



IFRS[®]
Accounting

Educational Module 19
Business Combinations and Goodwill

IFRS for SMEs[®]

Accounting Standard
Third Edition



International Accounting Standards Board

IFRS[®] Foundation
Supporting Material for the
***IFRS for SMEs[®]* Accounting Standard**

including the full text of
Section 19 *Business Combinations and Goodwill*
of the *IFRS for SMEs* Accounting Standard issued by
the International Accounting Standards Board in February 2025

with extensive explanations, self-assessment questions and case studies

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The requirements of Section 19 *Business Combinations and Goodwill* of the *IFRS for SMEs* Accounting Standard are set out in this module and shown with grey shading. Appendix B of the *IFRS for SMEs* Accounting Standard contains the glossary (Glossary) and is part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 19.

This module has been prepared by International Accounting Standards Board (IASB) technical staff. The educational notes and examples inserted by the staff are not shaded. These educational notes and examples do not form part of the *IFRS for SMEs* Accounting Standard and have not been approved by the IASB.

INTRODUCTION

IFRS for SMEs® Accounting Standard

The *IFRS for SMEs* Accounting Standard (Standard) is intended for use by entities that publish general purpose financial statements and that do not have public accountability (referred to as small and medium-sized entities—see Section 1 *Small and Medium-sized Entities* of the Standard).

The objective of general purpose financial statements is to provide financial information about a reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

More information about the Standard and its supporting materials is available on the IFRS Foundation website: www.ifrs.org.

This module

This educational module supports the requirements for the accounting for and the reporting of business combinations and goodwill applying Section 19 *Business Combinations and Goodwill* of the Standard.

The module:

- provides explanations and examples to improve understanding of the requirements in Section 19;
- identifies the significant judgements required in the accounting for and the reporting of business combinations and goodwill;
- includes questions designed to test your understanding of the requirements in Section 19; and
- includes case studies that provide a practical opportunity to apply the Section 19 requirements.

After completing this module, you should be able:

- to identify a business combination;
- to understand and apply the acquisition method of accounting for business combinations;
- to identify the acquirer in a business combination;
- to identify the acquisition date;
- to recognise and measure the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree;
- to recognise and measure goodwill or a gain from a bargain purchase;
- to account for goodwill after its initial recognition;
- to determine what information should be disclosed about a business combination; and
- to demonstrate an understanding of the significant judgements that are required in accounting for business combinations and goodwill.

Which version of the Standard does the module refer to?

Any reference in this module to ‘the *IFRS for SMEs* Accounting Standard’ or to ‘the Standard’ is to the third edition of the Standard, issued in February 2025.

Introduction to the requirements

Section 19 sets out the financial reporting requirements for business combinations and goodwill.

Business combinations are accounted for by applying the acquisition method, which involves four steps:

- step one—identify the acquirer;
- step two—identify the acquisition date;
- step three—recognise and measure the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and
- step four—recognise and measure goodwill or a gain from a bargain purchase.

After initial recognition of goodwill acquired in a business combination, the acquirer measures it at cost less accumulated amortisation and accumulated impairment losses. Goodwill is considered to have a finite useful life and is amortised over that finite period.

Section 19 also specifies disclosure requirements for business combinations that occurred during the reporting period and for goodwill and contingent consideration that is recognised in the statement of financial position.

What has changed in the third edition of the Standard?

Section 19 of the second edition of the Standard was based on an earlier version of IFRS 3 *Business Combinations* (issued in 2004). In the third edition of the Standard, the IASB updated Section 19 to align with the current version of IFRS 3 (issued in 2008).

In summary, the IASB updated Section 19 by:

- amending the definition of a business and adding guidance on applying that definition;
- amending the guidance on identifying the acquirer, including when a new entity is formed to effect a business combination;
- amending the requirements for recognising and measuring the identifiable assets acquired and liabilities assumed in the business combination, such as the requirements for recognising contingent liabilities;
- amending the requirements for contingent consideration, to require contingent consideration to be recognised as part of the consideration transferred in exchange for the acquiree, with subsequent changes in the measurement of contingent consideration recognised in profit or loss;
- amending the requirements for acquisition-related costs, to require these costs to be recognised as expenses in profit or loss;
- adding requirements for a business combination achieved in stages (a step acquisition); and
- adding disclosure requirements for contingent consideration.

Transition requirements are explained on pages 70–71.

REQUIREMENTS AND EXAMPLES

Scope of this section

- 19.1 This section applies to a transaction or other event that meets the definition of a **business combination**. It sets out requirements for how an **acquirer** recognises and measures in its financial statements:
- (a) the identifiable **assets** acquired, the **liabilities** assumed and any **non-controlling interest** in the **acquiree**; and
 - (b) the **goodwill** acquired or a gain from a bargain purchase.
- 19.2 This section does not apply to:
- (a) combinations of entities or **businesses** under common **control**. Common control means that 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.
 - (b) formations of a **joint arrangement** in the financial statements of the joint arrangement itself.
 - (c) an acquisition of an asset or a group of assets that does not constitute a business.

Educational notes

A 'business combination' is defined as (see the Glossary):

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 the Standard.

Combinations under common control

Paragraph 19.2(a) of Section 19 of the *IFRS for SMEs Accounting Standard* (Standard) excludes from the scope of Section 19 combinations of entities or businesses under common control. Because the Standard does not specify how to account for such combinations, the management of an entity, in accordance with paragraph 10.4 of Section 10 *Accounting Policies, Estimates and Errors* of the Standard, uses its judgement in developing and applying an accounting policy that results in information that is reliable and relevant to the economic decision-making needs of users of an entity's financial statements. Management's accounting policy is required to result in financial statements that:

- represent faithfully the financial position, financial performance and cash flows of the entity;
- reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
- are neutral—that is, free from bias;

-
- are prudent; and
 - are complete in all material respects.

Paragraph 10.5 of Section 10 specifies that in developing and applying such accounting policies, management must refer to and consider, in descending order, the applicability of:

- the requirements and guidance in the Standard dealing with similar and related issues; and
- the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 *Concepts and Pervasive Principles* of the Standard.

Although the Standard permits management to consider the requirements and guidance in full IFRS Accounting Standards (see paragraph 10.6 of Section 10), doing so for these business combinations does not provide any additional guidance because full IFRS Accounting Standards contain the same exclusion for combinations of entities under common control (see paragraph 2(c) of IFRS 3 *Business Combinations*).

The scope exclusion in paragraph 19.2(a) does not preclude an entity from applying Section 19 to a business combination under common control, if appropriate. However, the scope exclusion means it is not mandatory to do so. In using its judgement, management might determine that applying the requirements of Section 19 by analogy would meet the requirements in paragraph 10.4. Alternatively, management might consider pronouncements from other standard-setting bodies, other accounting literature and accepted industry practice, to the extent that these do not conflict with the hierarchy in paragraph 10.5 and would, in management's view, meet the requirements in paragraph 10.4. Taking this alternative approach might lead to the use of other methods, such as the pooling of interests method, which is commonly used for business combinations under common control. This method combines the pre-business combination carrying amounts of assets, liabilities and reserves of the combining entities or businesses.

Joint arrangements

A joint arrangement is an arrangement of which two or more parties have joint control. Joint arrangements can take the form of jointly controlled operations, jointly controlled assets or jointly controlled entities (see the Glossary). Joint arrangements are accounted for in accordance with Section 15 *Joint Arrangements* of the Standard.

An asset or a group of assets

Section 19 applies to business combinations, in which the entity obtains control of one or more businesses. Therefore, the acquisition of an asset or a group of assets that does not constitute a business is outside the scope of Section 19. Asset acquisitions are accounted for by applying other sections of the Standard. Each asset is accounted for by applying the appropriate section—for example, if an acquired asset qualifies as property, plant or equipment, Section 17 *Property, Plant and Equipment* would apply.

Determining whether the acquisition of an asset or group of assets constitutes a business is covered on pages 11–21.

Examples—Transactions outside the scope of Section 19

Ex 1 SME A operates a painting and decorating business and is owned entirely by Mr X. Mr X also owns SME B, which operates a garden maintenance business. Both SMEs had been operating successfully for 10 years when Mr X decided to transfer his shares in SME B to SME A because of the significant tax savings Mr X will potentially realise.

