

S02.02-AS-02-I.2

I - Goodwill (and Business Combination): General principles

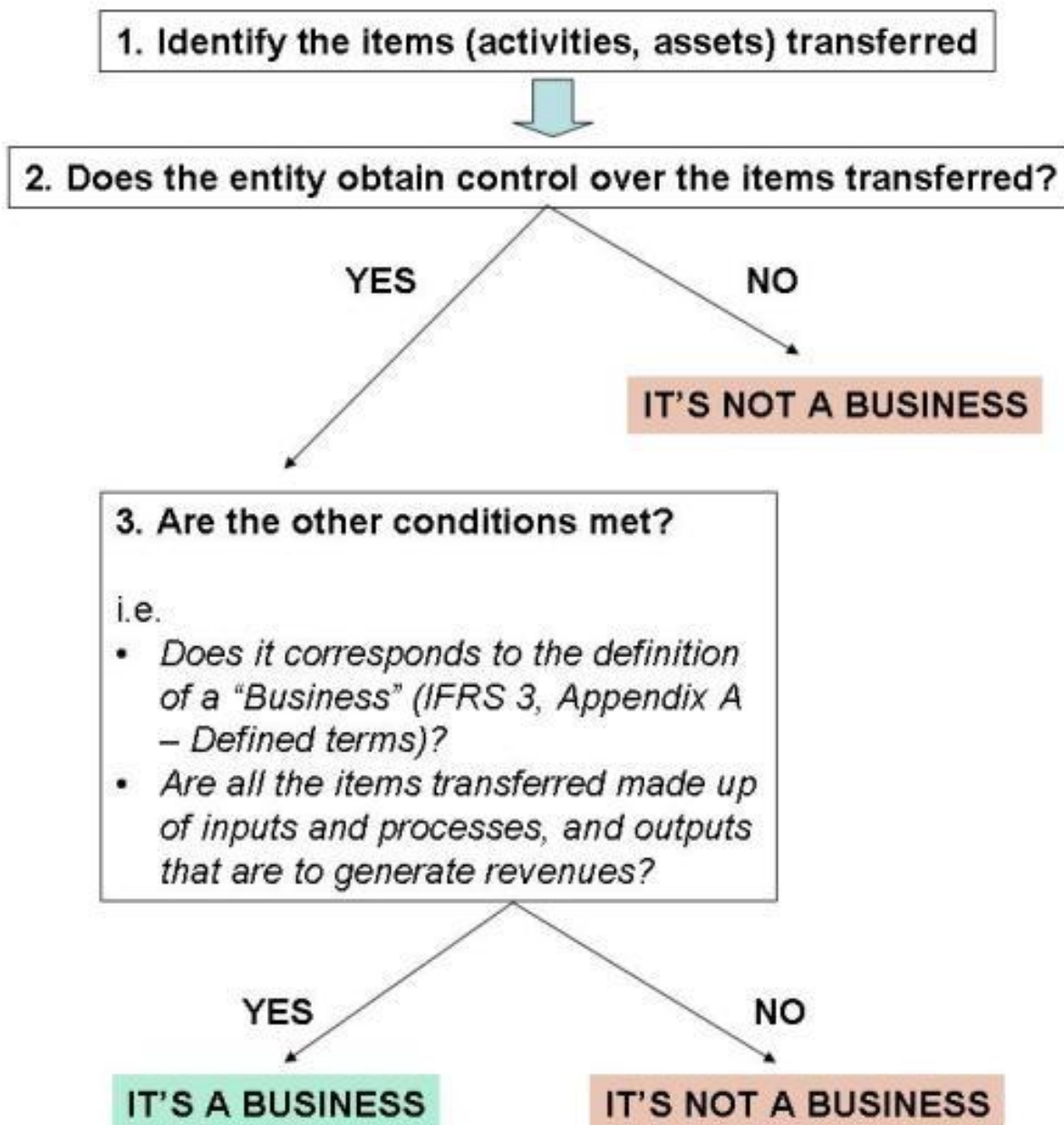
2. Acquisition method

2.1. Beforehand

IDENTIFY IF AN EVENT DOES REPRESENT A BUSINESS COMBINATION UNDER IFRS 3

An entity shall determine whether a transaction or other event is a business combination by applying the definition in this chapter, 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.

