IFRS

STAFF PAPER

December 2021

IASB® meeting

Project	**Second Comprehensive Review of the *IFRS for SMEs*® Standard**
Paper topic	Towards an Exposure Draft—IFRS 3 *Business Combinations*
CONTACT	Mostafa Mouit mmouit@ifrs.org

Introduction

1. This paper discusses whether and how to propose amendments to the *IFRS for SMEs* Standard to align with:

    (a) the definition of a business, issued in October 2018 (2018 definition of a business); and

    (b) IFRS 3 (2008) *Business Combinations*.[1]

2. Section 19 *Business Combinations and Goodwill* of the *IFRS for SMEs* Standard is currently based on IFRS 3 (2004).

3. In this paper, the term SMEs refers to small and medium-sized entities that are eligible to apply the *IFRS for SMEs* Standard.

Purpose of the paper

4. The purpose of this paper is to ask the International Accounting Standards Board (IASB) to:

    (a) consider all forms of feedback on the Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard*, published in January 2020, and the

[1] Collectively referred to as 'IFRS 3' requirements in this paper.

recommendations of the SME Implementation Group (SMEIG) on the alignment of Section 19 of the *IFRS for SMEs* Standard with IFRS 3, including the 2018 definition of a business; and

(b) decide whether and how to propose amendments to the *IFRS for SMEs* Standard to align with parts of IFRS 3, including the 2018 definition of a business.

Summary of staff recommendations

5. The staff recommend the IASB propose amendments to Section 19 of the *IFRS for SMEs* Standard to:

   (a) align the definition of a business in the *IFRS for SMEs* Standard with the 2018 definition of a business and include, in a new appendix to Section 19, application guidance:

      (i) incorporating the optional concentration test, as set out in paragraphs B7A–B7B of IFRS 3;

      (ii) including a decision tree to help SMEs in assessing whether an acquired process is substantive; and

      (iii) including the application guidance for assessment as set out in paragraphs B8–B12D of IFRS 3, alongside with the relevant illustrative examples.

   (b) align with the requirements for acquisition-related costs and contingent consideration as set out in IFRS 3 to require an SME to:

      (i) recognise acquisition-related costs as an expense at the time of the acquisition; and

      (ii) recognise contingent consideration at fair value and subsequently measure it at fair value at each reporting date with changes in fair value recognised in profit or loss (except for the subsequent measurement of any contingent consideration that meets the definition of equity instrument). If measuring contingent consideration at fair value would involve undue cost or effort, an SME would be required to measure the contingent consideration using a 'best estimate' (the most likely outcome)—with changes in the subsequent measurement being recognised in profit or loss—and provide the related disclosures.

(c) introduce requirements for the accounting for acquisition achieved in stages (step acquisitions) as set out in IFRS 3. The staff also recommend the IASB ask for further views on these requirements in the Invitation to Comment.

(d) introduce guidance (in the new appendix to Section 19) for a new entity formed in a business combination as set out in paragraph B18 of IFRS 3 and, consequently, introduce the application guidance relevant to SMEs as set out in paragraphs B13–B17 of IFRS 3.

6. The staff are asking the IASB to decide whether it would like:

(a) to retain the requirements of Section 19—so that an SME measures any non-controlling interest in the acquiree at the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets; or

(b) to propose amendments to Section 19 (to align with IFRS 3) to permit an SME to choose—on a transaction-by-transaction basis—whether to measure any non-controlling interest in an acquiree:

(i) at its fair value; or

(ii) as the non-controlling interests' proportionate share of the recognised amounts of the acquiree's identifiable net assets.

Structure of the paper

7. This paper is structured as follows:

(a) question in the Request for Information (paragraphs 9–10 of this paper);

(b) overall feedback and SMEIG recommendations (paragraphs 11–15 of this paper);

(c) staff analysis applying the alignment principles:

(i) aligning with the 2018 definition of a business (paragraphs 17–30 of this paper);

(ii) aligning with the acquisition method of accounting as set out in IFRS 3 (paragraphs 31–65 of this paper); and

(iii) introducing requirements for the accounting for step acquisitions as set out in IFRS 3 (paragraphs 66–79 of this paper);

(d) other matters arising from the Request for Information (paragraphs 80–87 of this paper);

(e) overall staff analysis—costs and benefits consideration (paragraphs 88–91 of this paper); and

(f) staff recommendations and questions for the IASB (paragraphs 92–93 of this paper).

(g) next steps (paragraph 94 of this paper).

8. There are two appendices to this paper:

(a) Appendix A to this paper sets out background to the development of IFRS 3 and Section 19 of the *IFRS for SMEs* Standard, including the IASB's considerations in the first comprehensive review of the *IFRS for SMEs* Standard.

(b) Appendix B to this paper sets out the IASB's rationale in the Request for Information for asking views on aligning the *IFRS for SMEs* Standard with IFRS 3.

Question in the Request for Information

9. In developing the Request for Information, depending on the topics, the IASB decided to ask the following types of questions:

(a) views on aligning the *IFRS for SMEs* Standard with the IFRS Standard, amendment to an IFRS Standard or IFRIC Interpretation (type 1 question);

(b) views on leaving the *IFRS for SMEs* Standard unchanged (that is, not aligning it with full IFRS Standards) (type 2 question); or

(c) request further information to help it reach a decision (type 3 question).

10. Question S5 of the Request for Information asked for views on:

(a) aligning the *IFRS for SMEs* Standard with the 2018 definition of a business (type 1 question);

(b) aligning Section 19 with IFRS 3 (2008) for acquisition-related costs and contingent consideration, including permitting an entity to use the undue cost or effort exemption and provide the related disclosures if measuring contingent consideration at fair value would involve undue cost or effort (type 1 question); and

(c) considering whether Section 19 needs to include requirements for the accounting for step acquisitions, and if the answer is yes, whether the requirements should be aligned with those of IFRS 3 (2008) (type 3 question).

Overall feedback and SMEIG recommendations

Methods for obtaining feedback

11. Feedback on Question S5 of the Request for Information was gathered in several ways, including:

(a) comment letters;

(b) an online survey; and

(c) outreach events.

Overall feedback

12. Overall, most respondents to the Request for Information supported aligning the *IFRS for SMEs* Standard:
    (a) with the 2018 definition of a business.
    (b) with IFRS 3 requirements for acquisition-related costs and contingent consideration.
13. In addition, most respondents supported including requirements for step acquisitions in Section 19 of the *IFRS for SMEs* Standard and aligning these requirements with those of IFRS 3.

SMEIG recommendations

14. The SMEIG met on 4–5 February 2021 to discuss the feedback on the Request for Information and develop recommendations to enable the IASB to decide on whether and, if so, how to align the *IFRS for SMEs* Standard with IFRS 3, including the 2018 definition of a business.
15. SMEIG members discussed the feedback as set out in paragraphs 12–13 of this paper. SMEIG members expressed mixed views on whether include the requirements for accounting for step acquisitions in Section 19 of the *IFRS for SMEs* Standard is relevant:
    (a) some members expressed the view that the requirements should not be introduced into the Standard because step acquisitions are not common among SMEs; and
    (b) other members expressed the view that the requirements should be introduced because requirements would be useful if SMEs entered into such transactions.

Staff analysis applying the alignment principles

16. At its March 2021 meeting, the IASB tentatively decided to apply the alignment approach with IFRS Standards as the starting point in developing an exposure draft of proposed amendments to the *IFRS for SMEs* Standard. In doing so, the IASB agreed to apply three alignment principles—relevance to SMEs, simplicity and faithful representation—including the assessment of costs and benefits (Agenda Paper 30 *Cover paper*, of this meeting, outlines the IASB's alignment approach).