After the transaction, Mr X owns all of SME A (as he did before), but SME A now has a subsidiary, SME B. Mr X no longer has a direct interest in SME B.

Before and after the transaction, SME A and SME B are both controlled by Mr X. Accordingly, this combination is a combination of businesses under common control and the accounting for this combination is outside the scope of Section 19. It does not matter that the common control is by an individual instead of by an entity; the scope exclusion applies regardless.

In accordance with paragraph 10.4, SME A uses judgement in developing and applying an appropriate accounting policy. SME A might consider using the acquisition method of accounting (applying the method set out in Section 19), if SME A judges that would be appropriate. Alternatively, SME A might consider the pronouncements of other standard-setting bodies, other accounting literature and accepted industry practice, to the extent that these do not conflict with the hierarchy in paragraph 10.5 and would, in SME A's view, meet the requirements in paragraph 10.4.

Ex 2 SME A formed a new entity, SME B, in which it holds all of the equity. SME B then acquired five subsidiaries of SME A. SME A has two other subsidiaries, but these are not involved in the restructuring of the group.

After the transaction, SME B is a subsidiary of SME A and the parent of five subsidiaries. SME B would first need to determine whether it is required to prepare consolidated financial statements (see paragraph 9.3 of Section 9 *Consolidated and Separate Financial Statements* of the Standard). This example assumes that SME B prepares consolidated financial statements.

SME B's acquisition of five of SME A's subsidiaries is a combination of entities under common control because all of the combining entities are ultimately controlled by the same party both before and after the transaction. Therefore, accounting for such combinations is outside the scope of Section 19.

In accordance with paragraph 10.4, SME B uses its judgement in developing and applying an appropriate accounting policy. SME B might consider using the acquisition method of accounting (applying the method set out in Section 19), if SME B judges that would be appropriate. Alternatively, SME B might consider the pronouncements of other standard-setting bodies, other accounting literature and accepted industry practices, to the extent that these do not conflict with the hierarchy in paragraph 10.5 and would, in SME B's view, meet the requirements in paragraph 10.4.

Ex 3 SME A and SME B each acquired 50% of SME C's ordinary shares, which carry voting rights at general meetings of shareholders. SME C manufactures plastic containers for storing edible oils and sells those containers to several third-party entities. The terms of the contractual arrangement between SME A and SME B specify that decisions relating to SME C require the approval of both SME A and SME B.

This transaction is not a business combination. Instead, it is the formation of a joint arrangement because SME A and SME B have contractually agreed to share control of SME C. As a result of this transaction, SME C is a jointly controlled entity. Consequently, SME A and SME B account for their investment in SME C in accordance with Section 15 instead of Section 19.

Identifying a business combination

19.3 An entity shall determine whether a transaction or other event meets the definition of a business combination. A business combination is a transaction or other event in which an entity (the acquirer) obtains control of one or more businesses (the acquiree). Paragraphs 19A.1–19A.10 provide guidance on how to determine whether the transaction or other event is a business combination. If the assets acquired and liabilities assumed do not constitute a business, the **reporting entity** shall account for the transaction or other event as an asset acquisition.

...

Definition of a business (application of paragraph 19.3)

19A.1 A business is 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. A business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs. These are the three elements of a business and their definitions:

- (a) an *input* is any economic resource that creates outputs or has the ability to contribute to the creation of outputs when one or more processes are applied to it. Examples of inputs include employees, non-current assets, intellectual property and the ability to obtain access to necessary materials or rights.
- (b) a *process* is any system, standard, protocol, convention or rule that, when applied to an input or inputs, creates outputs or has the ability to contribute to the creation of outputs. Examples of processes include strategic management processes, operational processes and resource management processes.
- (c) an *output* is the result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income or generate other income from ordinary activities.

Optional test to identify concentration of fair value

- 19A.2 Paragraph 19A.3 sets out an optional concentration test for a simplified assessment of whether an acquired set of activities and assets is a business. An entity is permitted to choose whether to apply the test for each transaction or other event. If the concentration test is:
- (a) met, the set of activities and assets is determined not to be a business and no further assessment is necessary; or
 - (b) not met (or if the entity chooses not to apply the test), the entity then performs the assessment set out in paragraphs 19A.4–19A.10.
- 19A.3 The concentration test is met, meaning an acquired set of activities and assets is determined not to be a business, 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. For the purposes of the concentration test:
- (a) gross assets acquired exclude cash and cash equivalents, deferred tax assets and goodwill resulting from the effects of deferred tax liabilities;
 - (b) the fair value of the gross assets acquired includes any consideration transferred (plus the non-controlling interest's proportionate share in the recognised amounts of the acquiree's net identifiable assets and the fair value of any previously held interest) in excess of the fair value of net identifiable assets acquired;
 - (c) a single identifiable asset includes any asset or group of assets that would be recognised and measured as a single identifiable asset in a business combination;
 - (d) if a tangible asset is attached to, and cannot be physically removed and used separately from, another tangible asset without incurring significant cost or significant diminution in utility or fair value to either asset (for example, land and buildings), those assets shall be considered a single identifiable asset; and
 - (e) the nature of each single identifiable asset and the risk characteristics (the risks associated with managing and creating outputs from the assets) are considered to assess whether assets are similar.

Educational notes

When considering whether a particular transaction is a business combination, an entity determines whether the assets acquired and liabilities assumed constitute a business.

The Glossary defines a business as:

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of:

- (a) providing goods or services to customers;
- (b) generating investment income (such as dividends or interest); or
- (c) generating other income from ordinary activities.

The Appendix to Section 19 sets out application guidance on the definition of a business, which an entity is required to apply when considering whether the acquired set of activities and assets constitutes a business.

Paragraph 19A.1 of the Appendix states that a business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs. It also defines the three elements of a business: inputs, processes and outputs.

Paragraphs 19A.2–19A.3 set out an optional concentration test for a simplified assessment of whether an acquired set of activities and assets is a business. The test is designed to reduce cost and complexity by avoiding the need, in some circumstances, for a detailed assessment of whether a business has been acquired. 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, the concentration test is met. In these circumstances, the set of activities and assets acquired is determined not to be a business and no further assessment is necessary.

However, if an entity chooses to apply the optional concentration test but the test is not met, the entity then applies the guidance in paragraphs 19A.4–19A.10 to assess whether it has acquired a business. That guidance also applies if the entity chooses not to apply the optional concentration test. See pages 15–21.

Examples—Optional concentration test applied

Ex 4 SME A buys a portfolio of 10 single-family homes that each have an in-place lease. The fair value of the consideration paid is equal to the aggregate fair value of the 10 single-family homes acquired. Each single-family home includes the land, building and property improvements. Each home has a different floor area and interior design. The 10 single-family homes are located in the same area and the classes of customers (for example, tenants) are similar. The risks associated with operating in the real estate market of the homes acquired are not significantly different. No employees, other assets, processes or other activities are transferred.

SME A chooses to apply the optional concentration test set out in paragraph 19A.3 and concludes that:

- each single-family home is considered a single identifiable asset in accordance with paragraph 19A.3 because:
 - the building and property improvements are attached to the land and cannot be removed without incurring significant cost; and
 - the building and the in-place lease are considered a single identifiable asset because they would be recognised and measured as a single identifiable asset in a business combination.
- the group of 10 single-family homes is a group of similar identifiable assets because the assets are similar in nature and the risks associated with managing and creating outputs are not significantly different. The risks are not significantly different because the types of homes and classes of customers are not significantly different.
- consequently, substantially all of the fair value of the gross assets acquired is concentrated in a group of similar identifiable assets.

Therefore, SME A concludes that the acquired set of activities and assets is not a business.

Ex 5 Assume the same facts as in Example 4, except that as part of the same transaction, SME A also buys a multi-tenant corporate office park with six 10-storey office buildings that are fully leased. The additional set of activities and assets acquired includes the land, buildings, leases and contracts for outsourced cleaning, security and maintenance. The aggregate fair value associated with the office park is similar to the aggregate fair value associated with the 10 single-family homes.