If an entity acquires control of one or more entities that are not businesses, it is therefore not a business combination. The following process is used to determine if it is a business or not:



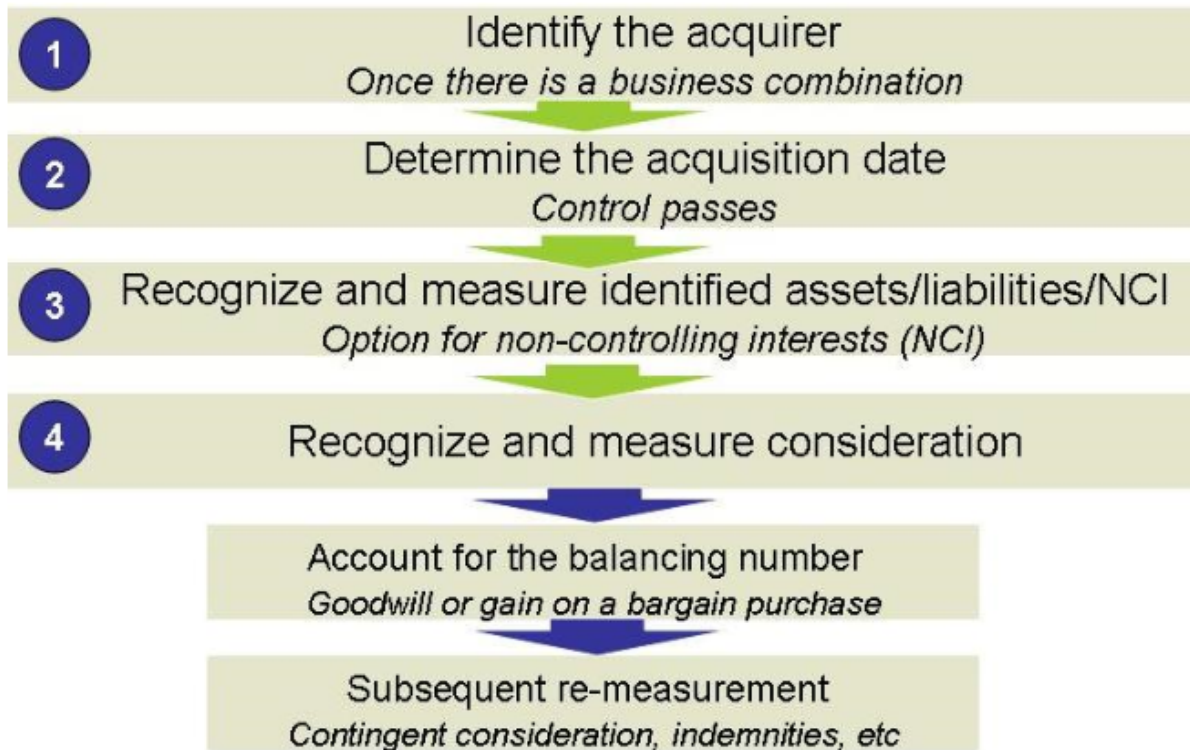
2.2. The acquisition method in 4 stages

An entity shall account for each business combination by applying the acquisition method.

(IFRS 3, par 5)

Applying the acquisition method requires:

- a. identifying the acquirer (see 2.2.1.);
- b. determining the **acquisition date** (see 2.2.2.);
- c. recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree (see 2.2.3.); and
- d. recognising and measuring **goodwill** or a gain from a bargain purchase (see 2.2.4.).



2.2.1. Identifying the acquirer

The acquisition method treats the business combination from the viewpoint of the acquirer. As a result, an acquirer must be identified for each business combination.

As a reminder, the acquirer is the entity that obtains control of the acquiree.

2.2.2. Determining the acquisition date

(IFRS 3, par 8)

The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.

(IFRS 3, par 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.

(...)

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

2.2.3.1. Recognition principle

(IFRS 3, par 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. (...)

In addition, at the acquisition date, the acquirer should also classify or designate the identifiable assets acquired and liabilities assumed in such a way as to **enable subsequent application of other IFRS's**.

Indeed, in certain situations, the IFRS system allows a different accounting treatment in accordance with the classification of the identifiable assets acquired and liabilities assumed.

The acquirer should make these classifications or designations on the basis of contractual arrangements, economic conditions, accounting or management policies and other relevant circumstances at the acquisition date.

2.2.3.2. Measurement principle

(IFRS 3, par 18)

The acquirer should measure the identifiable assets acquired and the liabilities assumed at **their acquisition-date fair values**.

When a business combination in which the acquirer obtains the control without buying the entire share capital of the target, the remaining interests (non-controlling interests "NCI") in equity are evaluated:

