

- measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values except where there are specified exceptions. The exceptions cover:
 - Leases and insurance: to be classified on the basis of the contractual terms and other factors at the inception of the contract;
 - Contingent liabilities: if there is a present obligation and can be measured reliably are recognized;
 - Some assets and liabilities that are recognised or measured in accordance with other IFRSs – including those within the scope of IAS 12 *Income Taxes*, IAS 19 *Employee Benefits*, IFRS 2 *Share-based Payment* and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;
 - A reacquired right for which there are special requirements; and
 - Indemnification assets: on a basis that is consistent with the related indemnified item;
- recognize and measure the goodwill acquired in the business combination or a gain from a bargain purchase; and

IFRS 3 also requires disclosure aimed at enabling the users to evaluate the nature and financial effects of a business combination either during the reporting period, or after the end of the reporting period but before the financial statements are authorized for issue. They cover numerous matters including:

- name/description of acquire, acquisition date, reasons for the combination;
- a qualitative description of the factors that make up the goodwill recognized;
- acquisition-date fair value of the total consideration transferred;
- the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed;
- for a bargain purchase the amount of any gain recognized why a gain resulted;
- a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period.

NEW ZEALAND

New Zealand financial reporting standards are based on the equivalent IFRSs – termed as 'New Zealand IFRS'. As such, with respect to entity combinations, the New Zealand public sector refers NZ IFRS 3 for guidance. NZ IFRS 3 is the same as IFRS 3 in all

material respects. There is currently no additional New Zealand financial reporting standard which supplements IFRS 3 for those entity combinations beyond its scope.

CANADA

The Canadian Public Sector Accounting Standards Board (PSAB) Section PS 2510 *Additional Areas of Consolidation* provides guidance for when an acquisition of a governmental unit occurs (an organization controlled by the government, other than a government business enterprise – including government departments, funds, agencies, service organizations, boards, government not-for-profit organizations, and government business-type organizations).

PS 2510 proposes a ‘purchase method’ approach to such transactions – notably:

- The government's interest in identifiable assets acquired and liabilities assumed would be based on their fair values at the date of acquisition;
- Any excess of the purchase cost over the government's interest in identifiable assets acquired and liabilities assumed, based on their fair values, should be accounted for as a purchase premium and expensed;
- Where the government's interest in the amounts assigned to identifiable assets acquired and liabilities assumed exceeds the purchase cost, it will be necessary to adjust such amounts to eliminate this excess.

However, if acquiring a Government Business Enterprise, the guidance in Section PS 3070 *Investments in Government Business Enterprises* states:

For acquired government business enterprises, the cost of the government's investment is the purchase cost of the acquisition. The purchase cost to the government is the sum of the fair value of the consideration given in the acquisition plus the expenses directly incurred by the government to effect the acquisition. At the date of acquisition, the total purchase cost is assigned to identifiable assets acquired and liabilities assumed. The government's interest in identifiable assets acquired and liabilities assumed would be based on their fair values at the date of acquisition. Any excess of the purchase cost over the government's interest in the amounts assigned to identifiable assets acquired less liabilities assumed would be considered to be a purchase premium which would be accounted for in accordance with paragraph PS 3070.17.

See appendix 3 for a fuller text.

AUSTRALIA

Australian financial reporting standards are based on the equivalent IFRSs. As such, with respect to entity combinations, except for a category of combination called ‘restructure of administrative arrangements’ Australian Accounting Standards Board (AASB) 3 *Business Combinations* is applicable in the Australian public sector. The key provisions of IFRS 3 with respect to the acquisition method are also present within AASB 3.

In adopting an IFRS, the AASB may, where necessary, insert ‘Aus’ paragraph(s) to denote specific additional commentary which addresses any particular Australian circumstances. Aus 2.1 of AASB 3 makes reference to a scoping exclusion for entity combinations called ‘restructure of administrative arrangements’ – guidance for such arrangements appears within a separate standard - AASB 1004 *Contributions*.

The provisions relating to the restructure of administrative arrangements in AASB 1004 apply only to the following categories of entities:

- Not-for-profit government departments;
- For-profit government departments; and
- Other government controlled not-for-profit entities.

The provisions do not apply to local or whole of government financial statements. Further, the scope of the requirements relating to such is limited to the transfer of a business as defined in AASB 3.

AASB 1004 defines a ‘restructure of administrative arrangements’ as:

“The reallocation or reorganisation of assets, liabilities, activities and responsibilities amongst the entities that the government controls that occurs as a consequence of a rearrangement in the way in which activities and responsibilities as prescribed under legislation or other authority are allocated between the government’s controlled entities.”

AASB 1004 then essentially requires that “transfers of resources resulting from such restructures are to be treated as movements in owner’s equity by government controlled not-for-profit entities and for-profit government departments that are transferees or transferors.”

See appendix 3 for a fuller text.

UNITED KINGDOM

The UK Accounting Standards Board’s guidance is FRS 6 *Acquisitions and Mergers*.

FRS 6 defines a business combination broadly, beyond the general context of an acquirer and acquiree, as the bringing together of separate entities into one economic entity as a result of one entity uniting with, or obtaining control over the net assets and operations of, another.

Mergers are considered a form of business combination that results in the creation of a new reporting entity formed from the combining parties, in which the shareholders of the combining entities come together in a partnership for the mutual sharing of the risks and benefits of the combined entity, and in which no party to the combination in substance obtains control over any other, or is otherwise seen to be dominant, whether by virtue of

the proportion of its shareholders' rights in the combined entity, the influence of its directors or otherwise.

An 'acquisition' is considered a business combination which is not a merger.

Where an acquisition has occurred, similar with IFRS 3, FRS 6 requires an acquisition-type approach with one primary difference. Under FRS 6, differences in the fair value of the consideration given and the fair value of the net assets of the entity acquired is accounted for as goodwill – either positive or negative. IFRS 3, allows recognitions of goodwill or a bargain purchase in the P&L.

Acquisition accounting is required to be applied to all business combinations unless the business combination meets the definition of a merger – for which 5 criteria are provided for determining if that definition has been met – paraphrased, those 5 criteria are:

- 1: No party to the combination is portrayed as either acquirer or acquired;
- 2: All parties to the combination, participate in establishing the management structure for the combined entity and in selecting the management personnel. Such decisions are made on a consensus basis;
- 3: The relative sizes of the combining entities are not so disparate that one party dominates the combined entity by virtue of its relative size;
- 4: Under the terms of the combination, the consideration received by equity shareholders of each party to the combination, in relation to their equity shareholding, comprises primarily equity shares in the combined entity; and any non-equity consideration, or equity shares carrying substantially reduced voting or distribution rights, represents an immaterial proportion of the fair value of the consideration received by the equity shareholders of that party;
- 5: No equity shareholders of any of the combining entities retain any material interest in the future performance of only part of the combined entity.

For those business combinations which satisfy the definition of a merger, the key requirements of merger accounting under FRS 6 are that the carrying value of the asset and liabilities of the parties to the combination are not required to be adjusted to fair value on consolidation.

FRS 6 also allows merger accounting for 'group reconstructions' even though there may be no business combination meeting the definition of a merger. A group reconstruction can be one of a number of arrangements, notably for the purposes of this paper, "the combination into a group of two or more companies that before the combination had the same shareholders".

See appendix 3 for a fuller text.

SOUTH AFRICA

The ASB has issued a discussion paper *Transfer of Functions* – comment deadline of April 30. It essentially proposes key definitions and guidance for transfers of functions that are undertaken between entities that are:

- commonly controlled - whether or not a purchase price is paid;
- not commonly controlled and no purchase consideration is paid; and
- mergers.

The paper acknowledges that within the public sector, one entity can be deemed to acquire another entity or part of an entity, which is not commonly controlled, and where a purchase consideration is paid/received. These are termed ‘entity combinations’ for which separate guidance will be developed at a later stage.

The paper notes that generally there are two main categories of transfers of functions, namely those involving entities that are:

- acquiring or being merged with other entities, and
- transferring specific activities from one entity to another.

Given the breadth of arrangements to which it covers, the proposed definition for transfers of functions is “The reallocation of government activities and responsibilities between entities by bringing together separate entities or functions into one reporting entity, or by transferring functions between entities”.

Further, given the broad use of the term ‘function’, its proposed definition is “...an integrated set of activities conducted and managed for the purpose of achieving an entity’s objectives. A function consists of inputs, processes to be applied to those inputs, and resulting outputs that may be used to:

- (a) provide a return to owners;
- (b) generate revenue;
- (c) reduce costs or improve efficiencies in the way in which resources are used; or
- (d) deliver goods and services”.

Recognition/De-recognition – Nature of Transfer

The nature of the transfer is central to the way in which recognition/de-recognition of the related assets and liabilities are treated. The paper proposes that transfers of functions be treated as a contribution from or distribution to owners when:

- (a) it meets the definition of a contribution from or distribution to owners; and
- (b) it is evidenced by of the following:
 - The issue or cancellation of equity instruments.

- A formal agreement establishing or reducing a financial interest in the net assets of either entity.
- Formal designation of the transfer (or a class of such transfer) by parties to the transaction as being either a contribution from or distribution to owners.

If the criteria are not met, the transfer should be accounted for as revenue and expenditure.

Measurement

Having determined the identifiable assets and identifiable liabilities subject to the transfer, an important distinction is made between transfers undertaken between entities under common control and those that are not, predominantly because of measurement issues.