SME A chooses to apply the optional concentration test set out in paragraph 19A.3.

SME A concludes that the single-family homes and the office park are not similar identifiable assets because the single-family homes and the office park differ significantly in the risks associated with operating the assets, obtaining tenants and managing tenants. In particular, the scale of operations and risks associated with the two classes of customers are significantly different.

Consequently, SME A concludes that the fair value of the gross assets acquired is not substantially all concentrated in a group of similar identifiable assets. No such concentration of fair value exists because the fair value of the office park is similar to the aggregate fair value of the 10 single-family homes and the office park is dissimilar to the single-family homes.

Therefore, SME A assesses whether the acquired set of activities and assets meets the minimum requirements to be considered a business in accordance with paragraphs 19A.4–19A.10.

Ex 6 SME A buys a legal entity that contains:

- **the rights to an in-process research and development project to develop a compound to treat diabetes that is in its final testing phase (Project 1). Project 1 includes the historical know-how, formula protocols, designs and procedures expected to be necessary to complete the final testing phase.**
- **a contract that provides outsourced clinical trials. The contract is priced at current market rate and several vendors in the marketplace could provide the same services. Therefore, the fair value associated with this contract is nil. SME A has no option to renew the contract.**

SME A chooses to apply the optional concentration test set out in paragraph 19A.3 and concludes that:

- Project 1 is a single identifiable asset because it would be recognised and measured as a single identifiable intangible asset in a business combination; and
- substantially all of the fair value of the gross assets acquired is concentrated in Project 1 because the acquired contract has a fair value of nil.

Therefore, SME A concludes that the acquired set of activities and assets is not a business.

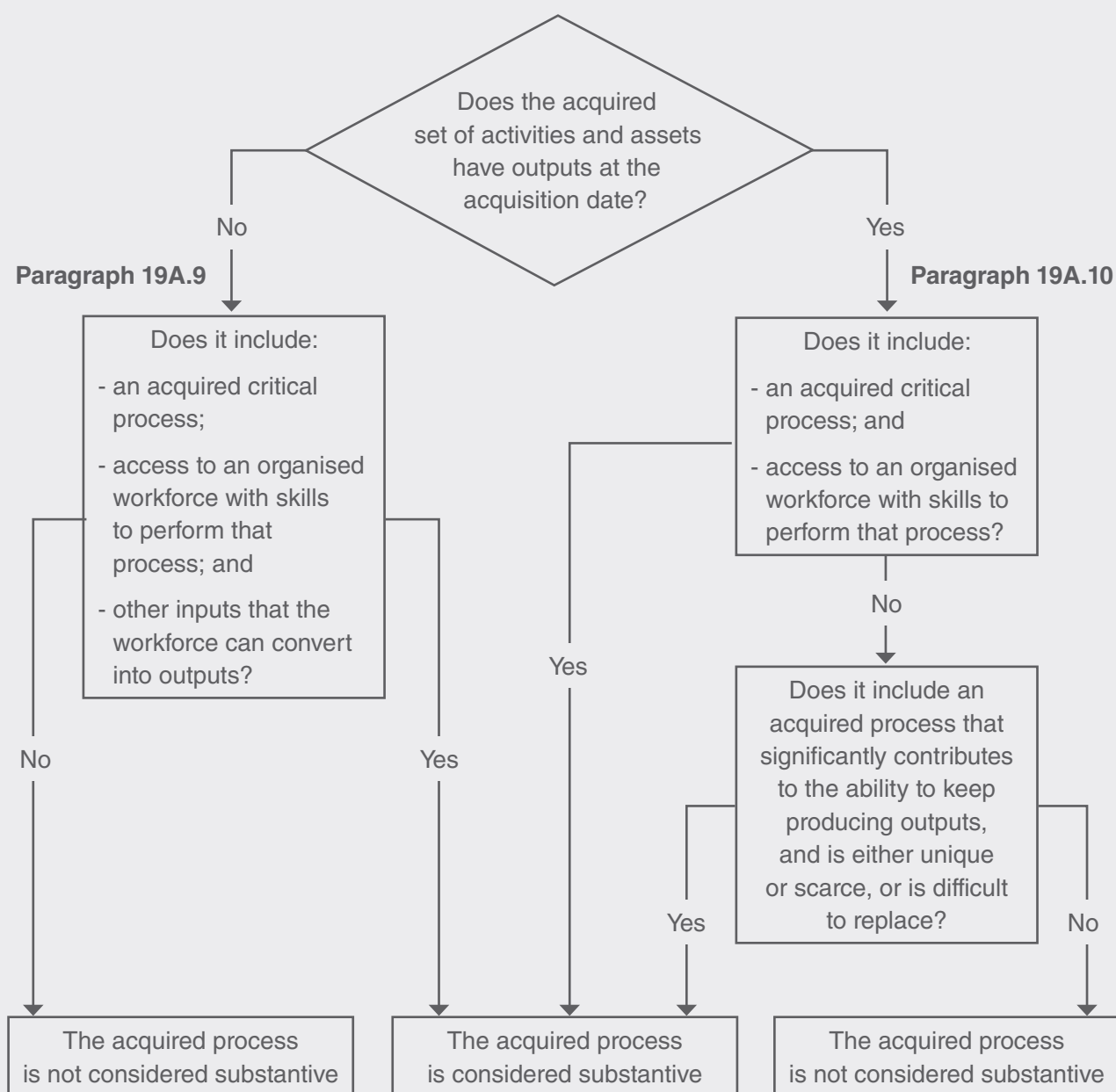
Elements of a business

- 19A.4 Although businesses usually have outputs, an integrated set of activities and assets can have no outputs and still qualify as a business. If an integrated set of activities and assets has two essential elements—inputs and processes applied to those inputs—it can be conducted and managed for the purposes identified in the definition of a business. A business need not include all of the inputs or processes that the seller used in operating that business. However, to be considered a business, an integrated set of activities and assets includes, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. Paragraphs 19A.7–19A.10 specify how to assess whether a process is substantive.
- 19A.5 If an acquired set of activities and assets has outputs, a continuation of **revenue** does not, on its own, show that the acquirer has acquired both an input and a substantive process.
- 19A.6 An acquirer determines whether a particular set of activities and assets is a business based on whether the integrated set is capable of being conducted and managed as a business by a market participant. It is not relevant whether a seller operated the set as a business or whether an acquirer intends to operate the set as a business.

Assessing whether an acquired process is substantive

19A.7 Paragraphs 19A.8–19A.10 explain how to assess whether an acquired process is substantive depending on whether the acquired set of activities and assets has no outputs (paragraph 19A.9) or has outputs (paragraph 19A.10). Figure 19.1 summarises how an entity assesses whether an acquired process is substantive.

Figure 19.1—How an entity assesses whether an acquired process is substantive



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- 19A.8 An example of an acquired set of activities and assets that does not have outputs at the acquisition date is an early-stage entity that has not started generating revenue. If an acquired set of activities and assets generates revenue at the acquisition date, it is considered to have outputs at that date. The acquired set has outputs even if it subsequently will no longer generate revenue from external customers—for example, because it will be integrated by an acquirer.
- 19A.9 If a set of activities and assets does not have outputs at the acquisition date, an acquired process (or group of processes) is considered substantive only if:
- (a) it is critical to the ability to develop or convert an acquired input or inputs into outputs; and
 - (b) the inputs acquired include both access to an organised workforce that has the necessary skills, knowledge or experience to perform that process (or group of processes) and other inputs that the organised workforce could develop or convert into outputs. Those other inputs could include:
 - (i) intellectual property that could be used to develop a good or service;
 - (ii) other economic resources—for example, technology or real estate—that could be developed to create outputs; or
 - (iii) rights to obtain access to necessary materials or rights that enable the creation of future outputs.
- 19A.10 If a set of activities and assets has outputs at the acquisition date, an acquired process (or group of processes) is considered substantive if, when applied to an acquired input or inputs, it:
- (a) is critical to the ability to continue producing outputs, and the inputs acquired include access to an organised workforce with the necessary skills, knowledge or experience to perform that process (or group of processes); or
 - (b) significantly contributes to the ability to continue producing outputs and:
 - (i) is considered unique or scarce; or
 - (ii) cannot be replaced without significant cost, effort or delay in the ability to continue producing outputs.