Aligning with the 2018 definition of a business

Feedback from comment letters

17. Most respondents supported aligning the *IFRS for SMEs* Standard with the 2018 definition of a business. Reasons given for this support include:

    (a) the definition of a business is an important definition;[2] and

    (b) aligning the definition of a business in the *IFRS for SMEs* Standard with the 2018 definition of a business will provide clarity and understandability for users of SME financial statements, and consistency and comparability of financial statements among SMEs.

18. For example, respondents said:

> …We note that this amendment was made in response to a need for clarification identified as part of the post-implementation review of IFRS 3. We believe that the amendment would also benefit users of the *IFRS for SMEs* Standard…
>
> ...We also consider that the amended definition provides greater clarity, therefore reducing the level of judgement involved in determining whether a transaction should be treated either as a business combination or an asset

[2] Question G1B of the Request for Information sought views on to what extent the alignment considers the important definitions.

acquisition. To this extent, alignment would make the *IFRS for SMEs* Standard easier to apply…

19. Some respondents who supported aligning the definition of a business in the *IFRS for SMEs* Standard with the 2018 definition of a business suggested including in the Standard:

    (a) the optional concentration test, as set out in paragraphs B7A–B7B of the IFRS 3, to permit a simplified assessment of whether an acquired set of activities and assets is not a business—so that the concentration test is met if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets; and

    (b) a decision tree to apply the definition to identify a business.

20. Two respondents expressed concerns about aligning the definition of a business in the *IFRS for SMEs* Standard with the 2018 definition of a business. These respondents said that the change to the definition of a business in full IFRS Standards only became effective and applied to acquisitions that occur on or after 1 January 2020, and it is unlikely to be relevant to many SMEs.

Feedback from online survey

21. Most respondents to the online survey also supported aligning the definition of a business in the *IFRS for SMEs* Standard with the 2018 definition of a business. In their view, the definition of a business is an important definition. Consistency with the definition of a business in IFRS 3 would reduce any possibility of confusion amongst preparers and users familiar with full IFRS Standards.

Staff analysis–aligning with the 2018 definition of a business

Relevance

22. Glossary of terms of the *IFRS for SMEs* Standard is aligned with IFRS 3 (2004) and defines a business as:

> An integrated set of activities and assets conducted and managed for the purpose of providing a return to investors or lower costs or other economic benefits directly and proportionately to policyholders or participants.

23. Therefore, the definition of a business is relevant to SMEs applying Section 19. The question to address in relevance is whether amending the *IFRS for SMEs* Standard to align with the improvements introduced by the 2018 definition of a business would make a difference in the decisions to users of SME financial statements.

24. The 2018 definition of a business is as follows:[3]

> An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.

25. The 2018 definition of a business:
    (a) confirmed that a business must include inputs and a process, and clarified that:
        (i) the process must be substantive; and
        (ii) the inputs and process must together significantly contribute to creating outputs; and
    (b) narrowed the definitions of a business by focusing the definition of outputs on goods and services provided to customers, investment returns and other income from ordinary activities, rather than on providing dividends or other economic benefits directly to investors or lowering costs.

26. The previous definition of outputs (see paragraph 25(b) of this paper) referred to lower costs and economic benefits provided directly to investors. This reference did not help to distinguish between an asset and a business, because it confused motives for acquiring an asset with the characteristics of the activities and assets acquired. Many asset acquisitions (for example, the purchase of new manufacturing equipment)

[3] Paragraphs B8–B12D of IFRS 3 explain the detailed assessment steps of the elements of a business.

may be made with the motive of lowering costs but may not involve acquiring a substantive process.[4]

27. The IASB noted that the 2018 definition of a business improves the consistency of application and makes it easier for entities to decide whether activities and assets they acquire are a business or a group of assets. This point was particularly referred to by respondents to the Request for Information who said the 2018 definition of a business would reduce any possibility of confusion amongst preparers and users familiar with full IFRS Standards.

28. The staff note that because accounting for the acquisition of a set of activities and assets depends on whether the set is a business or a group of assets (one important difference is that the acquiring group recognises 'goodwill' only in acquiring a business, not in acquiring a group of assets), the improvements introduced in the 2018 definition of a business would make a difference in the decisions to users of SME financial statements (as it could result in a different conclusion on whether the set is a business or a group of assets). The staff, therefore, think that aligning the definition of a business in the *IFRS for SMEs* Standard with the 2018 definition of a business will be an improvement that brings benefit to users and preparers of financial statements prepared applying the *IFRS for SMEs* Standard and therefore, is relevant to SMEs.

Simplicity and faithful representation

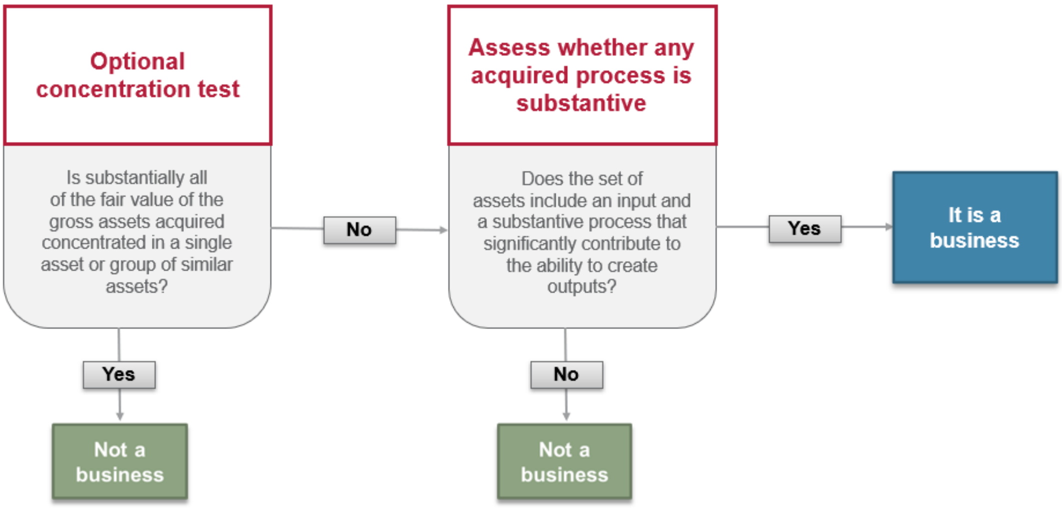
29. As discussed in paragraph 27 of this paper, the 2018 definition of a business provides a clearer definition than the definition currently in the *IFRS for SMEs* Standard and is simpler for preparers to apply. The staff, therefore, believe that the 2018 definition of a business should not be simplified further.

30. However, the staff think that some guidance that would assist SMEs applying the requirements of the 2018 definition of a business could be included in the *IFRS for SMEs* Standard, by introducing a new appendix to Section 19 (application guidance):

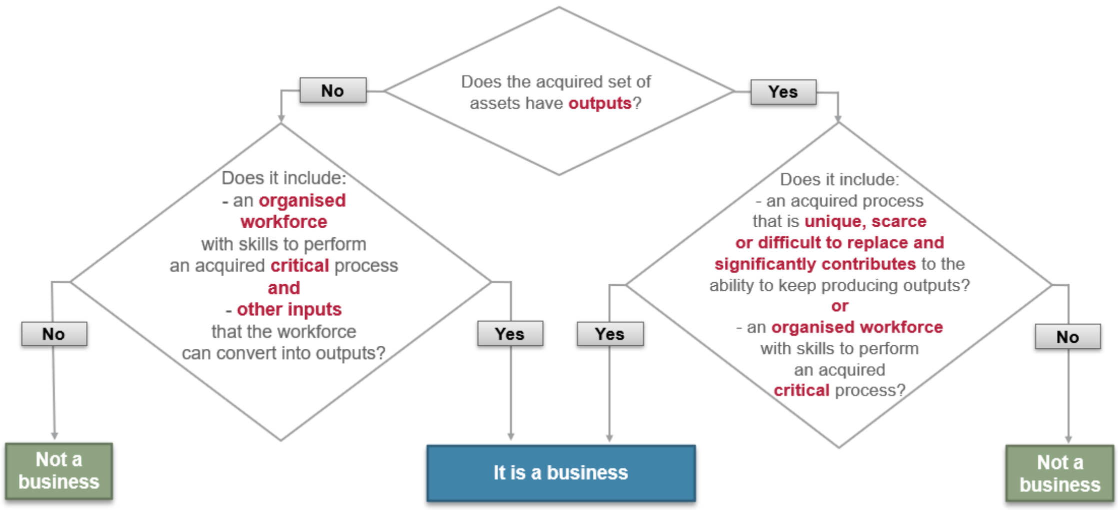
    (a) incorporating the optional concentration test, as set out in paragraphs B7A–B7B of IFRS 3—as the IASB designed the concentration test with the aim of

[4] Paragraph BC21S of the Basis for Conclusions on IFRS 3.

making it easy to understand and (in some straightforward cases that are easy to explain) simple to operate and less costly than applying the detailed assessment otherwise required by paragraphs B8–B12D of IFRS 3.