Overall the ASB favors the use of carrying value as a measurement basis for assets and liabilities acquired or assumed as part of a transfer of functions between entities under common control – regardless of whether it is an exchange transaction or no purchase consideration is paid. Recognition at fair value is considered inappropriate most notably because such transactions under common control could not be deemed to be done at arms-length and therefore inconsistent with the definition of fair value.

For transfers not under common control and no purchase consideration paid, the ASB favors the recipient measuring the assets and liabilities at fair value. Comments are being sought on the measurement basis for the transferor.

Mergers

Mergers are a special type of transfer of function defined as “... the creation of a new reporting entity formed from the combining parties, in which the combining entities come together for the mutual sharing of the risks and benefits of the combined entity, and in which no party to the transfer in substance obtains control over any other, or is otherwise seen to be dominant”.

If there is a merger, the paper makes several proposals most notably the application of the pooling of interests method - the combined entity using the carrying values of assets and liabilities on initial consolidation.

A full version of the paper is available from the ASB website:

<http://www.asb.co.za/content.html?navID=57&categoryID=5>

APPENDIX 2

IFRS 3 *Business Combinations*

This version includes amendments resulting from IFRSs issued up to 17 January 2008.

IAS 22 *Business Combinations* was issued by the International Accounting Standards Committee in October 1998. It was a revision of IAS 22 *Business Combinations* (issued in December 1993), which replaced IAS 22 *Accounting for Business Combinations* (issued in November 1983).

In April 2001 the International Accounting Standards Board (IASB) resolved that all Standards and Interpretations issued under previous Constitutions continued to be applicable unless and until they were amended or withdrawn.

In March 2004 the IASB issued IFRS 3 *Business Combinations*. It replaced IAS 22 and three Interpretations:

- SIC-9 *Business Combinations—Classification either as Acquisitions or Unitings of Interests*
- SIC-22 *Business Combinations—Subsequent Adjustment of Fair Values and Goodwill Initially Reported*
- SIC-28 *Business Combinations—“Date of Exchange” and Fair Value of Equity Instruments*.

IFRS 3 was amended by IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (issued March 2004).

IAS 1 *Presentation of Financial Statements* (as revised in September 2007) amended the terminology used throughout IFRSs, including IFRS 3.

In January 2008 the IASB issued a revised IFRS 3.

The following Interpretations refer to IFRS 3:

- SIC-32 *Intangible Assets—Web Site Costs* (issued March 2002 and amended by IFRS 3 in March 2004)
- IFRIC 9 *Reassessment of Embedded Derivatives* (issued March 2006).

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International Financial Reporting Standard 3 *Business Combinations* (IFRS 3) is set out in paragraphs 1–68 and Appendices A–C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the IFRS. Definitions of other terms are given in the Glossary for International Financial Reporting Standards. IFRS 3 should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Reasons for issuing the IFRS

- IN1 The revised International Financial Reporting Standard 3 *Business Combinations* (IFRS 3) is part of a joint effort by the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) to improve financial reporting while promoting the international convergence of accounting standards. Each board decided to address the accounting for business combinations in two phases. The IASB and the FASB deliberated the first phase separately. The FASB concluded its first phase in June 2001 by issuing FASB Statement No. 141 *Business Combinations*. The IASB concluded its first phase in March 2004 by issuing the previous version of IFRS 3 *Business Combinations*. The boards' primary conclusion in the first phase was that virtually all business combinations are acquisitions. Accordingly, the boards decided to require the use of one method of accounting for business combinations—the acquisition method.
- IN2 The second phase of the project addressed the guidance for applying the acquisition method. The boards decided that a significant improvement could be made to financial reporting if they had similar standards for accounting for business combinations. Thus, they decided to conduct the second phase of the project as a joint effort with the objective of reaching the same conclusions. The boards concluded the second phase of the project by issuing this IFRS and FASB Statement No. 141 (revised 2007) *Business Combinations* and the related amendments to IAS 27 *Consolidated and Separate Financial Statements* and FASB Statement No. 160 *Noncontrolling Interests in Consolidated Financial Statements*.
- IN3 The IFRS replaces IFRS 3 (as issued in 2004) and comes into effect for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. Earlier application is permitted, provided that IAS 27 (as amended in 2008) is applied at the same time.

Main features of the IFRS

- IN4 The objective of the IFRS is to enhance the relevance, reliability and comparability of the information that an entity provides in its financial statements about a business combination and its effects. It does that by establishing principles and requirements for how an acquirer:
- (a) recognises and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree;
 - (b) recognises and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and
 - (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

Core principle

- IN5 An acquirer of a business recognises the assets acquired and liabilities assumed at their acquisition-date fair values and discloses information that enables users to evaluate the nature and financial effects of the acquisition.

Applying the acquisition method

- IN6 A business combination must be accounted for by applying the acquisition method, unless it is a combination involving entities or businesses under common control. One of the parties to a business combination can always be identified as the acquirer, being the entity that obtains control of the other business (the acquiree). Formations of a joint venture or the acquisition of an asset or a group of assets that does not constitute a business are not business combinations.
- IN7 The IFRS establishes principles for recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. Any classifications or designations made in

recognising these items must be made in accordance with the contractual terms, economic conditions, acquirer's operating or accounting policies and other factors that exist at the acquisition date.

IN8 Each identifiable asset and liability is measured at its acquisition-date fair value. Any non-controlling interest in an acquiree is measured at fair value or as the non-controlling interest's proportionate share of the acquiree's net identifiable assets.

IN9 The IFRS provides limited exceptions to these recognition and measurement principles:

- (a) Leases and insurance contracts are required to be classified on the basis of the contractual terms and other factors at the inception of the contract (or when the terms have changed) rather than on the basis of the factors that exist at the acquisition date.
- (b) Only those contingent liabilities assumed in a business combination that are a present obligation and can be measured reliably are recognised.
- (c) Some assets and liabilities are required to be recognised or measured in accordance with other IFRSs, rather than at fair value. The assets and liabilities affected are those falling within the scope of IAS 12 *Income Taxes*, IAS 19 *Employee Benefits*, IFRS 2 *Share-based Payment* and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.
- (d) There are special requirements for measuring a reacquired right.
- (e) Indemnification assets are recognised and measured on a basis that is consistent with the item that is subject to the indemnification, even if that measure is not fair value.

IN10 The IFRS requires the acquirer, having recognised the identifiable assets, the liabilities and any non-controlling interests, to identify any difference between:

- (a) the aggregate of the consideration transferred, any non-controlling interest in the acquiree and, in a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree; and
- (b) the net identifiable assets acquired.

The difference will, generally, be recognised as goodwill. If the acquirer has made a gain from a bargain purchase that gain is recognised in profit or loss.

IN11 The consideration transferred in a business combination (including any contingent consideration) is measured at fair value.

IN12 In general, an acquirer measures and accounts for assets acquired and liabilities assumed or incurred in a business combination after the business combination has been completed in accordance with other applicable IFRSs. However, the IFRS provides accounting requirements for reacquired rights, contingent liabilities, contingent consideration and indemnification assets.

Disclosure

IN13 The IFRS requires the acquirer to disclose information that enables users of its financial statements to evaluate the nature and financial effect of business combinations that occurred during the current reporting period or after the reporting date but before the financial statements are authorised for issue. After a business combination, the acquirer must disclose any adjustments recognised in the current reporting period that relate to business combinations that occurred in the current or previous reporting periods.

International Financial Reporting Standard 3 *Business Combinations*

Objective

- 1 The objective of this IFRS is to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a *business combination* and its effects. To accomplish that, this IFRS establishes principles and requirements for how the *acquirer*:
- (a) recognises and measures in its financial statements the *identifiable* assets acquired, the liabilities assumed and any *non-controlling interest* in the *acquiree*;
 - (b) recognises and measures the *goodwill* acquired in the business combination or a gain from a bargain purchase; and
 - (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

Scope

- 2 This IFRS applies to a transaction or other event that meets the definition of a business combination. This IFRS does not apply to:
- (a) the formation of a joint venture.
 - (b) the acquisition of an asset or a group of assets that does not constitute a *business*. In such cases the acquirer shall identify and recognise 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. The cost of the group shall be allocated 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.
 - (c) a combination of entities or businesses under common control (paragraphs B1–B4 provide related application guidance).

Identifying a business combination

- 3 **An entity shall determine whether a transaction or other event is a business combination by applying the definition in this IFRS, which requires that the assets acquired and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition. Paragraphs B5–B12 provide guidance on identifying a business combination and the definition of a business.**

The acquisition method

- 4 **An entity shall account for each business combination by applying the acquisition method.**
- 5 Applying the acquisition method requires:
- (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.

Identifying the acquirer

- 6 **For each business combination, one of the combining entities shall be identified as the acquirer.**
- 7 The guidance in IAS 27 *Consolidated and Separate Financial Statements* shall be used to identify the acquirer—the entity that obtains *control* of the acquiree. If a business combination has occurred but applying the guidance in IAS 27 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–B18 shall be considered in making that determination.

Determining the acquisition date

- 8 **The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.**
- 9 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 might obtain control 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. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.