Educational notes

An entity applies the guidance in paragraphs 19A.4–19A.10 to assess whether it has acquired a business if:

- the entity chooses to apply the optional concentration test in paragraph 19A.3 but the test is not met; or
- the entity does not choose to apply the optional concentration test.

To constitute a business, an integrated set of activities and assets is required to have two essential elements: inputs and processes applied to those inputs, including at least one process that is assessed as being substantive in accordance with paragraphs 19A.7–19A.10.

A set of activities and assets acquired could be a business, even if it has no outputs—for example, an entity in the development stage that has not yet started generating revenue could be a business. Conversely, if an acquired set of activities and assets has outputs, a continuation of revenue does not, on its own, show that the acquirer has acquired both an input and a substantive process.

Assessing whether a particular set of activities and assets constitutes a business is based on whether that set is capable of being conducted and managed as a business, irrespective of whether the seller operated the set as a business and irrespective of whether the acquirer intends to do so. For example, an entity might acquire the operations of a competitor and immediately suspend those operations to protect and grow its market share. In evaluating whether the acquired set of activities and assets comprise a business, it is not relevant that the acquirer does not intend to operate the set as a business.

Examples—A business

Ex 7 SME A acquired SME B, an IT company that applies a computer programming process to develop accounting software and sells that software directly to customers. SME B has the intellectual property, staff and non-current assets (for example, computer equipment) that are necessary to develop and sell software. SME B has many software licensing contracts and several purchase orders from customers.

SME A chooses not to apply the optional concentration test set out in paragraph 19A.3 and therefore assesses whether the acquired set of activities and assets meets the minimum requirements to be considered a business in accordance with paragraphs 19A.4–19A.10.

The acquired set of activities and assets has outputs at the acquisition date (that is, the accounting software for sale to customers). Therefore, SME A applies the criteria in paragraph 19A.10.

SME A determines that the criterion in paragraph 19A.10(a) is met because:

- the acquired process (that is, the computer programming process) is critical to the ability to continue producing outputs when applied to the acquired inputs (such as the computer equipment); and
- the set of activities and assets includes an organised workforce with the necessary skills, knowledge and experience to perform the acquired process.

Therefore, SME A concludes that the acquired process is substantive. Furthermore, SME A concludes that the criterion in paragraph 19A.4 is met because the substantive process and inputs together significantly contribute to the ability to create outputs.

Consequently, SME A concludes that the acquired set of activities and assets is a business.

Ex 8 SME A buys a multi-tenant corporate office park with six 10-storey office buildings that are fully leased. The set of activities and assets acquired includes: land; buildings; leases; employees responsible for leasing, managing tenants, and managing and supervising all operational processes; and contracts for outsourced cleaning, security and maintenance.

SME A chooses not to apply the optional concentration test set out in paragraph 19A.3 and therefore assesses whether the acquired set of activities and assets meets the minimum requirements to be considered a business in accordance with paragraphs 19A.4–19A.10.

The acquired set of activities and assets has outputs at the acquisition date because it generates revenue through the in-place leases. Consequently, SME A applies the criteria in paragraph 19A.10.

SME A determines that the criterion in paragraph 19A.10(a) is met because:

- the acquired processes (that is, leasing, managing tenants, and managing and supervising the operational processes) are critical to the ability to continue producing outputs when applied to the acquired inputs (the land, buildings and in-place leases); and
- the set of activities and assets includes an organised workforce with the necessary skills, knowledge or experience to perform the acquired processes.

Therefore, SME A concludes that the acquired processes are substantive. Furthermore, SME A concludes that the criterion in paragraph 19A.4 is met because those substantive processes and inputs together significantly contribute to the ability to create outputs.

Consequently, SME A concludes that the acquired set of activities and assets is a business.

Ex 9 SME A acquired a legal entity, SME B. SME B's operations include: research and development activities on several drug compounds it is developing (in-process research and development projects); strategic management and operational processes to manage and conduct the research and development activities; senior management and scientists who have the necessary skills, knowledge or experience to perform research and development activities; and tangible assets (including a corporate headquarters, a research lab and lab equipment). SME B does not yet have a marketable product and has not yet generated revenue.

SME A chooses not to apply the optional concentration test set out in paragraph 19A.3 and therefore assesses whether the acquired set of activities and assets meets the minimum requirements to be considered a business in accordance with paragraphs 19A.4–19A.10.

The acquired set of activities and assets does not have outputs at the acquisition date. Therefore, SME A applies the criteria in paragraph 19A.9.

SME A determines that the criteria in paragraph 19A.9 are met because:

- the acquired processes (the strategic management and operational processes) are critical to the ability to develop or convert the acquired inputs into outputs; and
- the inputs acquired include both:
 - an organised workforce that has the necessary skills, knowledge or experience to perform the acquired processes; and
 - other inputs (including the in-process research and development projects and the tangible assets) that the organised workforce could develop or convert into outputs.

Therefore, SME A concludes that the acquired processes are substantive. Furthermore, SME A concludes that the criterion in paragraph 19A.4 is met because the acquired substantive processes and the acquired inputs together significantly contribute to the ability to create outputs.

Consequently, SME A concludes that the acquired set of activities and assets is a business.

Examples—Not a business

Ex 10 SME A buys broadcasting assets from another entity, SME B. The set of assets acquired includes only the communications licence, the broadcasting equipment and an office building. It does not include the processes necessary to broadcast programmes, nor does it include any employees, other assets, other processes or other activities. Before the acquisition date, SME B had stopped broadcasting.

SME A chooses not to apply the optional concentration test set out in paragraph 19A.3 and therefore assesses whether the acquisition meets the minimum requirements to be considered a business in accordance with paragraphs 19A.4–19A.10.

The set of assets acquired does not have outputs because SME B had stopped broadcasting before the acquisition date. Therefore, SME A applies the criteria in paragraph 19A.9.

SME A concludes that those criteria are not met because the acquisition does not include an organised workforce and therefore the acquisition does not include a substantive process.

Consequently, SME A concludes that it has not acquired a business.

Ex 11 SME A buys a closed manufacturing facility—the land and the building—and the related equipment. To comply with local laws, SME A must take over the employees who worked in the facility. No other assets, processes or other activities are transferred. The manufacturing facility had stopped producing outputs before the acquisition date.

SME A chooses not to apply the optional concentration test set out in paragraph 19A.3 and therefore assesses whether the acquisition meets the minimum requirements to be considered a business in accordance with paragraphs 19A.4–19A.10.

The manufacturing facility does not have outputs at the acquisition date because it had stopped producing outputs before then. Therefore, SME A applies the criteria in paragraph 19A.9.

The acquisition includes an organised workforce with the necessary skills, knowledge or experience to use the equipment, but it does not include another acquired input (such as intellectual property or inventories) that the organised workforce could develop or convert into outputs. The facility and the equipment cannot be developed or converted into outputs.

Consequently, SME A concludes that it has not acquired a business.

- 19.4 An acquirer might obtain control of an acquiree in various ways—for example, by:
- (a) transferring **cash, cash equivalents** or other assets (including net assets that constitute a business);
 - (b) incurring liabilities;
 - (c) issuing equity instruments; or
 - (d) providing more than one type of consideration.
- 19.5 A business combination might be structured in various ways for legal, taxation or other reasons. Examples of these structures include transactions or other events in which:
- (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 instruments, 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; or
 - (d) a group of former owners of one of the combining entities obtains control of the combined entity.

Educational notes

Section 19 applies to business combinations regardless of the structure of the transaction. Possible structures include:

- an acquirer obtaining the equity of another business such that the business becomes a subsidiary of the acquirer;
- one or more unincorporated businesses being purchased by an acquirer and forming part of the acquirer, without becoming its subsidiary or subsidiaries; and
- two or more entities combining by transferring their equity interests or net assets to a newly formed entity.

The consideration can take various forms—for example, equity instruments, cash, cash equivalents, other assets or a combination of any of these. Transactions involving ‘other assets’ might involve the transfer of tangible assets, such as property, or intangible assets, such as patents.