(b) including a decision tree to help SMEs in assessing whether an acquired process is substantive. The staff think that incorporating a decision tree would help SMEs to apply the 2018 definition of a business consistently and reduce potential application questions.



(c) including the application guidance assessment as set out in paragraphs B8–B12D of IFRS 3—alongside with the relevant illustrative examples (that would be common to the broader group of SMEs) demonstrating the application of the new definition of a business.

Aligning with the acquisition method of accounting as set out in IFRS 3

1—Acquisition-related costs

31. In the Request for Information that IASB asked for views on aligning the *IFRS for SMEs* Standard with IFRS 3 for acquisition-related costs—ie views on requiring an SME to recognise acquisition-related costs as an expense at the time of the acquisition.

Feedback from comment letters

32. Most respondents supported aligning the *IFRS for SMEs* Standard with IFRS 3 for acquisition-related costs. Reasons given for this support include that:

    (a) requiring an SME to recognise acquisition-related costs as an expense at the time of the acquisition:

        (i) would more faithfully represent the underlying economics of a business combination, as the acquisition-related costs are not part of the consideration transferred between the buyer and seller in exchange for the acquiree—instead, these costs are separate transactions in which the buyer pays for the fair value of services received.

        (ii) would enhance comparability and provide better-quality information to the users of the financial statements.

    (b) acquisition-related costs do not generally represent assets of the acquirer at the date of acquisition and as such should not be a factor in the determination of goodwill.

Feedback from online survey

33. Many respondents to the online survey also supported aligning the *IFRS for SMEs* Standard with IFRS 3 for acquisition-related costs. In their view, in most cases, alignment would not make a significant difference in effort or cost for acquisition-related costs. Alignment would improve comparability not only with entities applying the *IFRS for SMEs* Standard, but also with entities applying IFRS Standards.

Staff analysis—acquisition related costs

Relevance

34. As discussed in paragraph A1 of Appendix A to this paper, Section 19 of the *IFRS for SMEs* Standard is based on IFRS 3 (2004).[5] Therefore, the acquisition-related costs topic is relevant to SMEs applying Section 19. The question to address in relevance is whether requiring an SME to expense these costs would make a difference in the decisions to users of SME financial statements.

35. The IASB noted, in paragraph B66 of the Request for Information (reproduced in paragraph B12 of Appendix B to this paper), that introducing requirements for acquisition-related costs to be recognised as an expense at the time of the acquisition would improve users' ability to understand the cost of the business combination. This approach would result in the amount of goodwill recognised more faithfully representing the underlying economics of the business combination and therefore, is relevant to SMEs. The feedback supports the analysis of the IASB as set out in the Request for Information and therefore the staff continue to consider the relevance principle is met.

Simplicity and faithful representation

36. The staff note that requiring an SME to recognise acquisition-related costs as an expense at the time of the acquisition would itself introduce a simplification in the *IFRS for SMEs* Standard.

37. The IASB note that the acquisition-related costs are not part of the fair value exchange between the buyer and the seller of the business combination and as such should be recognised separately—so that the acquisition-related costs do not represent the assets of the acquirer at the acquisition date but, rather, represent a separate transaction in which the buyer pays for the fair value of services received. The staff, therefore, think that aligning the *IFRS for SMEs* Standard with IFRS 3 for the acquisition-related costs will be an improvement that brings benefit to users and preparers of financial statements prepared applying the *IFRS for SMEs* Standard.

[5] Currently, under Section 19, any costs directly attributable to the business combination are added to the cost of the business combination (see paragraph 19.11 of the *IFRS for SMEs* Standard).

2—Contingent consideration

38. In the Request for Information the IASB asked for views on aligning the *IFRS for SMEs* Standard with IFRS 3 for the contingent consideration—ie views on requiring an SME to recognise contingent consideration at fair value and subsequently measure it at fair value at each reporting date with changes in fair value recognised in profit or loss.

Feedback from comment letters

39. Many respondents supported aligning the *IFRS for SMEs* Standard with IFRS 3 for contingent consideration to:

(a) require an SME to recognise contingent consideration at fair value and subsequently account for it as a financial instrument with changes in fair value recognised in profit or loss; and

(b) permit an SME to apply the undue cost or effort exemption, and provide the related disclosures, if measuring contingent consideration at fair value would involve undue cost or effort.

40. Reasons given for this support include that the requirements in paragraph 39 of this paper:

(a) would more faithfully represent the underlying economics of a business combination; and

(b) would enhance comparability and provide better-quality information to the users of the financial statements.

41. For example, some of respondents said:

> …The obligation or right associated with a contingent consideration arrangement exists at the date of acquisition, regardless of whether it is probable (or can be measured reliably) at that date. A failure to recognise that obligation or right at the date of acquisition would not reflect the fair value of consideration transferred for the business combination at that date…

> …It is generally difficult to measure contingent consideration at fair value at the time of business combination and in subsequent periods. The implementation cost may even exceed the expected benefits. That said, we do not disagree with alignment as long as entities are permitted to use the 'undue cost or effort' exemption...

42. A small number of respondents who supported requiring an SME to recognise contingent consideration at fair value to align with IFRS 3 suggested requiring an SME to measure the contingent consideration at the best estimate in accordance with Section 21 *Provisions and Contingencies* of the *IFRS for SMEs* Standard, if measuring contingent consideration at fair value would involve undue cost or effort.

43. Two respondents expressed concern that requiring an SME to measure the contingent consideration at fair value could create complexities for SMEs. In their view, measuring contingent consideration at fair value contradicts the simplicity principle, and by applying for the undue cost or effort exemption, there is a risk that SMEs will treat this exemption as an accounting policy choice—for example, an SME might choose only to disclose information about contingent liabilities instead of attempting to estimate their fair value. As a result, these respondents recommended that the current requirements for the contingent consideration in the *IFRS for SMEs* Standard are retained unchanged.

Feedback from online survey

44. Many respondents to the online survey also supported aligning the *IFRS for SMEs* Standard with IFRS 3 for the contingent consideration. In their view, in most cases, alignment would not make a significant difference in effort or cost for contingent consideration. Alignment would improve comparability not only with entities applying the *IFRS for SMEs* Standard, but also with entities applying IFRS Standards.

Staff analysis—contingent consideration

Relevance

45. As discussed in paragraph A1 of Appendix A to this paper, Section 19 of the *IFRS for SMEs* Standard is based on IFRS 3 (2004).[6] Therefore, the contingent consideration topic is relevant to SMEs applying Section 19. The question to address in relevance is whether recognising the contingent consideration at fair value would make a difference in the decisions to users of SME financial statements.