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

Recognition principle

- 10 **As of the acquisition date, the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in paragraphs 11 and 12.**

Recognition conditions

- 11 To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the *Framework for the Preparation and Presentation of Financial Statements* at the acquisition date. For example, costs 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. Therefore, the acquirer does not recognise those costs as part of applying the acquisition method. Instead, the acquirer recognises those costs in its post-combination financial statements in accordance with other IFRSs.
- 12 In addition, to qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must be part of what the acquirer and the acquiree (or its former *owners*) exchanged in the business combination transaction rather than the result of separate transactions. The acquirer shall apply the guidance in paragraphs 51–53 to determine which assets acquired or liabilities assumed are part of the exchange for the acquiree and which, if any, are the result of separate transactions to be accounted for in accordance with their nature and the applicable IFRSs.
- 13 The acquirer's application of the recognition principle and conditions may result in recognising some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its financial statements. For example, the acquirer recognises the acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.
- 14 Paragraphs B28–B40 provide guidance on recognising operating leases and intangible assets. Paragraphs 22–28 specify the types of identifiable assets and liabilities that include items for which this IFRS provides limited exceptions to the recognition principle and conditions.

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

- 15 **At the acquisition date, the acquirer shall classify or designate the identifiable assets acquired and liabilities assumed as necessary to apply other IFRSs subsequently. The acquirer shall make those classifications or designations on the basis of the contractual terms, economic conditions, its operating or accounting policies and other pertinent conditions as they exist at the acquisition date.**
- 16 In some situations, IFRSs provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the acquirer shall make on the basis of the pertinent conditions as they exist at the acquisition date include but are not limited to:
- (a) classification of particular financial assets and liabilities as a financial asset or liability at fair value through profit or loss, or as a financial asset available for sale or held to maturity, in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*;
 - (b) designation of a derivative instrument as a hedging instrument in accordance with IAS 39; and
 - (c) assessment of whether an embedded derivative should be separated from the host contract in accordance with IAS 39 (which is a matter of ‘classification’ as this IFRS uses that term).
- 17 This IFRS provides two exceptions to the principle in paragraph 15:
- (a) classification of a lease contract as either an operating lease or a finance lease in accordance with IAS 17 *Leases*; and
 - (b) classification of a contract as an insurance contract in accordance with IFRS 4 *Insurance Contracts*.
- The acquirer shall classify those 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).

Measurement principle

- 18 **The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.**
- 19 For each business combination, the acquirer shall measure any non-controlling interest in the acquiree either at fair value or at the non-controlling interest’s proportionate share of the acquiree’s identifiable net assets.
- 20 Paragraphs B41–B45 provide guidance on measuring the fair value of particular identifiable assets and a non-controlling interest in an acquiree. Paragraphs 24–31 specify the types of identifiable assets and liabilities that include items for which this IFRS provides limited exceptions to the measurement principle.

Exceptions to the recognition or measurement principles

- 21 This IFRS provides limited exceptions to its recognition and measurement principles. Paragraphs 22–31 specify both the particular items for which exceptions are provided and the nature of those exceptions. The acquirer shall account for those items by applying the requirements in paragraphs 22–31, which will result in some items being:
- (a) recognised either by applying recognition conditions in addition to those in paragraphs 11 and 12 or by applying the requirements of other IFRSs, with results that differ from applying the recognition principle and conditions.
 - (b) measured at an amount other than their acquisition-date fair values.

Exception to the recognition principle

Contingent liabilities

- 22 IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* defines a contingent liability as:

- (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 of 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.
- 23 The requirements in IAS 37 do not apply in determining which contingent liabilities to recognise as of the acquisition date. Instead, the acquirer shall recognise as of the acquisition date 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. 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. Paragraph 56 provides guidance on the subsequent accounting for contingent liabilities.

Exceptions to both the recognition and measurement principles

Income taxes

- 24 The acquirer shall 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*.
- 25 The acquirer shall account for the potential tax effects of temporary differences and carryforwards of an acquiree that exist at the acquisition date or arise as a result of the acquisition in accordance with IAS 12.

Employee benefits

- 26 The acquirer shall recognise and measure a liability (or asset, if any) related to the acquiree's employee benefit arrangements in accordance with IAS 19 *Employee Benefits*.

Indemnification assets

- 27 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 specified amount on a liability arising from a particular contingency; in other words, the seller will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset. The acquirer shall recognise an indemnification asset at the same time that it recognises the indemnified item measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts. Therefore, if the indemnification relates to an asset or a liability that is recognised at the acquisition date and measured at its acquisition-date fair value, the acquirer shall recognise the indemnification asset at the acquisition date measured at its acquisition-date fair value. 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 (paragraph B41 provides related application guidance).
- 28 In some circumstances, the indemnification may relate to an asset or a 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 a liability, for example, 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 shall be 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. Paragraph 57 provides guidance on the subsequent accounting for an indemnification asset.

Exceptions to the measurement principle

Reacquired rights

- 29 The acquirer shall 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. Paragraphs B35 and B36 provide related application guidance.

Share-based payment awards

- 30 The acquirer shall measure a liability or an equity instrument related to the replacement of an acquiree's share-based payment awards with share-based payment awards of the acquirer in accordance with the method in IFRS 2 *Share-based Payment*. (This IFRS refers to the result of that method as the 'market-based measure' of the award.)

Assets held for sale

- 31 The acquirer shall 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 IFRS.

Recognising and measuring goodwill or a gain from a bargain purchase

- 32 The acquirer shall recognise goodwill as of the acquisition date measured as the excess of (a) over (b) below:

- (a) the aggregate of:
 - (i) the consideration transferred measured in accordance with this IFRS, which generally requires acquisition-date fair value (see paragraph 37);
 - (ii) the amount of any non-controlling interest in the acquiree measured in accordance with this IFRS; and
 - (iii) in a business combination achieved in stages (see paragraphs 41 and 42), the acquisition-date fair value of the acquirer's previously held *equity interest* in the acquiree.
- (b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this IFRS.

- 33 In a business combination in which the acquirer and the acquiree (or its former owners) exchange only equity interests, the acquisition-date fair value of the acquiree's equity interests may be more reliably measurable than the acquisition-date fair value of the acquirer's equity interests. If so, the acquirer shall 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 equity interests transferred. To determine the amount of goodwill in a business combination in which no consideration is transferred, the acquirer shall use the acquisition-date fair value of the acquirer's interest in the acquiree determined using a valuation technique in place of the acquisition-date fair value of the consideration transferred (paragraph 32(a)(i)). Paragraphs B46–B49 provide related application guidance.

Bargain purchases

- 34 Occasionally, an acquirer will make a bargain purchase, which is a business combination in which the amount in paragraph 32(b) exceeds the aggregate of the amounts specified in paragraph 32(a). If that excess remains after applying the requirements in paragraph 36, the acquirer shall recognise the resulting gain in profit or loss on the acquisition date. The gain shall be attributed to the acquirer.
- 35 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 or measurement exceptions for particular items discussed in paragraphs 22–31 may also result in recognising a gain (or change the amount of a recognised gain) on a bargain purchase.

- 36 Before recognising a gain on a bargain purchase, the acquirer shall reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed and shall recognise any additional assets or liabilities that are identified in that review. The acquirer shall then review the procedures used to measure the amounts this IFRS requires to be recognised at the acquisition date for all of the following:

- (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.

Consideration transferred

- 37 The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of 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 consideration transferred in the business combination shall be measured in accordance with paragraph 30 rather than at fair value.) Examples of potential forms of consideration include cash, other assets, a business or a subsidiary of the acquirer, *contingent consideration*, ordinary or preference equity instruments, options, warrants and member interests of *mutual entities*.
- 38 The consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, non-monetary assets or a business of the acquirer). If so, the acquirer shall remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognise the resulting gains or losses, if any, in profit or loss. However, sometimes the transferred assets or liabilities remain within the combined entity after the business combination (for example, because the assets or 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 shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date and shall not recognise a gain or loss in profit or loss on assets or liabilities it controls both before and after the business combination.

Contingent consideration

- 39 The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement (see paragraph 37). The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.
- 40 The acquirer shall classify an obligation to pay contingent consideration 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*, or other applicable IFRSs. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 provides guidance on the subsequent accounting for contingent consideration.

Additional guidance for applying the acquisition method to particular types of business combinations

A business combination achieved in stages

- 41 An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date. For example, on 31 December 20X1, Entity A holds a 35 per cent non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40 per cent interest in Entity B, which gives it control of Entity B. This IFRS refers to such a transaction as a business combination achieved in stages, sometimes also referred to as a step acquisition.

- 42 In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income (for example, because the investment was classified as available for sale). If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

A business combination achieved without the transfer of consideration

- 43 An acquirer sometimes obtains control of an acquiree without transferring consideration. The acquisition method of accounting for a business combination applies to those combinations. Such circumstances include:
- (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.
 - (c) The acquirer and acquiree agree to combine their businesses by contract alone. The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously. Examples of business combinations achieved by contract alone include bringing two businesses together in a stapling arrangement or forming a dual listed corporation.
- 44 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.

Measurement period

- 45 **If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date. During the measurement period, the acquirer shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period 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 shall not exceed one year from the acquisition date.**
- 46 The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify and measure the following as of the acquisition date in accordance with the requirements of this IFRS:
- (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.
- 47 The acquirer shall 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.