Examples—Ways of effecting a business combination¹

Ex 12 SME A delivers CU375,000 in cash in exchange for all of the equity interests in SME B, a company operating a car hire business.²

This transaction is a business combination effected by the transfer of cash to the previous owners of the shares in SME B.

Ex 13 SME A issues 10,000 new shares in itself in exchange for 80% of the equity interests in SME B, a company operating a construction business. Before this transaction, SME A had 100,000 shares in issue.

This transaction is a business combination effected by the issue of SME A's equity instruments to the previous owners of 80% of the shares in SME B.

Ex 14 SME A acquires 100% of the equity interests in SME B, a company operating a clothes retailing business, in exchange for:

- CU10,000 in cash;
- an office building; and
- 1,000 shares in Entity C.

This transaction is a business combination effected by the transfer of SME A's assets.

Ex 15 SME A has two divisions: a shoe manufacturing division and a handbag manufacturing division. Both divisions are businesses, although they are structured within one legal entity. SME B agrees to buy the handbag manufacturing division from SME A in exchange for CU100,000 in cash.

This transaction is a business combination effected by the transfer of cash from SME B to the previous owner of the business, SME A.

Ex 16 SME A and SME B enter into an agreement to merge their businesses. They agree that SME A will issue equity instruments in itself to the equity holders of SME B in exchange for their equity instruments in SME B. As a result, SME A acquires a subsidiary, SME B, and the former equity holders in SME B are now part-owners of SME A, together with the original owners of SME A.

This transaction is a business combination effected by the transfer of SME A's equity instruments to the previous owners of the equity instruments in SME B.

¹ In these examples and in all of the later examples in this module, it is assumed that the transactions described meet the definition of a business combination and are within the scope of Section 19 *Business Combinations and Goodwill* of the third edition of the *IFRS for SMEs Accounting Standard* (Standard).

² In this example, and in all other examples in this module, monetary amounts are denominated in 'currency units' (CU).

Ex 17 SME A and SME B enter into an agreement to merge their businesses. They agree to form a new entity, SME C, which issues equity instruments in itself to the equity holders of SME A and SME B in exchange for their equity instruments in SME A and SME B. As a result, SME C has two subsidiaries, SME A and SME B. The former equity holders in SME A and SME B are now part-owners of SME C.

This transaction is a business combination effected by the transfer of equity instruments in a new entity to the previous owners of the equity instruments in SME A and SME B.

Accounting for business combinations and goodwill

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

19.7 To apply the acquisition method, an entity shall:

- (a) identify the acquirer;
- (b) identify the acquisition date;
- (c) recognise and measure the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and
- (d) recognise and measure goodwill or a gain from a bargain purchase.

Educational notes

An entity is required to use the acquisition method to account for all business combinations within the scope of Section 19. If the business combination involved separate legal entities, the acquirer is required to prepare consolidated financial statements (subject to the exemptions in Section 9) and apply the acquisition method in those consolidated financial statements. If the business combination involved unincorporated businesses, the acquirer would apply the acquisition method in both its separate and consolidated financial statements (if prepared).

The Standard does not permit the use of the pooling of interests method (as described on page 5) when accounting for a business combination within the scope of Section 19.

Each of the four steps involved in applying the acquisition method is addressed in subsequent paragraphs of Section 19. Specifically:

- paragraphs 19.8–19.10 and 19A.11–19A.15 contain guidance on identifying the acquirer;
- paragraph 19.11 defines the acquisition date;
- paragraphs 19.12–19.21 set out the principles, and exceptions to those principles, for recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and

- paragraphs 19.22–19.28 set out requirements for recognising and measuring goodwill or a gain from a bargain purchase.

Examples 18 and 19 are basic examples to illustrate application of the acquisition method. Specific aspects of applying the acquisition method (such as identifying the acquirer) are illustrated in later examples.

Examples—Applying the acquisition method³

Ex 18 SME A purchased a competitor's (SME B's) taxi business for CU42,000, which was paid in cash on the date of acquisition. The business combination was effected when the assets, liabilities and operations of the taxi business were transferred to SME A.

The assets and liabilities of the acquired business at the acquisition date are:

	<i>Carrying amount in SME B's financial statements</i>	<i>Fair value</i>
	CU	CU
Taxis	15,000	20,000
Taxi licences	5,000	15,000
Brand (registered trade name)	—	6,000
Trade payables	(1,000)	(1,000)
Total	19,000	40,000

In this instance, SME A purchased the operations and net assets of the taxi business from SME B. Accordingly, the journal entry for the purchase of the business is made directly in the accounting records of SME A because SME A now owns the net assets of the business directly, instead of owning them indirectly through a subsidiary.

³ In Examples 18–19, deferred tax is ignored.

Immediately before the acquisition, SME A's statement of financial position was:

	<i>Carrying amount</i> CU
Assets	
Non-current assets	
Property, plant and equipment—taxis	35,000
Intangible assets—taxi licences	10,000
	<u>45,000</u>
Current assets	
Cash	60,000
	<u>60,000</u>
Total assets	<u>105,000</u>
Equity	
Share capital	5,000
Retained earnings	100,000
Total equity	<u>105,000</u>

SME A (the acquirer) accounts for the business combination by recognising the identifiable assets acquired (the taxis, taxi licences and brand) and the liabilities assumed (the trade payables) at their respective fair values at the date of acquisition, and by recognising and measuring goodwill, with the following journal entry:

	CU	CU
Dr Property, plant and equipment—taxis	20,000	
Dr Intangible assets—taxi licences	15,000	
Dr Intangible asset—brand	6,000	
Dr Goodwill ^(a)	2,000	
Cr Trade payables		1,000
Cr Cash		42,000

To recognise the acquisition of SME B's taxi business.

(a) Excess of the consideration transferred over the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed (see paragraph 19.22).

Immediately after the acquisition, SME A's statement of financial position would be:

	<i>Before acquisition</i> CU	<i>Effect of acquisition</i> CU	<i>After acquisition</i> CU
Assets			
Non-current assets			
Property, plant and equipment—taxis	35,000	20,000	55,000
Goodwill	—	2,000	2,000
Intangible asset—taxi licences	10,000	15,000	25,000
Intangible asset—brand	—	6,000	6,000
	45,000	43,000	88,000
Current assets			
Cash	60,000	(42,000)	18,000
	60,000	(42,000)	18,000
Current liabilities			
Trade payables	—	(1,000)	(1,000)
	—	(1,000)	(1,000)
Total net assets	105,000	—	105,000
Equity			
Share capital	5,000	—	5,000
Retained earnings	100,000	—	100,000
Total equity	105,000	—	105,000

Ex 19 The facts are the same as in Example 18. However, in this example, the business combination was effected when SME A, the acquirer, bought all of the shares in issue of SME B (SME B's only business is its taxi business) for CU42,000 in cash.

In SME A's separate financial statements and its general ledger, it accounts for the investment in SME B using the cost model. Consequently, the investment would be recognised at CU42,000.

SME A prepares its consolidated financial statements by combining the financial statements of the parent and its subsidiaries line by line, adding together like items of assets, liabilities, equity, income and expenses and then making consolidation adjustments.

In preparing SME A's consolidated statement of financial position at the acquisition date, management would make the following consolidation adjustments:

	CU	CU
Dr Property, plant and equipment—taxis	5,000	
Dr Intangible assets—taxi licences	10,000	
Dr Intangible asset—brand	6,000	
Dr Goodwill	2,000	
Dr Equity (SME B's pre-acquisition equity)	19,000	
Cr SME A's investment in SME B		42,000

SME A's consolidated statement of financial position immediately after the acquisition would be calculated (assuming SME B had share capital of CU1,000 and retained earnings of CU18,000) as:

	SME A <i>Carrying amount</i> CU	SME B <i>Carrying amount</i> CU	Consolidation adjustments CU	Consolidated CU
Assets				
Non-current assets				
Investment in subsidiary	42,000	—	(42,000)	—
Property, plant and equipment—taxis	35,000	15,000	5,000	55,000
Goodwill	—	—	2,000	2,000
Intangible asset—taxi licenses	10,000	5,000	10,000	25,000
Intangible asset—brand	—	—	6,000	6,000
	87,000	20,000	(19,000)	88,000
Current assets				
Cash	18,000	—	—	18,000
	18,000	—	—	18,000
Current liabilities				
Trade payables	—	(1,000)	—	(1,000)
	—	(1,000)	—	(1,000)
Total net assets	105,000	19,000	(19,000)	105,000
Equity				
Share capital	5,000	1,000	(1,000)	5,000
Retained earnings	100,000	18,000	(18,000)	100,000
Total equity	105,000	19,000	(19,000)	105,000

Identifying the acquirer

- 19.8 For each business combination, one of the combining entities shall be identified as the acquirer.
- 19.9 Section 9 *Consolidated and Separate Financial Statements* shall be used to identify the acquirer—that is, to identify the entity that obtains control of another entity (the acquiree).
- 19.10 If an entity applying Section 9 is not able to clearly identify which of the combining entities is the acquirer, the entity shall consider the factors in paragraphs 19A.11–19A.15 to make that determination.