46. The IASB noted in paragraph B66 of the Request for Information (reproduced in paragraph B12 of Appendix B to this paper) that requiring an SME to recognise the contingent consideration in a business combination at fair value would improve users' ability to understand the cost of the business combination. This approach would result in the amount of goodwill recognised more faithfully representing the underlying economics of the business combination. The feedback supports the analysis of the IASB as set out in the Request for Information and therefore the staff continue to consider the relevance principle is met.

47. The staff also acknowledge that requiring an SME to recognise the contingent consideration at fair value would extend the use of fair value in the *IFRS for SMEs* Standard. However, the staff had in mind that:

    (a) in assessing the economic effectiveness of the acquisition, an SME will have estimated the fair value of the contingent consideration;

    (b) delaying the recognition of the contingent consideration ignores that the acquirer's agreement to make contingent payments is the obligating event in a business combination; and

    (c) at its October 2021 meeting, the IASB tentatively decided to align the definition of fair value in the *IFRS for SMEs* Standard with that in IFRS 13 *Fair Value Measurement*, including the guidance and the principles of the fair value hierarchy set out in IFRS 13 (see paragraph 88(b) of this paper).

[6] Currently, under Section 19, the contingent consideration is included in the cost of the business combination at the acquisition date, if its payment is probable and can be reliably measured. A change in the estimate of contingent consideration is treated as additional consideration and as an adjustment to the cost of the business combination. Consequently, it changes the amount of goodwill (see paragraphs 19.12–19.13 of the *IFRS for SMEs* Standard).

Simplicity and faithful representation

48. Feedback supports permitting an SME to apply the undue cost or effort exemption—and provide the related disclosures—if measuring contingent consideration at fair value would involve undue cost or effort. However, the staff acknowledge the respondents' concern that an SME could disclose information only about contingent consideration instead of measuring at fair value. The staff think that failure to recognise that obligation or right at the acquisition date would not faithfully represent the economic consideration exchanged at that date.

49. To address the concern of respondents and to balance simplicity and faithful representation, the staff think that if measuring contingent consideration at fair value would involve undue cost or effort an SME should:

    (a) measure the contingent consideration using the 'best estimate' approach (the most likely outcome) to estimate the amount that would be required to settle the contingent consideration at the reporting date. 'Best estimate' is a term already used in several sections of the *IFRS for SMEs* Standard[7] and a term that SMEs are familiar with. As such, using the best estimate could facilitate the measurement of the contingent consideration.

    (b) recognise in profit or loss any changes in the subsequent measurement of the contingent consideration previously recognised (due to updating the best estimate). This is consistent with the IASB's conclusion, as set out in

[7] For example:

(a) paragraph 2.51 of the *IFRS for SMEs* Standard states that most liabilities other than financial liabilities are measured at the best estimate of the amount that would be required to settle the obligation at the reporting date. (The Board tentatively decided to propose to align Section 2 of the *IFRS for SMEs* Standard with the 2018 *Conceptual Framework*. The staff note that instead of the definition in the current paragraph 2.51 the current value would be defined as a measurement basis in which refers to fulfilment value for liabilities—fulfilment value is the present value of the cash, or other economic resources, that an entity expects to be obliged to transfer as it fulfils a liability).

(b) paragraph 21.7 of the *IFRS for SMEs* Standard states that an entity shall measure a provision at the best estimate of the amount required to settle the obligation at the reporting date. The best estimate is the amount an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time.

(c) paragraph 11.25 of the *IFRS for SMEs* Standard requires that impairment loss for financial assets measured at cost less impairment to be measured as the difference between the asset's carrying amount and the best estimate (which will necessarily be an approximation) of the amount that the entity would receive for the asset if it were to be sold at the reporting date.

paragraph BC357 of the Basis for Conclusions on IFRS 3, that those subsequent changes in value are generally directly related to post-combination events and changes in circumstances related to the combined entity. Thus, they should not affect the measurement of the consideration transferred or goodwill on the acquisition date.

50. The staff believe that the accounting treatment set out in paragraph 49 of this paper would improve information about the cost of the business combination, as it would achieve a balance between:

(a) the recognition requirement of contingent consideration at the date of the acquisition—so that it represents the economic effectiveness of the acquisition; and

(b) the subsequent measurement of the contingent consideration through the profit or loss—such that there is no remeasurement for the goodwill.

3—Exceptions to the acquisition method

51. As set out in paragraph B9 of Appendix B to this paper, in the Request for Information the IASB did not seek views on aligning Section 19 of the *IFRS for SMEs* Standard with the requirements in IFRS 3 (2008):

(a) introducing the option to measure non-controlling interests at fair value;

(b) changing the recognition criteria for recognising an intangible asset acquired in a business combination;

(c) clarifying that an assembled workforce is not recognised as an intangible asset; and

(d) providing additional guidance on reacquired rights.

52. Although the IASB acknowledged that not aligning Section 19 with some parts of IFRS 3 would result in the *IFRS for SMEs* Standard diverging from the acquisition method of accounting it considered this approach struck a balance between simplicity and faithful representation.

53. The IASB reasoned that:

(a) goodwill acquired in a business combination is amortised over its useful life applying the *IFRS for SMEs* Standard. Consequently, intangible assets acquired in the business combination that are not recognised separately are amortised through the annual amortisation of goodwill. The allocation of items between intangible assets and goodwill has therefore a less significant impact on the financial statements prepared applying the *IFRS for SMEs* Standard.

(b) by requiring an SME to recognise acquisition-related costs as an expense at the time of the acquisition and the contingent consideration in a business combination at fair value:

(i) users of SME financial statements would gain an improved understanding of the cost of the business combination; and

(ii) the amount of goodwill arising from the business combination would more faithfully represent the underlying economics of the business combination.

Measuring non-controlling interests, and therefore goodwill as set out in IFRS 3

54. Paragraph 19 of IFRS 3 states that, for each business combination, the acquirer shall measure at the acquisition date components of non-controlling interests in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either:

(a) fair value; or

(b) the present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets.

55. As noted in paragraph 51 of this paper, the IASB did not seek views on aligning the *IFRS for SMEs Standard* with the option to measure non-controlling interests at fair value. The IASB considered introducing such an option would introduce complexity in

the *IFRS for SMEs* Standard, particularly when the acquiree's shares are not traded in an active market.[8]

56. The staff acknowledge that removing options is generally consistent with the IASB’s approach to simplifying the *IFRS for SMEs* Standard. Furthermore, given the IASB did not seek views respondents did not address this matter in detail.

57. However, the staff note that, consistent with the reporting entity concept (the reporting entity notion) and considering that the IASB tentatively decided to propose aligning Section 2 of the *IFRS for SMEs* Standard with the 2018 *Conceptual Framework*, conceptually, a non-controlling interest in an acquiree should be determined as the sum of:

   (a) the non-controlling interest’s proportional interest in the recognised amount of the identifiable assets acquired and liabilities assumed; plus

   (b) the non-controlling interest’s share of goodwill—so that in measuring a non-controlling interest, its share of goodwill should be recognised (often referred to as the ‘full goodwill’ alternative).[9]

58. Paragraphs BC207–BC216 of the Basis for Conclusions on IFRS 3 explains the IASB deliberated that:

   (a) in principle, it is undesirable to have two residual amounts in accounting for a business combination (the goodwill and the non-controlling interest).

   (b) in concept, the non-controlling interest in the acquiree is a component of a business combination in which less than 100 per cent of the equity interests are acquired (the non-controlling interest, like other components of the combination, should be measured at fair value).

   (c) introducing a choice of measurement basis for non-controlling interests was not the IASB’s first preference. Although the IASB supports the principle of measuring all components of a business combination at fair value, support for that principle was not unanimous.

[8] Currently, applying Section 19 of the *IFRS for SMEs* Standard, any non-controlling interest in the acquiree is measured only at the non-controlling interest’s proportionate share of the recognised amounts of the acquiree’s identifiable net assets (see paragraph 19.14 of the *IFRS for SMEs* Standard).
[9] Paragraph BC205 of the Basis for Conclusions on IFRS 3.