- 48 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.
- 49 During the measurement period, the acquirer shall recognise adjustments to the provisional amounts as if the accounting for the business combination had been completed at the acquisition date. Thus, the acquirer shall revise comparative information for prior periods presented in financial statements as needed, including making any change in depreciation, amortisation or other income effects recognised in completing the initial accounting.
- 50 After the measurement period ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Determining what is part of the business combination transaction

- 51 **The acquirer and the acquiree may have a pre-existing relationship or other arrangement before negotiations for the business combination began, or they may enter into an arrangement during the negotiations that is separate from the business combination. In either situation, the acquirer shall identify any amounts that are not part of what the acquirer and the acquiree (or its former owners) exchanged in the business combination, ie amounts that are not part of the exchange for the acquiree. The acquirer shall recognise as part of applying the acquisition method only the consideration transferred for the acquiree and the assets acquired and liabilities assumed in the exchange for the acquiree. Separate transactions shall be accounted for in accordance with the relevant IFRSs.**
- 52 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. The following are examples of separate transactions that are not to be included in applying the acquisition method:
- (a) a transaction that in effect settles pre-existing relationships between the acquirer and acquiree;
 - (b) a transaction that remunerates employees or former owners of the acquiree for future services; and
 - (c) a transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs.

Paragraphs B50–B62 provide related application guidance.

Acquisition-related costs

- 53 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. The acquirer shall account for 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 shall be recognised in accordance with IAS 32 and IAS 39.

Subsequent measurement and accounting

- 54 In general, an acquirer shall subsequently measure and account for assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination in accordance with other applicable IFRSs for those items, depending on their nature. However, this IFRS provides guidance on subsequently measuring and accounting for the following assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination:

- (a) reacquired rights;
- (b) contingent liabilities recognised as of the acquisition date;
- (c) indemnification assets; and
- (d) contingent consideration.

Paragraph B63 provides related application guidance.

Reacquired rights

- 55 A reacquired right recognised as an intangible asset shall 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 shall include the carrying amount of the intangible asset in determining the gain or loss on the sale.

Contingent liabilities

- 56 After initial recognition and until the liability is settled, cancelled or expires, the acquirer shall measure a contingent liability recognised in a business combination at the higher of:

- (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.

Indemnification assets

- 57 At the end of each subsequent reporting period, the acquirer shall 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 shall derecognise the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it.

Contingent consideration

- 58 Some changes in the fair value of contingent consideration that the acquirer recognises after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date. Such changes are measurement period adjustments in accordance with paragraphs 45–49. However, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project, are not measurement period adjustments. The acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:

- (a) Contingent consideration classified as equity shall not be remeasured and its subsequent settlement shall be accounted for within equity.
- (b) Contingent consideration classified as an asset or a liability that:
 - (i) is a financial instrument and is within the scope of IAS 39 shall be measured at fair value, with any resulting gain or loss recognised either in profit or loss or in other comprehensive income in accordance with that IFRS.

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

Disclosures

- 59 The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:
- (a) during the current reporting period; or
 - (b) after the end of the reporting period but before the financial statements are authorised for issue.
- 60 To meet the objective in paragraph 59, the acquirer shall disclose the information specified in paragraphs B64—B66.
- 61 The acquirer shall 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 period or previous reporting periods.
- 62 To meet the objective in paragraph 61, the acquirer shall disclose the information specified in paragraph B67.
- 63 If the specific disclosures required by this and other IFRSs do not meet the objectives set out in paragraphs 59 and 61, the acquirer shall disclose whatever additional information is necessary to meet those objectives.

Effective date and transition

Effective date

- 64 This IFRS shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. Earlier application is permitted. However, this IFRS shall be applied only at the beginning of an annual reporting period that begins on or after 30 June 2007. If an entity applies this IFRS before 1 July 2009, it shall disclose that fact and apply IAS 27 (as amended in 2008) at the same time.

Transition

- 65 Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of this IFRS shall not be adjusted upon application of this IFRS.
- 66 An entity, such as a mutual entity, that has not yet applied IFRS 3 and had one or more business combinations that were accounted for using the purchase method shall apply the transition provisions in paragraphs B68 and B69.

Income taxes

- 67 For business combinations in which the acquisition date was before this IFRS is applied, the acquirer shall apply the requirements of paragraph 68 of IAS 12, as amended by this IFRS, prospectively. That is to say, the acquirer shall not adjust the accounting for prior business combinations for previously recognised changes in recognised deferred tax assets. However, from the date when this IFRS is applied, the acquirer shall recognise, as an adjustment to profit or loss (or, if IAS 12 requires, outside profit or loss), changes in recognised deferred tax assets.

Withdrawal of IFRS 3 (2004)

- 68 This IFRS supersedes IFRS 3 *Business Combinations* (as issued in 2004).

Appendix A Defined terms

This appendix is an integral part of the IFRS.

acquiree	The business or businesses that the acquirer obtains control of in a business combination .
acquirer	The entity that obtains control of the acquiree .
acquisition date	The date on which the acquirer obtains control of the acquiree .
business	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.
business combination	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.
contingent consideration	Usually, an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met. However, contingent consideration also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met.
control	The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
equity interests	For the purposes of this IFRS, <i>equity interests</i> is used broadly to mean ownership interests of investor-owned entities and owner, member or participant interests of mutual entities .
fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.
goodwill	An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.
identifiable	An asset is <i>identifiable</i> if it either: <ul style="list-style-type: none">(a) is separable, ie 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; or(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
intangible asset	An identifiable non-monetary asset without physical substance.
mutual entity	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.

non-controlling interest	The equity in a subsidiary not attributable, directly or indirectly, to a parent.
owners	For the purposes of this IFRS, <i>owners</i> is used broadly to include holders of equity interests of investor-owned entities and owners or members of, or participants in, mutual entities .

Appendix B Application guidance

This appendix is an integral part of the IFRS.

Business combinations of entities under common control (application of paragraph 2(c))

- B1 This IFRS does not apply to a business combination of entities or businesses under common control. A business combination involving entities or businesses under common control 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 business combination, and that control is not transitory.
- B2 A group of individuals shall be regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities. Therefore, a business combination is outside the scope of this IFRS when the same group of individuals has, as a result of contractual arrangements, ultimate collective power to govern the financial and operating policies of each of the combining entities so as to obtain benefits from their activities, and that ultimate collective power is not transitory.
- B3 An entity may be controlled by an individual or by a group of individuals acting together under a contractual arrangement, and that individual or group of individuals may not be subject to the financial reporting requirements of IFRSs. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a business combination to be regarded as one involving entities under common control.
- B4 The extent of non-controlling interests in each of the combining entities before and after the business combination is not relevant to determining whether the combination involves entities under common control. Similarly, the fact that one of the combining entities is a subsidiary that has been excluded from the consolidated financial statements is not relevant to determining whether a combination involves entities under common control.

Identifying a business combination (application of paragraph 3)

- B5 This IFRS defines a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses. An acquirer might obtain control of an acquiree in a variety of ways, for example:
- (a) by transferring cash, cash equivalents or other assets (including net assets that constitute a business);
 - (b) by incurring liabilities;
 - (c) by issuing equity interests;
 - (d) by providing more than one type of consideration; or
 - (e) without transferring consideration, including by contract alone (see paragraph 43).
- B6 A business combination may be structured in a variety of ways for legal, taxation or other reasons, which include but are not limited to:

- (a) one or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer;
- (b) one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners;
- (c) all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity (sometimes referred to as a roll-up or put-together transaction); or
- (d) a group of former owners of one of the combining entities obtains control of the combined entity.

Definition of a business (application of paragraph 3)

B7 A business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business. The three elements of a business are defined as follows:

- (a) **Input:** Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it. Examples include non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.
- (b) **Process:** Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs. Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)
- (c) **Output:** The result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

B8 To be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs, which together are or will be used to create outputs. However, a business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes.

B9 The nature of the elements of a business varies by industry and by the structure of an entity's operations (activities), including the entity's stage of development. Established businesses often have many different types of inputs, processes and outputs, whereas new businesses often have few inputs and processes and sometimes only a single output (product). Nearly all businesses also have liabilities, but a business need not have liabilities.

B10 An integrated set of activities and assets in the development stage might not have outputs. If not, the acquirer should consider other factors to determine whether the set is a business. Those factors include, but are not limited to, whether the set:

- (a) has begun planned principal activities;
- (b) has employees, intellectual property and other inputs and processes that could be applied to those inputs;
- (c) is pursuing a plan to produce outputs; and
- (d) will be able to obtain access to customers that will purchase the outputs.

Not all of those factors need to be present for a particular integrated set of activities and assets in the development stage to qualify as a business.

- B11 Determining whether a particular set of assets and activities is a business should be based on whether the integrated set is capable of being conducted and managed as a business by a market participant. Thus, in evaluating whether a particular set is a business, it is not relevant whether a seller operated the set as a business or whether the acquirer intends to operate the set as a business.
- B12 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.