Educational notes

The acquisition method views a business combination from the acquirer's perspective. Accounting for a business combination applying Section 19 requires the identification of the acquirer.

The key to identifying the acquirer is to determine which entity has obtained control of another entity (the acquiree) in the business combination.

Paragraphs 9.4–9.12 of Section 9 set out requirements for determining if an entity has control over another entity. Therefore, Section 19 requires an entity to use Section 9 to identify the acquirer in a business combination. However, if an entity applying Section 9 is unable to clearly identify which of the combining entities is the acquirer, Section 19 requires the entity to consider the factors in paragraphs 19A.11–19A.15 of the Appendix to Section 19 to make that determination.

Identifying the acquirer (application of paragraphs 19.8–19.10)

- 19A.11 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.
- 19A.12 In a business combination effected primarily by exchanging equity instruments, the acquirer is usually the entity that issues its equity instruments. An entity considers other pertinent facts and circumstances to identify the acquirer in a business combination effected by exchanging equity instruments. For example, the acquirer is usually the combining entity:
- (a) whose owners, as a group, retain or receive after the business combination the largest portion of the voting rights in the combined entity;
 - (b) whose single owner or organised group of owners holds the largest minority voting interest in the combined entity, if no other owner or organised group of owners has a significant voting interest;

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- (c) whose owners have the ability to elect, appoint or remove a majority of the members of the governing body of the combined entity;
 - (d) whose (former) management dominates the senior management of the combined entity; or
 - (e) that pays a premium over the pre-combination fair value of the equity instruments of the other combining entity or entities.

19A.13 The acquirer is usually the combining entity whose size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities.

19A.14 In a business combination involving more than two entities, an entity identifies the acquirer by considering, among other things, which of the combining entities initiated the combination and the relative size of the combining entities.

19A.15 A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the business combination is the acquirer, in accordance with paragraph 19.10 and the guidance in paragraphs 19A.11–19A.14. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration might be the acquirer.

Educational notes

An entity considers all relevant facts and circumstances when identifying the acquirer.

In most business combinations involving SMEs, it will be clear which entity is the acquirer. However, in some cases, especially those involving combinations sometimes referred to as ‘mergers of equals’, identifying the acquirer might be more difficult. If the entity is unable to clearly identify which of the combining entities is the acquirer by applying Section 9, Section 19 requires an entity to consider the factors in paragraphs 19A.11–19A.15.

In a business combination that is effected primarily by exchanging equity interests, the acquirer is usually (but not always) the entity that issues its equity interests. Other pertinent facts and circumstances should also be considered when identifying the acquirer in a business combination effected by exchanging equity interests, including:

- 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 voting rights, an entity is permitted, but is not required, to consider the more detailed application guidance in IFRS 3. That application guidance requires an entity to consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities.
- 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 entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity.

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- the composition of the governing body of the combined entity. The acquirer is usually the combining entity whose owners have the ability to elect, appoint or remove a majority of the members of the board of directors or other governing body of the combined entity.
 - the composition of the senior management of the combined entity. The acquirer is usually the combining entity whose (former) management dominates the senior management of the combined entity. It can be difficult to identify who dominates senior management if two owner-managed businesses combine and the former owners continue working for, and managing, the business. However, one former owner reporting to the other or the other factors might indicate which entity is the acquirer.
 - 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 in the other combining entity or entities.

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.

In a business combination that involves more than two entities, determining the acquirer involves considering, among other things, which of the combining entities initiated the combination and the relative size of the combining entities.

A new entity formed to effect a business combination is not necessarily the acquirer. In particular, if a new entity is formed to issue equity instruments to effect a business combination, paragraph 19A.15 requires that one of the combining entities that existed before the business combination be identified as the acquirer. The guidance in paragraphs 19A.11–19A.14 is applied to determine which of those entities is the acquirer.

In contrast, if a new entity that was formed to effect a business combination transfers cash or other assets or incurs liabilities as consideration in the business combination, it might be the acquirer. In this situation, an entity would consider other relevant facts and circumstances to determine if the new entity is the acquirer.

Examples—Identifying the acquirer

Ex 20 SME A delivers CU375,000 in cash and issues 1,000 of its own equity instruments (approximately 5% of its total share capital) in exchange for receiving all of the equity interests in SME B, a company operating a car hire business.

The business combination results in SME A obtaining control of SME B. SME A is the acquirer.

Ex 21 SME A and SME B enter into an agreement to merge their businesses. They agree that SME A will issue equity instruments in itself to the equity holders of SME B in exchange for their equity instruments in SME B. As a result, SME A acquires a subsidiary, SME B. Furthermore, after the business combination, the shareholding structure of SME A is that 60% are held by its original owners and 40% are held by the previous owners of SME B.

The business combination results in SME A obtaining control of SME B. In the absence of other information, 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. SME A is the acquirer.

Ex 22 Two previously independent entities, SME A and SME B, are to be combined. To effect the business combination, a new entity, SME C, is formed. SME C issues shares to the owners of SME A and SME B in exchange for all the shares of both SME A and SME B. SME C is created solely to formalise the organisational structure.

Because SME C is a new entity created to effect the business combination and does so by issuing shares, it is not permitted to be the acquirer for accounting purposes, although it is the legal parent of both of the other entities. Paragraph 19A.15 of Section 19 requires one of the entities that existed prior to the combination, SME A or SME B, to be identified as the acquirer based upon all relevant facts and circumstances. This situation is explored further in Examples 23–24.

Ex 23 The facts are the same as in Example 22. In this example, SME A is significantly larger (measured by reference to the assets of each of the combining entities) than SME B and SME A's former shareholders hold a larger proportion of SME C than SME B's former shareholders. In addition, it was SME A that approached the owners of SME B to initiate the combination and that carried out due diligence on SME B.

In the absence of evidence to the contrary, SME A is the acquirer.

Ex 24 The facts are the same as in Example 22. In this example, SME A and SME B are approximately the same size (measured by reference to the assets of each of the combining entities). However, the former shareholders of SME B have the power to appoint the majority of SME C's board of directors, the latter's governing body.

In the absence of evidence to the contrary, SME B is the acquirer.

Identifying the acquisition date

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

Educational notes

For all business combinations, the acquirer must identify the acquisition date, which is the date on which the acquirer obtains control of the acquiree. The acquisition date is often the date on which the acquirer legally transfers the consideration, becomes the legal owner of the acquiree and acquires the assets and assumes the liabilities of the acquiree (often called the closing date). However, the acquisition date is not always the closing date and might instead be before or after the closing date. It might not be the date written in the documents, but is instead the date on which the acquirer obtains control of the acquiree. It is necessary to consider all facts and circumstances in identifying the acquisition date.

Examples—Date of acquisition

- Ex 25** The shares in SME B are owned equally by three individuals, Mses X, Y and Z. On 1 January 20X1, SME A acquired Ms X's shares in SME B in exchange for CU10,000 in cash. On 1 March 20X2, SME A acquired Ms Y's shares in SME B in exchange for CU11,200 in cash.

In the absence of evidence to the contrary, the date of acquisition (being the date the acquirer obtains control of the acquiree) is 1 March 20X2.