59. In the light of the IASB’s deliberations on this area, the staff acknowledge that:

(a) the principle is to require measuring non-controlling interests at fair value—which means that goodwill includes a portion attributable to ordinary non-controlling interests; and

(b) the exception is to permit measuring non-controlling interests as the non-controlling interests’ proportionate share of the recognised amount of the acquiree’s identifiable net assets—which means that goodwill recognised relates only to the controlling interest acquired.

60. The staff acknowledge the IASB’s reasoning when developing the Request for Information was to simplify the accounting for SMEs. However, not incorporating the option to measure non-controlling interests at fair value could be perceived as inconsistent with the IASB’s tentative decision to align Section 2 of the *IFRS for SMEs* Standard with the 2018 *Conceptual Framework*. Also, it could be perceived as removing the principle, while incorporating the exception.

61. In addition, the staff think that by incorporating the IFRS 3 requirements on step acquisitions (see paragraphs 66–79 of this paper), an SME would be required to remeasure its previously held equity interest in the acquisition at fair value. So, if less than 100 percent of a subsidiary is acquired in a step acquisition transaction, then the SME is required to measure:

(a) its non-controlling interest at fair value (in which it held an equity interest immediately before the date of acquisition); and

(b) other parties' non-controlling interest at the proportionate share of the acquiree’s identifiable net assets (the current requirements of Section 19).

62. For example, on 31 December 20X1, Entity A holds a 30 per cent non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40 per cent interest in Entity B, and obtains control of Entity B. So, Entity A remeasures its previously held equity interest in Entity B (the 30 per cent) at its acquisition-date fair value. In the meantime, Entity A measures the other parties' non-controlling interest (the remaining 30 per cent) at the proportionate share of the acquiree’s identifiable net assets (the current requirements of Section 19).

63. The staff think the IASB could allow the option to measure non-controlling interests at fair value as set out in IFRS 3; in the example in paragraph 62 of this paper complexity is not increased, as Entity A measures its previously held equity interest at fair value. So, measuring the other parties' non-controlling interests at fair value on the acquisition date is consistent with the way in which other components of equity are measured and is therefore useful in decision making as the value of non-controlling interests can be identified.

64. Aligning Section 19 with IFRS 3, by introducing the option to measure non-controlling interests at fair value, will help limit the divergence against the acquisition method of accounting required by IFRS 3 as mentioned in paragraph B10 of Appendix B to this paper.[10]

65. Therefore, the staff are asking the IASB if it would like:

(a) to retain the requirements of Section 19—so that an SME measure any non-controlling interest in the acquiree at the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets; or

(b) to propose amendments to Section 19 (to align with IFRS 3) to permit an SME to choose—on a transaction-by-transaction basis—whether to measure any non-controlling interest in an acquiree:

(i) at its fair value; or

(ii) as the non-controlling interests' proportionate share of the recognised amount of the acquiree's identifiable net assets.

[10] *Report and Feedback Statement: Post-implementation Review of IFRS 3 Business Combinations, page 23,* acknowledges that measuring non-controlling interests at fair value can be challenging. However, the current measurement option addresses this issue, because it permits, on a transaction-by-transaction basis, the measurement of non-controlling interests at the proportionate share of the acquiree's identifiable net assets (ie an entity can choose to measure non-controlling interests at the proportionate share of the acquiree's net assets when measuring non-controlling interests at fair value is complex).

Introducing requirements for the accounting for step acquisitions as set out in IFRS 3

Feedback from comment letters

66. Most respondents supported introducing into the *IFRS for SMEs* Standard the requirements for the accounting for step acquisitions as set out in IFRS 3. Reasons given for this support include:

    (a) the topic is relevant for SMEs;

    (b) introducing the requirements for the accounting for step acquisitions:

        (i) would enhance comparability and provide useful information about business combinations that are achieved in stages;

        (ii) would reduce diversity in accounting for step acquisitions, and thereby improve greater consistency in how these transactions are accounted for;

        (iii) would not be unnecessarily complex for SMEs; and

        (iv) would ensure that the fair values of the consideration given, and net assets acquired, are measured on a consistent basis (ie on the same date).

67. For example, respondents said:

> …SMEs are more likely than not to acquire shares in steps with the intention of acquiring controlling interest at the end…

> …introducing step acquisition would improve comparability and advances the faithful representation principle. The end will be a better-quality information to users of SMEs financial statements. Again, if this is not clearly provided for in the IFRS for SMEs Standard, divergent practices may become the order of such transactions among SMEs with the resultant consequence of lack of comparability of their financial statements…

68. Two respondents who supported introducing the requirements for the accounting for step acquisitions as set out in the IFRS 3 also suggested incorporating simplifications specific to SMEs. Previously, applying full IFRS Standards, the fair value of previous holdings was not remeasured, and this could be a simplification specific to SMEs. For example, one accounting firm said:

> …the guidance should be simplified and not fully aligned to IFRS 3. Instead, we suggest that accumulated cost might provide a cost-efficient alternative, since it negates the complexity in the IFRS requirement to fair value previously held interests…

69. Two respondents expressed concerns that the *IFRS for SMEs* Standard must remain concise and said the gap in application guidance—in the event an SME undertakes a step acquisition—can appropriately be filled by applying the hierarchy in paragraphs 10.2–10.6 of the *IFRS for SMEs* Standard.

Feedback from online survey

70. Many respondents to the online survey also supported introducing into the *IFRS for SMEs* Standard the requirements for the accounting for step acquisitions as set out in IFRS 3. In their view, introducing requirements for the accounting for step acquisitions would fill a gap, because Section 19 currently does not include such requirements.

SMEIG recommendation

71. As discussed in paragraph 15 of this paper, SMEIG members expressed mixed views on including in the *IFRS for SMEs* Standard the requirements for accounting for step acquisitions, depending on whether they are relevant for SMEs.

Staff analysis

Relevance

72. The IASB sought views, as set out in paragraph B61 of the Request for Information (reproduced in paragraph B7 of Appendix B to this paper), on the need to introduce

requirements for step acquisitions in Section 19 (information about relevance). The feedback in paragraphs 66–67 and paragraph 70 of this paper explains that most respondents supported introducing into the *IFRS for SMEs* Standard the requirements for the accounting for step acquisitions as set out in IFRS 3.

73. Some respondents said that, in the absence of requirements for accounting for step acquisitions, applying the hierarchy in paragraphs 10.2–10.6 of the *IFRS for SMEs* Standard may result in the SME selecting an accounting policy consistent with IFRS 3. The staff acknowledge this but note that paragraphs 10.2—10.6 do not *require* an SME to refer to full IFRS Standards in selecting an accounting policy.[11]

74. In developing the Request for Information the IASB asked for views on the relevance of this topic. The feedback on the Request for Information provides evidence that including requirements for step acquisitions aligned with IFRS 3 satisfies the relevance condition. The staff acknowledge that the SMEIG had mixed views on this matter and believe that this could be best addressed by the IASB proposing to include requirements for step acquisitions in an exposure draft and asking for further views on these requirements in the Invitation to Comment.

Simplicity and faithful representation

75. Feedback from two respondents suggested that the requirements on step acquisitions should be simplified and not fully aligned to IFRS 3. Instead, in their view applying the accumulated cost approach—and not to remeasure any previously held equity interest to fair value—might provide a cost-efficient alternative and reduce complexity.

76. The staff note that paragraph 14.8(i)(i) of the *IFRS for SMEs* Standard states that in discontinuing the equity method

> …An investor shall cease using the equity method from the date that significant influence ceases:
>
> (i) the associate becomes a subsidiary or joint venture, the investor shall remeasure its previously held equity interest to

[11] Currently, under Section 19, it does not provide explicit guidance on the accounting for step acquisitions.

fair value and recognise the resulting gain or loss, if any, in profit or loss.