Identifying the acquirer (application of paragraphs 6 and 7)

- B13 The guidance in IAS 27 *Consolidated and Separate Financial Statements* shall be used to identify the acquirer—the entity that obtains control of the acquiree. If a business combination has occurred but applying the guidance in IAS 27 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–B18 shall be considered in making that determination.
- B14 In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.
- B15 In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called ‘reverse acquisitions’, the issuing entity is the acquiree. Paragraphs B19–B27 provide guidance on accounting for reverse acquisitions. Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:
- (a) *the relative voting rights in the combined entity after the business combination*—The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. In determining which group of owners retains or receives the largest portion of the voting rights, an entity shall consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities.
 - (b) *the existence of a large minority voting interest in the combined entity if no other owner or organised group of owners has a significant voting interest*—The acquirer is usually the combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity.
 - (c) *the composition of the governing body of the combined entity*—The acquirer is usually the combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity.
 - (d) *the composition of the senior management of the combined entity*—The acquirer is usually the combining entity whose (former) management dominates the management of the combined entity.
 - (e) *the terms of the exchange of equity interests*—The acquirer is usually the combining entity that pays a premium over the pre-combination fair value of the equity interests of the other combining entity or entities.
- B16 The acquirer is usually the combining entity whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities.
- B17 In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities.
- B18 A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer by applying the guidance in paragraphs B13–B17. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

Reverse acquisitions

B19 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 paragraphs B13–B18. 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. For example, 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 the 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 paragraphs B13–B18 results in identifying:

- (a) the public entity as the **acquiree** for accounting purposes (the accounting acquiree); and
- (b) the private entity as the **acquirer** for accounting purposes (the accounting acquirer).

The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles in this IFRS, including the requirement to recognise goodwill, apply.

Measuring the consideration transferred

B20 In a reverse acquisition, the accounting acquirer usually issues no consideration for the acquiree. Instead, the accounting acquiree usually issues its equity shares to the owners of the accounting acquirer. Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree is based on the number of equity interests the legal subsidiary would have had to issue to give the owners of the legal parent the same percentage equity interest in the combined entity that results from the reverse acquisition. The fair value of the number of equity interests calculated in that way can be used as the fair value of consideration transferred in exchange for the acquiree.

Preparation and presentation of consolidated financial statements

B21 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).

B22 Because the consolidated financial statements represent the continuation of the financial statements of the legal subsidiary except for its capital structure, the consolidated financial statements reflect:

- (a) the assets and liabilities of the legal subsidiary (the accounting acquirer) recognised and measured at their pre-combination carrying amounts.
- (b) the assets and liabilities of the legal parent (the accounting acquiree) recognised and measured in accordance with this IFRS.
- (c) the retained earnings and other equity balances of the legal subsidiary (accounting acquirer) **before** the business combination.
- (d) the amount recognised as issued equity interests in the consolidated financial statements 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 this IFRS. However, the equity structure (ie 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.

- (e) the non-controlling interest's proportionate share of the legal subsidiary's (accounting acquirer's) pre-combination carrying amounts of retained earnings and other equity interests as discussed in paragraphs B23 and B24.

Non-controlling interest

- B23 In a reverse acquisition, some of the owners of the legal acquiree (the accounting acquirer) might not exchange their equity interests for equity interests of the legal parent (the accounting acquiree). Those owners are treated as a non-controlling interest in the consolidated financial statements after the reverse acquisition. That is because the owners of the legal acquiree that do not exchange their equity interests for equity interests of the legal acquirer have an interest in only the results and net assets of the legal acquiree—not in the results and net assets of the combined entity. Conversely, even though the legal acquirer is the acquiree for accounting purposes, the owners of the legal acquirer have an interest in the results and net assets of the combined entity.
- B24 The assets and liabilities of the legal acquiree are measured and recognised in the consolidated financial statements at their pre-combination carrying amounts (see paragraph B22(a)). Therefore, in a reverse acquisition the non-controlling interest reflects the non-controlling shareholders' proportionate interest in the pre-combination carrying amounts of the legal acquiree's net assets even if the non-controlling interests in other acquisitions are measured at their fair value at the acquisition date.

Earnings per share

- B25 As noted in paragraph B22(d), the equity structure in the consolidated financial statements following a reverse acquisition reflects the equity structure of the legal acquirer (the accounting acquiree), including the equity interests issued by the legal acquirer to effect the business combination.
- B26 In calculating the weighted average number of ordinary shares outstanding (the denominator of the earnings per share calculation) during the period in which the reverse acquisition occurs:
 - (a) the number of ordinary shares outstanding from the beginning of that period to the acquisition date shall be computed on the basis of the weighted average number of ordinary shares of the legal acquiree (accounting acquirer) outstanding during the period multiplied by the exchange ratio established in the merger agreement; and
 - (b) the number of ordinary shares outstanding from the acquisition date to the end of that period shall be the actual number of ordinary shares of the legal acquirer (the accounting acquiree) outstanding during that period.
- B27 The basic earnings per share for each comparative period before the acquisition date presented in the consolidated financial statements following a reverse acquisition shall be calculated by dividing:
 - (a) the profit or loss of the legal acquiree attributable to ordinary shareholders in each of those periods by
 - (b) the legal acquiree's historical weighted average number of ordinary shares outstanding multiplied by the exchange ratio established in the acquisition agreement.

Recognising particular assets acquired and liabilities assumed (application of paragraphs 10–13)

Operating leases

- B28 The acquirer shall recognise no assets or liabilities related to an operating lease in which the acquiree is the lessee except as required by paragraphs B29 and B30.
- B29 The acquirer shall determine whether the terms of each operating lease in which the acquiree is the lessee are favourable or unfavourable. The acquirer shall recognise 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. Paragraph B42 provides guidance on measuring the acquisition-date fair value of assets subject to operating leases in which the acquiree is the lessor.
- B30 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, for example, as a customer relationship. In that situation, the acquirer shall recognise the associated identifiable intangible asset(s) in accordance with paragraph B31.

Intangible assets

- B31 The acquirer shall recognise, separately from goodwill, the identifiable intangible assets acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion.
- B32 An intangible asset that meets the contractual-legal criterion is identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations. For example:
- (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.
 - (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.
 - (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.
- B33 The separability criterion means that an acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability. An intangible asset that the acquirer would be able to sell, license or otherwise exchange for something else of value meets the separability criterion even if the acquirer does not intend to sell, license or otherwise exchange it. An acquired intangible asset 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. For example, 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.

- B34 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. For example:
- (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.
 - (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.

Reacquired rights

- B35 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 such 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 identifiable intangible asset that the acquirer recognises separately from goodwill. Paragraph 29 provides guidance on measuring a reacquired right and paragraph 55 provides guidance on the subsequent accounting for a reacquired right.
- B36 If the terms of the contract giving rise to a reacquired right are favourable or unfavourable relative to the terms of current market transactions for the same or similar items, the acquirer shall recognise a settlement gain or loss. Paragraph B52 provides guidance for measuring that settlement gain or loss.

Assembled workforce and other items that are not identifiable

- B37 The acquirer subsumes into goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. For example, 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. Because the assembled workforce is not an identifiable asset to be recognised separately from goodwill, any value attributed to it is subsumed into goodwill.
- B38 The acquirer also subsumes into goodwill any value attributed to items that do not qualify as assets at the acquisition date. For example, the acquirer might attribute value to potential contracts the acquiree is negotiating with prospective new customers at the acquisition date. Because those potential contracts are not themselves assets at the acquisition date, the acquirer does not recognise them separately from goodwill. 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.
- B39 After initial recognition, an acquirer accounts for intangible assets acquired in a business combination in accordance with the provisions of IAS 38 *Intangible Assets*. However, as described in paragraph 3 of IAS 38, the accounting for some acquired intangible assets after initial recognition is prescribed by other IFRSs.
- B40 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. For example, 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, see paragraph 29, which establishes an exception to the fair value measurement principle for reacquired rights recognised in a business combination.) 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.

Measuring the fair value of particular identifiable assets and a non-controlling interest in an acquiree (application of paragraphs 18 and 19)

Assets with uncertain cash flows (valuation allowances)

- B41 The acquirer shall not 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 this IFRS 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.

Assets subject to operating leases in which the acquiree is the lessor

- B42 In measuring the acquisition-date fair value of an asset such as a building or a patent that is subject to an operating lease in which the acquiree is the lessor, the acquirer shall take into account the terms of the lease. In other words, the acquirer does not recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms as paragraph B29 requires for leases in which the acquiree is the lessee.

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

- B43 For competitive or other reasons, the acquirer may intend not to use an acquired asset, for example, a research and development intangible asset, 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. Nevertheless, the acquirer shall measure the asset at fair value determined in accordance with its use by other market participants.

Non-controlling interest in an acquiree

- B44 This IFRS allows the acquirer to measure a non-controlling interest in the acquiree at its fair value at the acquisition date. Sometimes an acquirer will be able to measure the acquisition-date fair value of a non-controlling interest on the basis of active market prices for the equity shares not held by the acquirer. In other situations, however, an active market price for the equity shares will not be available. In those situations, the acquirer would measure the fair value of the non-controlling interest using other valuation techniques.
- B45 The fair values of the acquirer's interest in the acquiree and the non-controlling interest on a per-share basis might 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 (also referred to as a minority discount) in the per-share fair value of the non-controlling interest.

Measuring goodwill or a gain from a bargain purchase

Measuring the acquisition-date fair value of the acquirer's interest in the acquiree using valuation techniques (application of paragraph 33)

- B46 In a business combination achieved without the transfer of consideration, the acquirer must substitute 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 (see paragraphs 32–34). The acquirer should measure the acquisition-date 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 are 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.

Special considerations in applying the acquisition method to combinations of mutual entities (application of paragraph 33)

- B47 When two mutual entities combine, the fair value of the equity or member interests in the acquiree (or the fair value of the acquiree) may be more reliably measurable than the fair value of the member interests transferred by the acquirer. In that situation, paragraph 33 requires the acquirer to 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. In addition, the acquirer in a combination of mutual entities shall recognise 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.
- B48 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.
- B49 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.