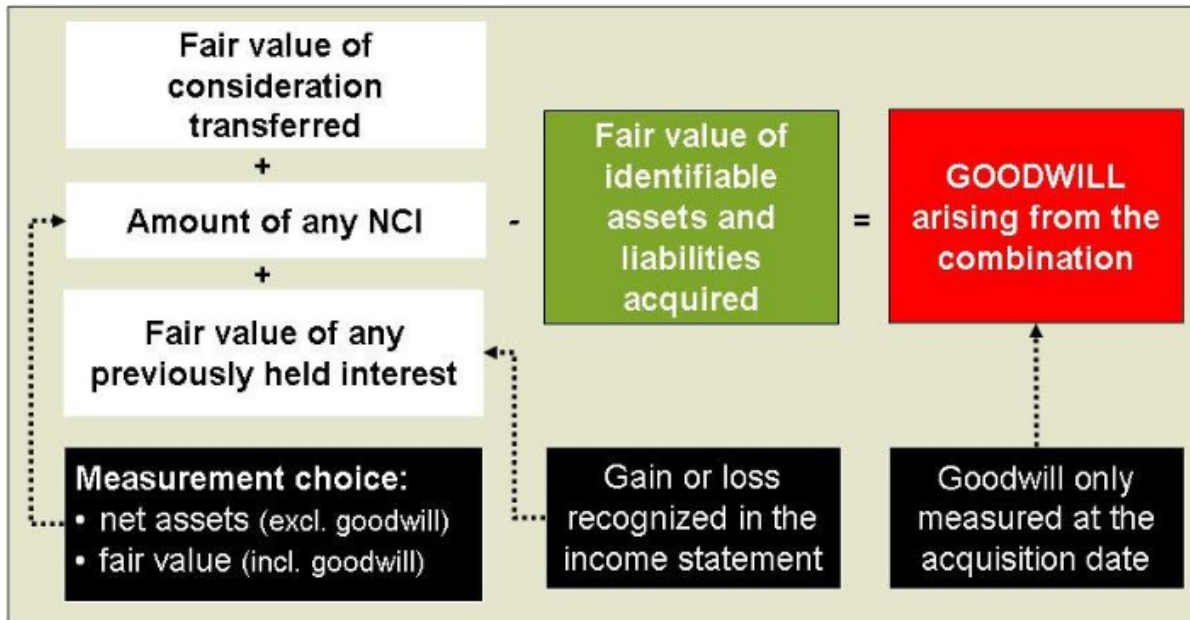
- at the fair value, or,
- at the amount of the interest portion which doesn't confer control in the net identifiable assets of the acquiree.

In this case, the entity should allocate a portion of the losses to the non-controlling interests, even if this lead to negative NCI.

2.2.3.3. Exceptions to the recognition or measurement principles

- Exceptions to the recognition principle: *Contingent liabilities*
- Exceptions to the recognition AND measurement principles:
 - *Income tax*
 - *Employee benefits*
 - *Indemnification assets (or liability guarantee)*
 - Exceptions to the measurement principle
 - *Reacquired rights*
 - *Share-based payment rights*
 - *Assets held for sale*

2.4. Recognizing and measuring goodwill or a gain from a bargain purchase



2.4.1. Goodwill

(IFRS 3, par 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 2.3.2.);
 - 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, 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.

To put it simple, **the following formula can be used to compute goodwill:**

Acquisition price - Assets & Liabilities measured at fair value = x

IF x > 0 --> Goodwill

IF x < 0 --> Negative goodwill (badwill)

In the case of a business combination in which the acquirer obtains control by steps, goodwill is evaluated by difference, at the acquisition date, between the fair value of any investment (participation) in the entity before the acquisition, consideration transferred and the net acquired assets.



Note

IFRS 3 (amended 2008) **no longer allows the capitalization of costs directly attributable to the acquisition**, but requires those costs to be recognized in P/L (expenses) (see 2.2.4.5. below).

2.4.2. Bargain purchase ("negative goodwill" or "badwill")

Occasionally, an acquirer may make a bargain purchase, which is a business combination in which the total acquisition cost exceeds the total identifiable assets acquired and liabilities assumed. This type of acquisition may occur, for example, in a business combination during a forced sale in which the seller is acting under compulsion.

IFRS 3 stipulates in this case that the acquirer shall recognize the resulting gain in P/L (called "badwill" or "negative goodwill") at the acquisition date.

(IFRS 3, par 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 (...),
- 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 in a business combination

(IFRS 3, par 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.** (...)*

Examples of potential forms of consideration include cash, other assets, a business or a subsidiary of the acquirer, a contingent consideration, ordinary or preference equity instruments, options, warrants and member interests of mutual entities.

Contingent consideration (earn-out clause for example):

(IFRS 3, par 39)

*The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall **recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.***

(IFRS 3, par 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 IAS 32 "Financial Instruments: Presentation".*

*The acquirer shall classify **as an asset a right to the return of previously transferred consideration if specified conditions are met.***

Changes to the liability value, after the acquisition date, are recorded in accordance with the appropriate IFRS rather than changing the goodwill value.

2.3. Measurement period

(IFRS 3, par 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 all items in the acquisition.

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 recognized 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 recognized as of that date.
- also recognize 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 **shall not exceed one year** from the acquisition date.

2.4. Determining what is part of the business combination transaction

(IFRS 3, par 51)

(...) 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, i.e. amounts that are not part of the exchange for the acquiree (arising from different agreements concluded between the parties either in annex to the business combination or subsequently).

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 IFRS's.

Examples: Payment of pre-existing transactions between buyer and acquiree, the replacement of acquiree share-based payments, compensation by the seller, embedded derivatives, cash flow hedges, leases).

Acquisition-related costs:

All acquisition-related costs are to be **recognized as period expenses** instead of being included in the acquisition cost.

(IFRS 3, par 53)

*(...) costs the acquirer incurs to effect a business combination. (...) The acquirer **shall account for these 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 "Financial Instruments: Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement".

See [examples of the acquisition method](#)