77. Applying paragraph 14.8(i)(i) of the *IFRS for SMEs* Standard an SME remeasures its previously held equity interest to fair value—if an investor ceases using the equity method from the date that significant influence has been lost, and the associate becomes a subsidiary.

78. The staff also think that using the accumulated cost approach results in recognising the identifiable assets and liabilities of the acquiree at a mixture of values, rather than at their acquisition-date fair values, as the determination of accumulating amounts involve accumulating the costs or carrying amounts of earlier purchases of interests in an entity. The staff, therefore, believe that:

(a) the accumulated cost approach could result in information that lacks consistency, understandability and usefulness; and

(b) measuring assets acquired or liabilities assumed at amounts other than their fair values at the acquisition date does not faithfully represent their economic values or the acquirer's economic circumstances resulting from the business combination.

79. Therefore, the staff recommend the IASB propose amendments to the *IFRS for SMEs* Standard to introduce requirements for the accounting for acquisition achieved in stages (step acquisitions) as set out in IFRS 3—such that an SME would be required to:

(a) measure the fair value of assets and liabilities acquired at the acquisition date, thereby determining the amount of goodwill at the acquisition date; and

(b) remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss in profit or loss.

Other matters arising from the Request for Information

Incorporate the guidance as set out in paragraph B18 of IFRS 3

Feedback and SMEIG recommendation

80. In commenting questions N4 and N5 of the Request for Information, a small number of respondents suggested the IASB expand Section 19 of the *IFRS for SMEs* Standard to include the guidance in paragraph B18 of IFRS 3 specifying that a new entity formed to effect a business combination is not necessarily the acquirer.

81. Paragraph B18 of IFRS 3 states:

> 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.

82. According to these respondents, the guidance would be helpful to preparers and users of the SME financial statements as these types of business combinations are common among SMEs in many jurisdictions.

83. At the September 2021 SMEIG meeting, one SMEIG member said that the IASB should include paragraph B18 of IFRS 3 in the *IFRS for SMEs* Standard as part of this second comprehensive review of the Standard rather than wait for the completion of the *Business Combination under Common Control* project because:

    (a) group reorganisation involving a new entity formed in business combination is a frequent transaction for SMEs; and

    (b) paragraph B18 of IFRS 3 is a fundamental principle and its absence in the *IFRS for SMEs* Standard has led to difficulty for SMEs.

Staff analysis applying the alignment principles

84. The feedback provides evidence that the topic is relevant for SMEs. Introducing guidance in the *IFRS for SMEs* Standard for a new entity formed in business combination would fill a gap because Section 19 of the *IFRS for SMEs* Standard currently does not include such guidance.

85. The staff acknowledge that SMEs are already familiar with the indicators set out in paragraph 19.10 of the *IFRS for SMEs* Standard in identifying an acquirer—for the situations in which it may be difficult to identify an acquirer. The staff, therefore, note that introducing the guidance as set out in paragraph B18 of IFRS 3 would not introducing complexity for SMEs.

86. Furthermore, introducing additional guidance would enhance comparability, reduce diversity and provide useful information about business combinations that have a new entity formed—if the new entity issues equity shares to effect the business combination.

87. Therefore, the staff recommend the IASB propose amendments to Section 19 to:

    (a) introduce the guidance as set out in paragraph B18 of IFRS 3; and

    (b) consequently, introduce the application guidance relevant to SMEs as set out in paragraphs B13–B17 of IFRS 3, by introducing a new appendix to Section 19 (application guidance).

Overall staff analysis—costs and benefits consideration

88. Taking the cost and benefit considerations into account, leveraging the timing element, which is an essential step in the review, the staff note that:

    (a) amending the *IFRS for SMEs* Standard to align with the IFRS 3 requirements:

        (i) may add some incremental costs—for example, by expanding the use of fair value which will require entities making more judgements. However, the staff think that those incremental costs might not be significant because the requirements of IFRS 3 do not introduce a new method of accounting but, rather, expand the use of the acquisition method with which entities applying the *IFRS for SMEs* Standard are already familiar.

(ii) would provide comparable and better-quality information to users. Adding some requirements would fill a gap. For example, the staff think that introducing requirements for the accounting for step acquisitions as set out in IFRS 3 arguably does not introduced a new requirement about measuring previously held equity interest to fair value. This is because the requirements in the *IFRS for SMEs* Standard, upon discontinuing the equity method, an investor—if an associate becomes a subsidiary—shall remeasure its previously held equity interest to fair value and recognise the resulting gain or loss, if any, in profit or loss.[12]

(b) the *IFRS for SMEs* Standard has already guidance on measuring fair value, and the IASB tentatively decided, in its October 2021 meeting, to align the definition of fair value in the *IFRS for SMEs* Standard with that in IFRS 13 and incorporate the principles of the fair value hierarchy set out in IFRS 13. Aligning the guidance will help SMEs in formulating the judgments.

89. Introducing the requirements to measure contingent consideration at fair value and to expense the costs of the acquisition is expected to provide users of financial statements with an improved understanding of the cost of the business combination.

90. In addition, the staff note that, in developing the 2018 definition of a business, the concentration test was designed to reduce cost and complexity by avoiding the need for a detailed assessment as required by paragraphs B8–B12D of IFRS 3.

[12] Paragraph 14.8(i)(i) of the *IFRS for SMEs* Standard.

91. On balance, the staff conclude the benefits of aligning the *IFRS for SMEs* Standard with IFRS 3 requirements as recommended in this paper will outweigh any increased costs of applying the IFRS 3 requirements.

Staff recommendations and questions for the IASB

92. In the light of the staff analysis, the staff recommend the IASB propose amendments to Section 19 of the *IFRS for SMEs* Standard to:

(a) align the definition of a business in the *IFRS for SMEs* Standard with the 2018 definition of a business and include, in a new appendix to Section 19, application guidance:

(i) incorporating the optional concentration test, as set out in paragraphs B7A–B7B of IFRS 3;

(ii) including a decision tree to help SMEs in assessing whether an acquired process is substantive; and

(iii) including the application guidance for assessment as set out in paragraphs B8–B12D of IFRS 3, alongside with the relevant illustrative examples.

(b) align with the requirements for acquisition-related costs and contingent consideration as set out in IFRS 3 to require an SME to:

(i) recognise acquisition-related costs as an expense at the time of the acquisition; and

(ii) recognise contingent consideration at fair value and subsequently measure it at fair value at each reporting date with changes in fair value recognised in profit or loss (except for the subsequent measurement of any contingent consideration that meets the definition of equity instrument).[13] If measuring contingent consideration at fair value would involve undue cost or effort, an SME would be required to measure the

[13] Contingent consideration classified as equity shall not be remeasured and its subsequent settlement shall be accounted for within equity.

contingent consideration using a 'best estimate' (the most likely outcome)—with changes in the subsequent measurement being recognised in profit or loss—and provide the related disclosures.

(c) introduce requirements for the accounting for step acquisitions as set out in IFRS 3. The staff also recommend the IASB ask for further views on these requirements in the Invitation to Comment.

(d) introduce guidance (in the new appendix to Section 19) for a new entity formed in a business combination as set out in paragraph B18 of IFRS 3 and, consequently, introduce the application guidance relevant to SMEs as set out in paragraphs B13–B17 of IFRS 3.

93. The staff are asking the IASB to decide whether it would like:

(a) to retain the requirements of Section 19—so that and SME measures any non-controlling interest in the acquiree at the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets; or

(b) to propose amendments to Section 19 (to align with IFRS 3) to permit an SME to choose—on a transaction-by-transaction basis—whether to measure any non-controlling interest in an acquiree:

(i) at its fair value; or

(ii) as the non-controlling interests' proportionate share of the recognised amounts of the acquiree's identifiable net assets.