Determining what is part of the business combination transaction (application of paragraphs 51 and 52)

- B50 The 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:
- (a) **the reasons for the transaction**—Understanding the reasons why the parties to the combination (the acquirer and the acquiree and their owners, directors and managers—and their agents) 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.

- (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.
- (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 benefits to the acquirer or the combined entity. If so, the acquiree or its former owners before the business combination are likely to receive little or no benefit from the transaction except for benefits they receive as part of the combined entity.

Effective settlement of a pre-existing relationship between the acquirer and acquiree in a business combination (application of paragraph 52(a))

B51 The acquirer and acquiree may have a relationship that existed before they contemplated the business combination, referred to here as a ‘pre-existing relationship’. A pre-existing relationship between the acquirer and acquiree may be contractual (for example, vendor and customer or licensor and licensee) or non-contractual (for example, plaintiff and defendant).

B52 If the business combination in effect settles a pre-existing relationship, the acquirer recognises a gain or loss, measured as follows:

- (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.)
 - (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.

B53 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 paragraph B52.

Arrangements for contingent payments to employees or selling shareholders (application of paragraph 52(b))

- B54 Whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the business combination or are separate transactions depends on the nature of the arrangements. Understanding the reasons 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.
- B55 If it is not clear whether an arrangement for payments to employees or selling shareholders is part of the exchange for the acquiree or is a transaction separate from the business combination, the acquirer should consider the following indicators:
- (a) *Continuing employment*—The terms of continuing employment by the selling shareholders who become key employees may be an indicator of the substance of a contingent consideration arrangement. The relevant terms of continuing employment may be included in an employment agreement, acquisition agreement or some other document. 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. For example, 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. Alternatively, 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. The pre-acquisition ownership interests held by parties related to selling shareholders who continue as key employees, such as family members, should also be considered.
 - (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, 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 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) and the income tax treatment of contingent payments 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 for contingent payments 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.

Acquirer share-based payment awards exchanged for awards held by the acquiree's employees (application of paragraph 52(b))

- B56 An acquirer may exchange its share-based payment awards (replacement awards) for awards held by employees of the acquiree. 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*. If 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 shall be included in measuring the consideration transferred in the business combination. The acquirer is 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 obliged to replace the acquiree's awards if replacement is required by:

- (a) the terms of the acquisition agreement;
- (b) the terms of the acquiree's awards; or
- (c) applicable laws or regulations.

In some situations, acquiree awards may expire as a consequence of a business combination. If the acquirer replaces those awards even though it is not obliged to do so, all of the market-based measure of the replacement awards shall be recognised as remuneration cost in the post-combination financial statements. That is to say, none of the market-based measure of those awards shall be included in measuring the consideration transferred in the business combination.

- B57 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 shall measure both the replacement awards granted by the acquirer and the acquiree awards as of the acquisition date in accordance with IFRS 2. The portion of the market-based measure of the replacement award that is part of the consideration transferred in exchange for the acquiree equals the portion of the acquiree award that is attributable to pre-combination service.
- B58 The portion of the replacement award attributable to pre-combination service 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. The vesting period is the period during which all the specified vesting conditions are to be satisfied. Vesting conditions are defined in IFRS 2.
- B59 The portion of a non-vested replacement award attributable to post-combination service, and therefore recognised as remuneration cost in the post-combination financial statements, equals the total market-based measure of the replacement award less the amount attributed to pre-combination service. 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. The acquirer shall attribute 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.

- B60 The portion of a non-vested replacement award attributable to pre-combination service, as well as the portion attributable to post-combination service, shall reflect the best available estimate of the number of replacement awards 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. Changes in the estimated number of replacement awards expected to vest are reflected in remuneration cost for the periods in which the changes or forfeitures occur not as adjustments to the consideration transferred in the business combination. Similarly, 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.
- B61 The same requirements for determining the portions of a replacement award attributable to pre-combination and post-combination service apply regardless of whether a replacement award is classified as a liability or as an equity instrument in accordance with the provisions of 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.
- B62 The income tax effects of replacement awards of share-based payments shall be recognised in accordance with the provisions of IAS 12 *Income Taxes*.

Other IFRSs that provide guidance on subsequent measurement and accounting (application of paragraph 54)

- B63 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:
- (a) IAS 38 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.
 - (b) IFRS 4 *Insurance Contracts* provides guidance on the subsequent accounting for an insurance contract acquired in a business combination.
 - (c) IAS 12 prescribes the subsequent accounting for deferred tax assets (including unrecognised deferred tax assets) and liabilities acquired in a business combination.
 - (d) IFRS 2 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.
 - (e) IAS 27 (as amended in 2008) provides guidance on accounting for changes in a parent's ownership interest in a subsidiary after control is obtained.

Disclosures (application of paragraphs 59 and 61)

- B64 To meet the objective in paragraph 59, the acquirer shall disclose the following information for each business combination that occurs during the reporting period:
- (a) the name and a description of the acquiree.
 - (b) the acquisition date.
 - (c) the percentage of voting equity interests acquired.

- (d) the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
- (e) 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.
- (f) the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:
 - (i) cash;
 - (ii) other tangible or intangible assets, including a business or subsidiary of the acquirer;
 - (iii) liabilities incurred, for example, a liability for contingent consideration; and
 - (iv) 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.
- (g) for contingent consideration arrangements and indemnification assets:
 - (i) the amount recognised as of the acquisition date;
 - (ii) a description of the arrangement and the basis for determining the amount of the payment; and
 - (iii) 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 shall disclose that fact.
- (h) for acquired receivables:
 - (i) the fair value of the receivables;
 - (ii) the gross contractual amounts receivable; and
 - (iii) the best estimate at the acquisition date of the contractual cash flows not expected to be collected.

The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables.
- (i) the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed.
- (j) for each contingent liability recognised in accordance with paragraph 23, the information required in paragraph 85 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. If a contingent liability is not recognised because its fair value cannot be measured reliably, the acquirer shall disclose:
 - (i) the information required by paragraph 86 of IAS 37; and
 - (ii) the reasons why the liability cannot be measured reliably.
- (k) the total amount of goodwill that is expected to be deductible for tax purposes.
- (l) for transactions that are recognised separately from the acquisition of assets and assumption of liabilities in the business combination in accordance with paragraph 51:
 - (i) a description of each transaction;
 - (ii) how the acquirer accounted for each transaction;
 - (iii) the amounts recognised for each transaction and the line item in the financial statements in which each amount is recognised; and
 - (iv) if the transaction is the effective settlement of a pre-existing relationship, the method used to determine the settlement amount.

- (m) the disclosure of separately recognised transactions required by (l) shall 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 shall also be disclosed.
- (n) in a bargain purchase (see paragraphs 34–36):
 - (i) the amount of any gain recognised in accordance with paragraph 34 and the line item in the statement of comprehensive income in which the gain is recognised; and
 - (ii) a description of the reasons why the transaction resulted in a gain.
- (o) 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:
 - (i) the amount of the non-controlling interest in the acquiree recognised at the acquisition date and the measurement basis for that amount; and
 - (ii) for each non-controlling interest in an acquiree measured at fair value, the valuation techniques and key model inputs used for determining that value.
- (p) in a business combination achieved in stages:
 - (i) the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date; and
 - (ii) 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 (see paragraph 42) and the line item in the statement of comprehensive income in which that gain or loss is recognised.
- (q) the following information:
 - (i) 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
 - (ii) 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 this subparagraph is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable. This IFRS uses the term ‘impracticable’ with the same meaning as in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

- B65 For individually immaterial business combinations occurring during the reporting period that are material collectively, the acquirer shall disclose in aggregate the information required by paragraph B64(e)–(q).
- B66 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 acquirer shall disclose the information required by paragraph B64 unless the initial accounting for the business combination is incomplete at the time the financial statements are authorised for issue. In that situation, the acquirer shall describe which disclosures could not be made and the reasons why they cannot be made.
- B67 To meet the objective in paragraph 61, the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:
- (a) if the initial accounting for a business combination is incomplete (see paragraph 45) 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:
 - (i) the reasons why the initial accounting for the business combination is incomplete;

- (ii) the assets, liabilities, equity interests or items of consideration for which the initial accounting is incomplete; and
 - (iii) the nature and amount of any measurement period adjustments recognised during the reporting period in accordance with paragraph 49.
- (b) 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:
 - (i) any changes in the recognised amounts, including any differences arising upon settlement;
 - (ii) any changes in the range of outcomes (undiscounted) and the reasons for those changes; and
 - (iii) the valuation techniques and key model inputs used to measure contingent consideration.
- (c) for contingent liabilities recognised in a business combination, the acquirer shall disclose the information required by paragraphs 84 and 85 of IAS 37 for each class of provision.
- (d) a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period showing separately:
 - (i) the gross amount and accumulated impairment losses at the beginning of the reporting period.
 - (ii) 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*.
 - (iii) adjustments resulting from the subsequent recognition of deferred tax assets during the reporting period in accordance with paragraph 67.
 - (iv) 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.
 - (v) 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.)
 - (vi) net exchange rate differences arising during the reporting period in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*.
 - (vii) any other changes in the carrying amount during the reporting period.
 - (viii) the gross amount and accumulated impairment losses at the end of the reporting period.
- (e) the amount and an explanation of any gain or loss recognised in the current reporting period that both:
 - (i) relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period; and
 - (ii) is of such a size, nature or incidence that disclosure is relevant to understanding the combined entity's financial statements.