- Ex 26** On 15 January 20X1, SME A signed an agreement to buy 100% of SME B for cash. The purchase agreement lists the acquisition date as 1 April 20X1. However, with effect from 15 January 20X1, SME A can direct the exercise of the voting rights held by shareholders in SME B. On 1 March 20X1, SME A directed the use of those voting rights to remove the directors of SME B and appoint directors of its choice. On 1 April 20X1, ownership of all of the shares in SME B transferred to SME A and the consideration was paid in cash.

In the absence of evidence to the contrary, the acquisition date is 15 January 20X1 because that is the date on which SME A first obtained the power to direct the relevant activities of SME B, through its ability to direct the exercise of voting rights held by shareholders in SME B.

- Ex 27** On 1 January 20X1, the owners of SME A and SME B started negotiations for SME A's acquisition of 100% of SME B's voting shares. On 1 April 20X1, the final agreement was signed and SME A obtained control of SME B. The agreement states that the acquisition is effective from 1 January 20X1 and SME A is entitled to all profits earned by SME B after this date. Consideration was transferred on 1 April 20X1 and the acquisition price was based on the net assets of SME B on 1 January 20X1.

The price is based on the net assets at 1 January 20X1 and the former owners of SME B are not entitled to any dividends after that date. However, in the absence of evidence to the contrary, the acquisition date is 1 April 20X1, which is the date on which SME A obtained control of SME B. 1 January 20X1 is not the acquisition date because that date is only a practical expedient for working out the price (being the basis of the consideration) and SME B's former owners were still controlling the business at that date.

Ex 28 On 1 January 20X1, SME A makes an offer to acquire 100% of SME B's voting shares. The amount offered is based on SME B's net assets at that date. The offer is subject to satisfactory completion of due diligence. Until due diligence is completed, SME A must be consulted before any major decision concerning SME B is made. SME A will be entitled to all profits from SME B after 1 January 20X1 if the acquisition is completed. On 2 February 20X1, the due diligence is successfully completed and the consideration and shares are transferred on the same day.

In the absence of evidence to the contrary, the acquisition date is 2 February 20X1, which is the date on which SME A obtains control of SME B. Although SME A has to be consulted regarding any major decision made in relation to SME B after 1 January 20X1, this does not mean SME A has the power to direct the relevant activities of SME B. The consultation is likely to be a protective right for SME A (which might be made clear in the agreement between the parties), because the price has been determined based on net assets at 1 January 20X1.

Ex 29 On 1 January 20X1, SME A acquired 1,000 of SME B's 3,000 voting shares. That voting interest gives SME A the power to participate in the financial and operating policy decisions of SME B (that is, a significant influence), but not to control SME B.

On 30 June 20X2, SME B repurchased and cancelled 1,500 of its own shares from parties other than SME A.

SME A has obtained control over SME B through its ownership of the majority of the voting rights attached to the shares of SME B (1,000 of the remaining 1,500 shares of SME B on issue).

In the absence of evidence to the contrary, SME A obtains control of SME B on 30 June 20X2 through its ownership of the majority of the voting rights attached to the shares of SME B (1,000 of the remaining 1,500 shares in SME B). Even though SME A took no action on 30 June 20X2, it gained control over SME B on that date as a result of SME B's repurchase of its own shares. Consequently, 30 June 20X2 is the date of acquisition.

Ex 30 On 1 January 20X1, SME A purchased the majority share of SME B's voting shares, but is precluded from exercising control over SME B because of contractual rights held by the other investors in SME B (for example, veto rights, board-membership rights or other substantive rights) for a period of time. All of those contractual rights lapse on 1 July 20X2.

In the absence of evidence to the contrary, when the contractual rights lapse on 1 July 20X2, SME A will obtain control of SME B through its ability to exercise the majority of the voting rights in SME B. The date of acquisition is 1 July 20X2.

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

Recognition principle

- 19.12 At 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—except as specified in paragraphs 19.16–19.21. An acquirer shall recognise the identifiable assets acquired and liabilities assumed only if they:
- (a) meet the definitions of assets and liabilities in Section 2 *Concepts and Pervasive Principles* at the acquisition date; and
 - (b) are part of what the acquirer and the acquiree (or the acquiree's former owners) exchanged in the business combination transaction rather than the result of separate transactions (see paragraph 19.32). The acquirer and the acquiree might enter into separate transactions before or during the negotiations for the business combination that are not part of what is exchanged in the business combination. These separate transactions shall be accounted for in accordance with the applicable sections of this Standard.

Educational notes

With some limited exceptions (see pages 40–45), the recognition principle requires an acquirer to recognise all identifiable assets acquired and liabilities assumed that meet the recognition criteria, regardless of whether they were recognised as assets or liabilities in the acquiree's financial statements.

Applying this principle requires identifying the assets acquired. Identifying tangible assets (such as inventories, land and buildings, and plant and equipment) is usually straightforward. However, identifying intangible assets might be more challenging because of their nature (they lack physical substance) and because they might not have been recognised as assets in the acquiree's financial statements. For example, the acquiree might have a brand that was not recognised as an asset in its financial statements because the brand was developed internally and therefore the costs to develop the brand were recognised as expenses when incurred.

Section 18 *Intangible Assets other than Goodwill* of the Standard states that an intangible asset is identifiable when:

- (a) it is separable, that is, capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or
- (b) it 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.

IFRS 3 provides application guidance on determining whether an intangible asset is identifiable (see paragraphs B31–B34 of IFRS 3). Also, the *Illustrative Examples accompanying IFRS 3* Business Combinations include examples of identifiable intangible assets acquired in a business combination, which are summarised in Table 1. An entity applying the *IFRS for SMEs* Accounting Standard might consider the application guidance in IFRS 3 and the accompanying examples, but is not required to do so (see paragraph 10.6 of Section 10 of the *IFRS for SMEs* Accounting Standard).

Table 1—Examples of identifiable intangible assets acquired in a business combination

Asset type	Examples
Marketing-related	Trademarks, trade names, service marks, collective marks, certification marks
	Trade dress (unique colour, shape or package design)
	Newspaper mastheads
	Internet domain names
	Non-competition agreements
Customer-related	Customer lists
	Order or production backlog
	Customer contracts, related customer relationships
	Non-contractual customer relationships
Artistic-related	Plays, operas, ballets
	Books, magazines, newspapers, other literary works
	Musical works, such as compositions, song lyrics, advertising jingles
	Pictures, photographs
	Video and audiovisual material, including motion pictures or films, music videos, television programmes
Contract-based	Licensing, royalty, standstill agreements
	Advertising, construction, management, service or supply contracts
	Construction permits
	Franchise agreements
	Operating and broadcast rights
	Servicing contracts
	Employment contracts
	Use rights, such as drilling, water, air, timber cutting and route authorities
Technology-based	Patented technology
	Computer software, mask works
	Unpatented technology
	Databases, including title plants
	Trade secrets, such as secret formulas, processes, recipes

Examples of items that are not identifiable include:

- an acquiree's assembled workforce (an existing collection of employees that permits the acquirer to continue to operate an acquired business from the acquisition date);
- synergies from combining the acquiree's net assets with those of the acquirer; and
- greater or enhanced market share.

Paragraph 19.12 also sets out recognition criteria that require the identifiable assets acquired and liabilities assumed to be recognised only if they:

- meet the definitions of 'assets' and 'liabilities' in Section 2 at the acquisition date.
- are part of what the acquirer and acquiree (or its former owners) exchanged in the business combination instead of being the result of separate transactions. Those separate transactions are accounted for in accordance with other applicable sections of the *IFRS for SMEs Accounting Standard*. IFRS 3 includes guidance on determining what is part of the business combination (see paragraphs 51–53 and B50–B62 of IFRS 3). For example, paragraph 52 of IFRS 3 explains that a transaction that remunerates employees or former owners of the acquiree for future services is a separate transaction that is not included in applying the acquisition method. An entity applying the *IFRS for SMEs Accounting Standard* might consider the guidance in IFRS 3 but is not required to do so (see paragraph 10.6 of Section 10).

Section 19 also includes specific requirements that determine whether particular types of assets and liabilities are recognised in a business combination (see pages 40–45).