Questions for the IASB

1. Does the IASB agree with the staff recommendation in paragraph 92(a) of this paper?
2. Does the IASB agree with the staff recommendation in paragraph 92(b) of this paper?
3. Does the IASB agree with the staff recommendation in paragraph 92(c) of this paper?
4. Does the IASB agree with the staff recommendation in paragraph 92(d) of this paper?

5. The staff also would like to know, as set out in detail in paragraph 93 of this paper, whether the IASB would like, for the purpose of measuring the non-controlling interests:
    (a) to retain the current requirements under Section 19; or
    (b) to propose amendments to Section 19 (to align with IFRS 3).

Next steps

94. If the IASB agree with the staff recommendations, the staff will develop proposals for an exposure draft as set out in paragraph 5 of this paper—and also as set out in paragraph 6 of this paper, if the IASB would like to propose the option for measuring the non-controlling interests. The staff also will bring a paper to the IASB at a future meeting on:

    (a) whether Section 19 needs to provide additional guidance on reacquired rights as set out in paragraphs B36 and B53 of IFRS 3, the staff will consult with the SMEIG members before bringing a paper to the IASB as the staff think that:

        (i) reacquired rights might be common amongst the SMEs—for example, in the retail industry, such rights include a right to use the acquirer's trade name under a franchise agreement; and

        (ii) 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, separately from the business combination, a settlement gain or loss—to recognise settlement of pre-existing relationship.

    (b) whether and how to propose amendments to the *IFRS for SMEs* Standard to align with IFRS Standards for the potential consequential amendments that would arise from the cross-cutting issues between IFRS 3 and IFRS 10 *Consolidated Financial Statements*.

Appendix A—Background

A1. Section 19 of the *IFRS for SMEs* Standard is based on IFRS 3 (2004)—the purchase method of business combinations is applied, which involves the following steps:

(a) identifying the acquirer;

(b) measuring the cost of the business combination; and

(c) allocating, at the acquisition date, the cost of the business combination to the assets acquired and liabilities and provisions for contingent liabilities assumed.

A2. Section 19 also addresses accounting for goodwill both at the time of a business combination and subsequently.

A3. IFRS 3 was issued in March 2004 (IFRS 3 (2004)) and replaced IAS 22 *Business Combinations*. In January 2008, the IASB issued a revised IFRS 3 (IFRS 3 (2008)). An entity shall account for each business combination by applying the acquisition method, which requires:[14]

(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.

A4. IFRS 3 (2008) seeks to enhance the relevance, reliability and comparability of information provided about business combinations and their effects.[15] It sets out principles for recognising and measuring acquired assets and liabilities, determining goodwill and making the necessary disclosures.

A5. The package of amendments introduced by IFRS 3 (2008) included changes to:

(a) the accounting for step and partial acquisitions;

[14] Paragraph BC14 of the Basis for Conclusions on IFRS 3 explains the change in terminology.
[15] Paragraph 1 of the IFRS 3.

(b) the measurement of non-controlling interests;

(c) the recognition of contingent consideration and its subsequent measurement;

(d) the recognition requirements and guidance for intangible assets; and

(e) the treatment of acquisition-related costs.

A6. The IASB had issued IFRS 3 (2008) when the first *Comprehensive Review of the* IFRS for SMEs *Standard* was undertaken. The IASB decided not to amend the *IFRS for SMEs* Standard to incorporate the changes introduced by IFRS 3 (2008) and made the following observations:[16]

> ... the changes in IFRS 3 (2008) would result in significant complexity for SMEs, particularly because of the additional fair value measurements required. Based on feedback from the Request for Information, SMEIG members and other interested parties, the current requirements in the IFRS for SMEs (based on IFRS 3 (2004)) is working well in practice and is well understood and accepted by preparers and users of SME financial statements.

A7. The scope of this second *Comprehensive Review of the* IFRS for SMEs *Standard* includes IFRS Standards and IFRIC Interpretations issued before the first comprehensive review, but that did not result in amendments to the Standard. At its March 2021 meeting, the IASB decided to confirm the scope of the review is as set out in the Request for Information. Consequently, this second comprehensive review re-considers aligning the *IFRS for SMEs* Standard with the IFRS 3 (2008).

A8. The IASB also completed a Post-implementation Review of IFRS 3 (2008) in June 2015. Based on the findings from the Post-implementation Review of IFRS 3, the IASB added the following projects to its work plan:

(a) Definition of a Business—this project is complete and an amendment to IFRS 3 was issued in October 2018; and

(b) Goodwill and Impairment—this project is ongoing.

[16] Paragraph BC198(c) of the Basis for Conclusions on the *IFRS for SMEs* Standard

A9. The staff proposes that as part of this second comprehensive review, the IASB consider aligning the *IFRS for SMEs* Standard with the 2018 definition of a business and IFRS 3 (2008) for the following reasons:

(a) the Post-implementation Review for IFRS 3 (2008) has been completed by the IASB, and the definition of a business has been amended.

(b) there now exists greater implementation experience of IFRS 3 (2008) as it has been applied in industry for a number of years.

(c) in the first comprehensive review the IASB prioritised providing entities with a stable platform[17] over aligning the *IFRS for SMEs* Standard with full IFRS Standards. The *IFRS for SMEs* Standard has been effective since 2009, with amendments made in 2015 following the first comprehensive review. Entities are familiar with applying the requirements of the *IFRS for SMEs* Standard, including the accounting for business combinations.

A10. The Request for Information sought views on aligning the *IFRS for SMEs* Standard with the 2018 definition of a business and parts of IFRS 3 (2008). The IASB's rationale is set out in paragraphs B55–B66 of the Request for Information and reproduced in Appendix B to this paper—For example, the Request for Information stated:

> IASB noted that IFRS 3 (2008) was developed to address known deficiencies in the requirements of IFRS 3 (2004) and to address application problems with the Standard. The IASB decided to address alignment by applying the 'alignment principles' to the significant improvements introduced in IFRS 3 (2008).

Differences between the IFRS 3 and Section 19

A11. The main differences between the requirements of the IFRS 3 and Section 19 are as described in the paragraphs that follow.

[17] Paragraph BC189 of the Basis for Conclusions on the *IFRS for SMEs* Standard.

A12. The definitions of 'business combination' and 'business' in the *IFRS for SMEs* Standard are different from those in the IFRS 3, possibly resulting in differences in application.

A13. Applying paragraph 19.11(b) of the *IFRS for SMEs* Standard, the cost of a business combination includes any costs directly attributable to the business combination (for example, finder's fees and advisory, legal, accounting, valuation and other professional or consulting fees that are directly attributable to the business combination). By contrast, IFRS 3 explicitly excludes such costs from the cost of a business combination (paragraph 53 of IFRS 3). Consequently, such costs generally form part of goodwill under the *IFRS for SMEs* Standard, whereas under IFRS 3 they are recognised as expenses in the period in which the costs are incurred and the services are received.

A14. Applying IFRS 3, if a business combination is achieved in stages, the acquirer remeasures any previously held equity interest in the acquiree at its acquisition-date fair value and takes this amount into account in the determination of goodwill (paragraphs 41–42 of IFRS 3). Section 19 of the *IFRS for SMEs* Standard does not provide explicit guidance on the accounting for a step acquisition.

A15. Contingent consideration is included in the cost of a business combination applying the *IFRS for SMEs* Standard, if its payment is probable and the amount can be measured reliably (paragraph 19.12 of the *IFRS for SMEs* Standard). IFRS 3, on the other hand, requires the fair value of contingent consideration to be included in the cost of a business combination regardless of whether payment is probable; its fair value being determined by considering the possible outcomes and estimating the probability of each (paragraph 39 of IFRS 3).