Transitional provisions for business combinations involving only mutual entities or by contract alone (application of paragraph 66)

- B68 Paragraph 64 provides that this IFRS applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. Earlier application is permitted. However, an entity shall apply this IFRS only at the

beginning of an annual reporting period that begins on or after 30 June 2007. If an entity applies this IFRS before its effective date, the entity shall disclose that fact and shall apply IAS 27 (as amended in 2008) at the same time.

B69 The requirement to apply this IFRS prospectively has the following effect for a business combination involving only mutual entities or by contract alone if the acquisition date for that business combination is before the application of this IFRS:

- (a) *Classification*—An entity shall continue to classify the prior business combination in accordance with the entity's previous accounting policies for such combinations.
- (b) *Previously recognised goodwill*—At the beginning of the first annual period in which this IFRS is applied, the carrying amount of goodwill arising from the prior business combination shall be its carrying amount at that date in accordance with the entity's previous accounting policies. In determining that amount, the entity shall eliminate the carrying amount of any accumulated amortisation of that goodwill and the corresponding decrease in goodwill. No other adjustments shall be made to the carrying amount of goodwill.
- (c) *Goodwill previously recognised as a deduction from equity*—The entity's previous accounting policies may have resulted in goodwill arising from the prior business combination being recognised as a deduction from equity. In that situation the entity shall not recognise that goodwill as an asset at the beginning of the first annual period in which this IFRS is applied. Furthermore, the entity shall not recognise in profit or loss any part of that goodwill when it disposes of all or part of the business to which that goodwill relates or when a cash-generating unit to which the goodwill relates becomes impaired.
- (d) *Subsequent accounting for goodwill*—From the beginning of the first annual period in which this IFRS is applied, an entity shall discontinue amortising goodwill arising from the prior business combination and shall test goodwill for impairment in accordance with IAS 36.
- (e) *Previously recognised negative goodwill*—An entity that accounted for the prior business combination by applying the purchase method may have recognised a deferred credit for an excess of its interest in the net fair value of the acquiree's identifiable assets and liabilities over the cost of that interest (sometimes called negative goodwill). If so, the entity shall derecognise the carrying amount of that deferred credit at the beginning of the first annual period in which this IFRS is applied with a corresponding adjustment to the opening balance of retained earnings at that date.

Appendix C Amendments to other IFRSs

The amendments in this appendix shall be applied for annual reporting periods beginning on or after 1 July 2009. If an entity applies this IFRS for an earlier period, these amendments shall be applied for that earlier period. Amended paragraphs are shown with new text underlined and deleted text struck through.

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The amendments contained in this appendix when this revised IFRS was issued in 2008 have been incorporated into the relevant IFRSs published in this volume.

APPENDIX 3

FULLER TEXT OF ENTITY COMBINATION GUIDANCE – SOME NATIONAL STANDARD SETTERS WITH PUBLIC SECTOR RESPONSIBILITY

CANADA	AUSTRALIA	UNITED KINGDOM
<p>PS 2510 Additional Areas of Consolidation</p> <p>ACQUISITIONS</p> <p>.11 Governments normally create governmental units, often through a restructuring of existing government resources, rather than acquire them. In the rare circumstances when a government acquires a governmental unit, the acquisition is normally made for policy reasons. An acquisition means that the government has acquired control of a governmental unit and the government, as the buyer, pays cash or other consideration to the seller either for shares representing voting control or for net assets.</p> <p>.12 <input type="checkbox"/> <i>Government financial statements should consolidate acquired governmental units line-by-line on a uniform basis of accounting, after eliminating inter-governmental unit transactions and balances in accordance with BASIC PRINCIPLES OF CONSOLIDATION, paragraphs PS 2500.08-.18, and taking into account paragraph PS 2510.31. [MAY 1999]</i></p> <p>.13 When including acquired governmental units in their financial statements, governments would apply the mechanics of the purchase method of combination, with one exception: when the</p>	<p>AASB 3 Business Combinations</p> <p>Aus 2.1 A restructure of administrative arrangements, as defined in Appendix A of AASB 1004 <i>Contributions</i>, is outside the scope of this Standard. AASB 1004 specifies requirements for restructures of administrative arrangements.²</p> <p>AASB 1004 Contributions</p> <p>Restructure of Administrative Arrangements</p> <p>Paragraphs 54 to 59 of this Standard apply only to government controlled not-for-profit entities and for-profit government departments.</p> <p>54 In relation to a restructure of administrative arrangements, a government controlled not-for-profit transferor entity or a for-profit government department transferor entity shall recognise distributions to owners and a government controlled not-for-profit transferee entity or a for-profit government department transferee entity shall recognise contributions by owners in respect of assets transferred.</p> <p>55 In relation to a restructure of administrative arrangements, a government controlled not-for-profit transferor entity or a for-profit government department transferor entity shall recognise contributions</p>	<p>FRS 6 Acquisitions and Mergers</p> <p>Key Definitions</p> <p>Acquisition :- A business combination that is not a merger.</p> <p>Business combination :- The bringing together of separate entities into one economic entity as a result of one entity uniting with, or obtaining control over the net assets and operations of, another.</p> <p>Group reconstruction :- Any of the following arrangements: (a) the transfer of a shareholding in a subsidiary undertaking from one group company to another; (b) the addition of a new parent company to a group; (c) the transfer of shares in one or more subsidiary undertakings of a group to a new company that is not a group company but whose shareholders are the same as those of the group's parent; (d) the combination into a group of two or more companies that before the combination had the same shareholders.</p> <p>Merger:- A business combination that results in the creation of a new reporting entity formed from the combining parties, in which the shareholders of the combining entities come together in a</p>

² The definition of, and requirements for, a restructure of administrative arrangements are included in the version of AASB 1004 issued in December 2007.

<p>purchase cost exceeds the government's share of the fair value of the net assets of the acquired governmental unit, the excess would be recognized as an expense in the period of acquisition in accordance with paragraphs PS 2510.23-.24.</p>	<p>by owners and a government controlled not-for-profit transferee entity or a for-profit government department transferee entity shall recognise distributions to owners in respect of liabilities transferred.</p>	<p>partnership for the mutual sharing of the risks and benefits of the combined entity, and in which no party to the combination in substance obtains control over any other, or is otherwise seen to be dominant, whether by virtue of the proportion of its shareholders' rights in the combined entity, the influence of its directors or otherwise.</p>
<p>Applying the purchase method Determining the purchase cost</p>	<p>56 When both assets and liabilities are transferred as a consequence of a restructure of administrative arrangements, a government controlled not-for-profit transferor entity or a for-profit government department transferor entity and a government controlled not-for-profit transferee entity or a for-profit government department transferee entity shall recognise a net contribution by owners or distribution to owners, as applicable.</p>	<p><i>Use of merger accounting</i></p>
<p>.14 Under the purchase method, the government's interest in assets acquired and liabilities assumed is accounted for in the financial statements at the cost to the government. The consolidated operating results of the government would include the government's proportionate share of the results of the acquired governmental unit from the date of acquisition only.</p>	<p>57 When activities are transferred as a consequence of a restructure of administrative arrangements, a government controlled not-for-profit transferee entity or a for-profit government department transferee entity shall disclose the expenses and income attributable to the transferred activities for the reporting period, showing separately those expenses and items of income recognised by the transferor during the reporting period. If disclosure of this information would be impracticable, that fact shall be disclosed, together with an explanation of why this is the case.</p>	<p>5 A business combination should be accounted for by using merger accounting if:</p>
<p>.15 <input type="checkbox"/> <i>The purchase cost of a governmental unit to a government should be determined by the fair value of the consideration given. In those cases where the fair value of the consideration is not clearly evident, the government's share of the fair value of the net assets acquired should be used as the purchase cost to the government. [MAY 1999]</i></p>	<p>58 For each material transfer, the assets and liabilities transferred as a consequence of a restructure of administrative arrangements during the reporting period shall be disclosed by class, and the counterparty transferor/transferee entity shall be identified. With respect to transfers that are individually immaterial, the assets and liabilities transferred shall be disclosed</p>	<p>(a) the use of merger accounting for the [4ASch 101 combination is not prohibited by companies legislation; and</p>
<p>.16 The general principles to be applied in determining the purchase cost will depend upon the nature of the transaction. Where the consideration given is cash or other assets, the cost will be the amount of cash disbursed or the fair value of other assets distributed. Where debt securities are issued or liabilities incurred, the cost to the government will be the present value thereof.</p>	<p>58 For each material transfer, the assets and liabilities transferred as a consequence of a restructure of administrative arrangements during the reporting period shall be disclosed by class, and the counterparty transferor/transferee entity shall be identified. With respect to transfers that are individually immaterial, the assets and liabilities transferred shall be disclosed</p>	<p>(b) the combination meets all the specific criteria set out in paragraphs 6-11 below and thus falls within the definition of a merger.</p>
<p>.17 <input type="checkbox"/> <i>The purchase cost and the amounts assigned to assets acquired and liabilities assumed should be determined as of the</i></p>		<p>Acquisition accounting should be used for all other business combinations, except as provided in paragraphs 13 and 14.</p>
		<p><i>Criteria for determining whether the definition of a merger is met</i></p>
		<p>6 Criterion 1 - No party to the combination is portrayed as either acquirer or acquired, either by its own board or management or by that of another party to the combination.</p>
		<p>7 Criterion 2 - All parties to the combination, as represented by the boards of directors or their appointees, participate in establishing the management structure for the combined entity and in selecting the management personnel, and such decisions are made on the basis of a consensus between the parties to the combination rather than purely by exercise of voting rights.</p>

<p><i>date of the acquisition.</i> [MAY 1999]</p> <p>.18 <input type="checkbox"/> <i>For the period in which a purchase of a governmental unit occurs, government financial statements should reflect the government's proportionate share of the results of the acquired governmental unit from the date of acquisition.</i> [MAY 1999]</p> <p>Allocating the purchase cost</p> <p>.19 At the date of acquisition, it will be necessary to assign the purchase cost to identifiable assets acquired (either individually or by type) and liabilities assumed. The government's interest in identifiable assets acquired and liabilities assumed would be based on their fair values at the date of acquisition. The allocation of the purchase cost would precede any adjustments which are necessary to put the accounting policies previously followed by the acquired organization on a common basis with those of the government.</p> <p>.20 Any excess of the purchase cost over the government's interest in the amounts assigned to identifiable assets acquired less liabilities assumed would be considered to be a purchase premium which would be accounted for in accordance with paragraph PS 2510.23.</p> <p>.21 Net assets acquired would not be recorded at more than cost. Accordingly, where the government's interest in the amounts assigned to identifiable assets acquired and liabilities assumed exceeds the purchase cost, it will be necessary to adjust such amounts to eliminate this excess. The allocation of the reduction to individual non-monetary assets or groups of non-monetary assets requires a re-examination of values previously assigned;</p>	<p>on an aggregate basis.</p> <p>59 The disclosures required by paragraph 58 will assist users to identify the assets and liabilities recognised or derecognised as a result of a restructure of administrative arrangements separately from other assets and liabilities and to identify the transferor/transferee entity.</p> <p>Appendix A Defined Terms</p> <p>Restructure of administrative arrangements</p> <p>The reallocation or reorganisation of assets, liabilities, activities and responsibilities amongst the entities that the government controls that occurs as a consequence of a rearrangement in the way in which activities and responsibilities as prescribed under legislation or other authority are allocated between the government's controlled entities.</p> <p>The scope of the requirements relating to restructures of administrative arrangements is limited to the transfer of a business (as defined in AASB 3 <i>Business Combinations</i>). The requirements do not apply to, for example, a transfer of an individual asset or a group of assets that is not a business.</p>	<p>8 Criterion 3 - The relative sizes of the combining entities are not so disparate that one party dominates the combined entity by virtue of its relative size.</p> <p>9 Criterion 4 - Under the terms of the combination or related arrangements, the consideration received by equity shareholders of each party to the combination, in relation to their equity shareholding, comprises primarily equity shares in the combined entity; and</p> <p>any non-equity consideration, or equity shares carrying substantially reduced voting or distribution rights, represents an immaterial proportion of the fair value of the consideration received by the equity shareholders of that party.</p> <p>Where one of the combining entities has, within the period of two years before the combination, acquired equity shares in another of the combining entities, the consideration for this acquisition should be taken into account in determining whether this criterion has been met.</p> <p>10 For the purpose of paragraph 9, the consideration should not be taken to include the distribution to shareholders of</p> <p>(a) an interest in a peripheral part of the business of the entity in which they were shareholders and which does not form part of the combined entity; or</p> <p>(b) the proceeds of the sale of such a business, or loan stock representing such proceeds.</p> <p>A peripheral part of the business is one that can be disposed of without having a material effect on the nature and focus of the entity's</p>
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<p>this is a matter of judgment and should be determined having regard to the circumstances of the acquisition.</p> <p>.22 <input type="checkbox"/> <i>The government's interest in identifiable assets acquired and liabilities assumed should be based on their fair values at the date of acquisition. When there is a difference between the purchase cost and the government's share of the fair value of the net assets of the acquired governmental unit:</i></p> <p>(a) <i>any excess of the purchase cost over the government's interest in identifiable assets acquired and liabilities assumed, based on their fair values, should be accounted for as a purchase premium in accordance with paragraph PS 2510.23.</i></p> <p>(b) <i>such that the government's interest in the identifiable assets acquired and liabilities assumed, based on their fair values, exceeds the purchase cost, the amounts assigned to identifiable non-monetary assets should be reduced to the extent that the excess is eliminated. [MAY 1999]</i></p> <p>.23 <input type="checkbox"/> <i>When the purchase of a governmental unit gives rise to a purchase premium, it should be recognized as an expense in the period of acquisition. [MAY 1999]</i></p> <p>.24 A purchase premium arising on acquisition of a governmental unit would be charged to expenses in the period of acquisition because the future net cash flows associated with a governmental unit, by definition, are unlikely to indicate that the purchase premium has been paid for anything but policy reasons. Governmental units receive funding from the government in order to pursue their activities and meet their debt requirements. Consequently, it</p>		<p>operations.</p> <p>11 <i>Criteria 5 - No equity shareholders of any of the combining entities retain any material interest in the future performance of only part of the combined entity.</i></p> <p>12 For the purposes of paragraphs 6-1 I above any convertible share or loan stock should be regarded as equity to the extent that it is converted into equity as a result of the business combination.</p> <p><i>Group reconstructions</i></p> <p>13 A group reconstruction may be accounted for by using merger accounting, even though there is no business combination meeting the definition of a merger, provided:</p> <p>(a) the use of merger accounting is not prohibited [4A Sch 101 by companies legislation;</p> <p>(b) the ultimate shareholders remain the same, and the rights of each such shareholder, relative to the others, are unchanged; and</p> <p>(c) no minority's interest in the net assets of the group is altered by the transfer.</p> <p>Merger accounting</p> <p>16 With merger accounting the carrying values of the [4A S C ~ 111 assets and liabilities of the parties to the combination are not required to be adjusted to fair value on consolidation, although appropriate adjustments should be made to achieve uniformity of accounting policies in the combining entities.</p> <p>17 The results and cash flows of all the combining entities should be brought into the financial statements of the combined entity from the beginning of the financial year in which the combination</p>
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<p>is unlikely that the portion of the purchase cost related to the purchase premium could be tied to projected future profits from revenues received from sources external to the government reporting entity and so should be a cost of the period of acquisition.</p> <p>PS 3070 <i>Investments in Government Business Enterprises</i></p> <p>.11 For acquired government business enterprises, the cost of the government's investment is the purchase cost of the acquisition. The purchase cost to the government is the sum of the fair value of the consideration given in the acquisition plus the expenses directly incurred by the government to effect the acquisition. At the date of acquisition, the total purchase cost is assigned to identifiable assets acquired and liabilities assumed. The government's interest in identifiable assets acquired and liabilities assumed would be based on their fair values at the date of acquisition. Any excess of the purchase cost over the government's interest in the amounts assigned to identifiable assets acquired less liabilities assumed would be considered to be a purchase premium which would be accounted for in accordance with paragraph PS 3070.17. The components of a government's investment in an acquired government business enterprise include, therefore:</p> <ul style="list-style-type: none"> (a) the unamortized portion of any purchase premium; (b) the unamortized portion of any fair value increments; and (c) the government's share of the carrying value of the net assets of the government business enterprise, 		<p>occurred, adjusted so as to achieve uniformity of accounting policies. The corresponding figures should be restated by including the results for all the combining entities for the previous period and their balance sheets for the previous balance sheet date, adjusted as necessary to achieve uniformity of accounting policies.</p> <p>18 The difference, if any, between the nominal value of the shares issued plus the fair value of any other consideration given, and the nominal value of the shares received in exchange should be shown as a movement on other reserves in the consolidated financial statements. Any existing balance on the share premium account or capital redemption reserve of the new subsidiary undertaking should be brought in by being shown as a movement on other reserves. These movements should be shown in the reconciliation of movements in shareholders' funds.</p> <p>19 Merger expenses are not to be included as part of this adjustment, but should be charged to the profit and loss account of the combined entity at the effective date of the merger, as reorganisation or restructuring expenses, in accordance with paragraph 20 of FRS 3 'Reporting Financial Performance'.</p> <p>Acquisition accounting</p> <p>20 Business combinations not accounted for by merger [4A Sch 9I accounting should be accounted for by acquisition accounting. Under acquisition accounting, the identifiable assets and liabilities of the companies acquired should be included in the acquirer's consolidated balance sheet at their fair value at the date of acquisition. The results and cash flows of the acquired companies should be brought into the group accounts only from the</p>
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<p>adjusted for inter-organizational gains and losses on assets remaining within the reporting entity at the financial statement date and any gains or losses arising on inter-organizational bond holdings.</p> <p>The total of components (a) and (b) comprise the remaining balance of any purchase price discrepancy.</p> <p>Purchase premium</p> <p>.17 <input type="checkbox"/> <i>A purchase premium arising on the acquisition of a government business enterprise should be deferred and amortized to the government's income from an investment in a government business enterprise. The amortization period should be the lesser of the life of the purchase premium and twenty years. The method of amortization should be:</i></p> <p>(a) <i>the straight line method; or</i></p> <p>(b) <i>another systematic method when it can be demonstrated to be more appropriate in the circumstances than the straight line method.</i></p> <p>[APRIL 2000]</p>		<p>date of acquisition. The figures for the previous period for the reporting entity should not be adjusted. The difference between the fair value of the net identifiable assets acquired and the fair value of the purchase consideration is goodwill, positive or negative.*</p>
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