A16. Applying the *IFRS for SMEs* Standard, if subsequently, the contingent consideration becomes both probable and can be measured reliably, the fair value amount is treated as an adjustment to the cost of the business combination (paragraph 19.13 of the *IFRS for SMEs* Standard) and so will affect the amount recognised for goodwill. Under IFRS 3, changes in the fair value of contingent consideration only affect the cost of the business combination if they are measurement period adjustments (adjustments made during the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination), otherwise they are accounted for separately (paragraph 58 of IFRS 3).

A17. After initial recognition applying the *IFRS for SMEs* Standard, goodwill is measured at cost less accumulated amortisation and any accumulated impairment losses. Goodwill is amortised over its useful life and cash-generating units to which goodwill has been allocated are subject to an impairment test if there is an indication of impairment. If an entity cannot establish reliably the useful life of goodwill, the life shall be determined based on management's best estimate but shall not exceed 10 years (paragraph 19.23 of the *IFRS for SMEs* Standard). Applying full IFRS Standards, goodwill is not amortised. However, cash-generating units to which goodwill has been allocated are subject to an impairment test at least annually and, additionally, when there is an indication of impairment (paragraphs 10(b) and 90 of IAS 36 *Impairment of Assets*).

A18. Applying Section 18, an intangible asset acquired in a business combination shall be recognised unless its fair value cannot be measured reliably without undue cost or effort at the acquisition date (paragraph 18.8 of the *IFRS for SMEs* Standard). IFRS 3 and IAS 38 *Intangible Assets* assume that if an intangible asset is separable or arises from contractual or other legal rights the reliable measurement criterion is always satisfied (paragraph 33 of IAS 38) and do not provide undue cost or effort exemptions.

A19. Applying the *IFRS for SMEs* Standard, contingent liabilities assumed in a business combination are recognised only when their fair value can be measured reliably (see paragraph 19.15(d)). Entities are required, under IFRS 3 to recognise contingent liabilities only if they are present obligations (and exclude those that are possible obligations) arising from past events whose fair value can be measured reliably.

A20. Applying the *IFRS for SMEs* Standard, a non-controlling interest is measured at the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets (sometimes called the proportionate share method—paragraph 19.14 of the *IFRS for SMEs* Standard). Using this method, goodwill that is attributable to the non-controlling interest is not recognised.

Applying the IFRS 3 (paragraph 19), the non-controlling interest is measured using either the full goodwill method or the proportionate share method. The difference between the two is that with the full goodwill method, the non-controlling interest's stake in the entity is valued at fair value and this is used, along with consideration paid by the parent for its stake in the subsidiary, to calculate the goodwill arising on 100% of the subsidiary. The full goodwill is recognised in the consolidated financial statements (that is, it includes goodwill attributable to the non-controlling interest). If the full goodwill method is used, at the acquisition date of a partly owned subsidiary, both goodwill and non-controlling interest are different from those calculated applying the *IFRS for SMEs* Standard.

A21. IFRS 3 and the *IFRS for SMEs* Standard are different in other ways:

(a) under the *IFRS for SMEs* Standard, the method used to account for business combinations is called the purchase method. Under IFRS 3 it is called the acquisition method.

(b) IFRS 3 contains additional exceptions from the recognition and/or fair value measurement requirements for the acquiree's identifiable assets and liabilities, for example, it includes exemptions and specific requirements for indemnification assets, leases, reacquired rights and share-based payments.

(c) IFRS 3 contains additional guidance in some specific areas that are not covered by the *IFRS for SMEs* Standard, for example reverse acquisitions, business combinations achieved without the transfer of consideration and the identification of intangible assets.

(d) the *IFRS for SMEs* Standard is drafted using simpler language than that used in full IFRS Standards.

Appendix B—IASB rationale in the Request for Information on aligning the *IFRS for SMEs* Standard with IFRS 3 (2008)

B1. Question S5 asks for views on the extent to which Section 19 should be aligned with IFRS 3 (2008). Currently, Section 19 is based on IFRS 3 (2004), which was revised in 2008.

B2. The IASB decided not to align the requirements of Section 19 with IFRS 3 (2008) during the first comprehensive review of the *IFRS for SMEs* Standard because the requirements of Section 19 were working well in practice and adding new fair value measurement requirements would introduce unnecessary complexity.

B3. In deciding to reconsider alignment of Section 19 with IFRS 3 (2008) the IASB noted that it had completed the post-implementation review of IFRS 3 (2008) and had access to additional implementation experience regarding IFRS 3 (2008).

B4. The IASB noted that IFRS 3 (2008) was developed to address known deficiencies in the requirements of IFRS 3 (2004) and to address application problems with the Standard. The IASB decided to address alignment by applying the 'alignment principles' to the significant improvements introduced in IFRS 3 (2008).

B5. The *IFRS for SMEs* Standard does not include requirements on the accounting for step acquisitions. If Section 19 was aligned with the IFRS 3 (2008), requirements for step acquisitions an acquirer would be required to:

(a) measure the fair value of assets and liabilities acquired at the acquisition date and thereby determine the amount of goodwill at the acquisition date; and

(b) remeasure its previously held equity interest in the acquisition.

B6. Introducing requirements for step acquisitions based on IFRS 3 (2008) into Section 19 would improve comparability and provide better-quality information to users. In the absence of requirements in the *IFRS for SMEs* Standard, entities may apply other practices.

B7. The IASB decided to seek views, first, on the need to introduce requirements for step acquisitions into Section 19 and then on whether those requirements should be aligned with IFRS 3 (2008).

B8. The IASB is also seeking views on aligning Section 19 with IFRS 3 (2008) so that:

(a) acquisition-related costs are recognised as an expense at the time of the acquisition. Applying IFRS 3 (2008), acquisition-related costs are considered not to be part of the fair value exchange between the buyer and seller of the business combination and therefore are recognised separately as an expense.

(b) contingent consideration in a business combination is recognised at fair value and subsequent changes are accounted for as remeasurements of a financial instrument. Recognising contingent consideration at fair value would provide users of financial statements prepared applying the *IFRS for SMEs* Standard with better information about the cost of the business combination. The IASB also proposes to simplify these requirements and seek views on permitting an entity to use the undue cost or effort exemption in paragraph 2.14A of the *IFRS for SMEs* Standard and provide the related disclosures if measuring contingent consideration at fair value would involve undue cost or effort.

B9. The IASB is not seeking views on aligning Section 19 with improvements in IFRS 3 (2008) that:

(a) introduced the option to measure non-controlling interests at fair value;

(b) changed the recognition criteria for recognising an intangible asset acquired in a business combination;

(c) clarified that an assembled workforce is not recognised as an intangible asset; and

(d) provided additional guidance on reacquired rights.

B10. The IASB decided that these improvements would introduce complexity into Section 19. The IASB noted that its decision not to seek views on aligning Section 19 with these improvements would result in the *IFRS for SMEs* Standard diverging from the acquisition method of accounting required by IFRS 3 (2008).

B11. The acquisition method of accounting views a business combination from the perspective of the acquirer. Applying the acquisition method, users of financial statements are provided with relevant information to assess the initial investment made and the subsequent performance of those investments.

B12. The IASB acknowledged the divergence; however, the topics it had decided to seek views on should provide a balance between simplicity and faithful representation. Specifically, the IASB noted that:

(a) introducing requirements for acquisition-related costs to be recognised as an expense at the time of the acquisition and for contingent consideration in a business combination to be recognised at fair value would improve users' ability to understand the cost of the business combination. This approach would result in the amount of goodwill recognised more faithfully representing the underlying economics of the business combination.

(b) applying the *IFRS for SMEs* Standard, goodwill acquired in a business combination is amortised over its useful life similarly to any other intangible asset. Consequently, intangible assets that have not been separately recognised in the business combination will be accounted for through the annual amortisation charge for goodwill so that the split of items between intangible assets and goodwill has a less significant impact on the financial statements prepared applying the *IFRS for SMEs* Standard than it does under full IFRS Standards.