Example—Identifiable intangible asset

Ex 31 SME A acquired all of the equity interests in SME B. Both SME A and SME B are executive education institutions that provide technical updates to market practitioners in accounting matters. SME B has a database of customers (former participants) that includes names, contact information, history of prior training sessions attended and feedback regarding subjects of interest. Applying paragraph 18.4 of Section 18, SME B does not recognise the database as an asset because it has been generated internally.

From SME A's point of view, the database is not generated internally. SME A acquired the database in a business combination. Customer databases generally do not arise from contractual or other legal rights, but frequently are sold, leased or exchanged. Consequently, provided the terms of confidentiality or other agreements do not prohibit SME B from selling, leasing or otherwise exchanging information about its customers, the database is an identifiable intangible asset.

Therefore, assuming that the database meets the specific recognition criteria in paragraph 19.16 of Section 19 for intangible assets acquired in a business combination (see pages 40–41), SME A would recognise the database separately from goodwill in its consolidated financial statements.

Example—Assets and liabilities at the acquisition date

Ex 32 SME A acquired all of the equity interests in SME B on 1 January 20X1. In December 20X0, SME B signed a contract to buy plant and equipment. The plant and equipment was delivered on 15 January 20X1.

When recognising the identifiable assets acquired and liabilities assumed, SME A does not recognise an asset for the plant and equipment, nor a liability to pay the supplier, because neither the asset nor the liability existed at the acquisition date.

However, the contract to buy the plant and equipment did exist at the acquisition date. The contract is an executory contract, in which the combined right and obligation to exchange the item of plant and equipment for cash constitutes a single asset or liability (see paragraphs 2.59–2.60 of Section 2). Whether the contract is an asset or a liability at the acquisition date depends on the terms of the contract relative to market terms. For example, if those terms are unfavourable relative to market terms, the contract would be a liability.

Example—Separate transaction

Ex 33 SME A acquired all of the equity interests in SME B on 1 January 20X1. As part of the acquisition plans developed during its negotiations with the former owners of SME B, SME A decided to hire outside consultants to identify future corporate goals and strategies for its organisational structure.

When recognising SME B's identifiable assets acquired and liabilities assumed, SME A does not include a liability for the consultants' costs because they are not part of what was acquired. These costs are incurred as a result of the business combination, but do not form part of the combination itself.

Measurement principle

- 19.13 The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values—except as specified in paragraphs 19.16–19.21.
- 19.14 For each business combination, the acquirer shall measure at the acquisition date any non-controlling interests in the acquiree at the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets.

Educational notes

Identifiable assets acquired and liabilities assumed

With some limited exceptions (see pages 40–45), the measurement principle requires all identifiable assets acquired and liabilities assumed to be measured at their fair value, as at the acquisition date.

The Standard defines ‘fair value’ as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date (see the Glossary). Section 12 *Fair Value Measurement* of the Standard sets out requirements for measuring fair value. For more information, see Section 12 and its related educational module, which includes an example of fair value measurements in a business combination.

IFRS 3 includes application guidance on measuring particular types of assets acquired and liabilities assumed in a business combination (see paragraphs B41–B43 of IFRS 3), which an entity applying the *IFRS for SMEs Accounting Standard* might, but is not required to, consider (see paragraph 10.6). In brief, that application guidance explains that:

- the acquisition-date value of assets with uncertain cash flows, such as trade receivables, takes into account the effects of uncertainty. Therefore, the acquirer does not recognise a separate valuation allowance for any contractual cash flows considered to be uncollectable or expected credit losses.
- the acquisition-date fair value of an asset, such as a building, that is subject to an operating lease in which the acquiree is the lessor takes into account the terms of the lease. Therefore, the acquirer does not recognise a separate asset or liability for an operating lease with favourable or unfavourable terms relative to market terms.
- the acquisition-date fair value of assets that the acquirer does not intend to use, or intends to use in a different way to other market participants, is measured assuming the highest and best use by market participants. For example, an acquirer might intend to use an acquired research and development intangible asset defensively by preventing others from using it. Nevertheless, the fair value of the intangible asset is measured assuming its highest and best use by market participants.

Non-controlling interest

At the acquisition date, an acquirer measures any non-controlling interest in the acquiree at that non-controlling interest’s proportionate share of the recognised amounts of the acquiree’s identifiable net assets.

The subsequent accounting for a non-controlling interest is addressed in Section 9 *Consolidated and Separate Financial Statements* of the Standard (see paragraphs 9.20–9.22 of Section 9).

Example—Non-controlling interest⁴

Ex 34 SME A acquired 80% of the shares of SME B, which operates a taxi business.

The assets and liabilities of SME B at the acquisition date are:

	<i>Carrying amount in SME B's financial statements</i>	<i>Fair value</i>
	CU	CU
Taxis	15,000	20,000
Taxi licences	5,000	15,000
Brand (registered trade name)	—	6,000
Trade payables	(1,000)	(1,000)
Total	19,000	40,000

In SME A's consolidated financial statements, the remaining 20% held by the original shareholders of SME B is accounted for as non-controlling interest. The non-controlling interest is measured at the date of acquisition as:

	CU
Fair value of assets acquired from SME B ^(a)	41,000
Fair value of liabilities assumed from SME B ^(b)	(1,000)
Fair value of net assets acquired from SME B	40,000
Equity interest held by non-controlling interest	20%
Total	8,000

(a) Taxis (CU20,000), taxi licences (CU15,000) and brand (CU6,000)

(b) Trade payables (CU1,000)

⁴ In this example, deferred tax is ignored.

Exceptions to the recognition and measurement principles

- 19.15 Paragraphs 19.16–19.21 provide exceptions to the **recognition** and measurement principles set out in paragraphs 19.12–19.14 and specify both the items for which exceptions are provided and the nature of those exceptions.
- 19.16 An acquirer shall recognise an **intangible asset** acquired in a business combination if the asset meets the recognition principles set out in Section 18 *Intangible Assets* other than Goodwill and the asset's fair value can be measured reliably without undue cost or effort at the acquisition date.
- 19.17 If an acquirer assumes a liability or **contingent liability** in a business combination and that liability or contingent liability would have been within the scope of Section 21 *Provisions and Contingencies* had the acquirer incurred it separately, the acquirer shall apply paragraph 21.6 to determine whether a present obligation exists at the acquisition date as a result of past events.
- 19.18 If an acquirer determines, in accordance with paragraph 19.17, that a present obligation exists, the acquirer shall recognise a contingent liability at the acquisition date if:
- (a) the present obligation meets the definition of a contingent liability in accordance with paragraph 21.12; and
 - (b) the fair value of the contingent liability can be measured reliably.
- 19.19 Therefore, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not **probable** that the acquirer will be required to transfer economic benefits to settle the present obligation. The acquirer does not apply the recognition requirements in paragraphs 21.4(b) and 21.12 to a contingent liability assumed in a business combination.
- 19.20 An acquirer shall recognise and measure in accordance with Section 29 *Income Tax* a **deferred tax asset** or **deferred tax liability** arising from the assets acquired and liabilities assumed in a business combination.
- 19.21 An acquirer shall recognise and measure in accordance with Section 28 *Employee Benefits* a liability (or asset, if any) related to the acquiree's **employee benefit** arrangements.

Educational notes

Paragraphs 19.16–19.21 provide some exceptions to the recognition and measurement principles in Section 19.

Intangible assets

Paragraph 19.16 requires an acquirer to recognise an intangible asset acquired in a business combination only if it meets the recognition principles in Section 18 and its fair value can be measured reliably without undue cost or effort at the acquisition date.

The recognition principles in Section 18 specify criteria that an entity is required to meet to recognise an intangible asset. Those criteria differ, depending on how the intangible asset was acquired. For example, paragraph 18.4 does not permit an entity to recognise an intangible asset that results from expenditure incurred internally on an intangible item.

Paragraph 18.8 applies to an intangible asset acquired as part of a business combination. It requires an intangible asset acquired in a business combination to be recognised, unless its fair value cannot be measured reliably without undue cost or effort at the acquisition date.

Therefore, if the ‘undue cost or effort’ exemption does not apply, an acquirer recognises an intangible asset acquired in a business combination in the acquirer’s consolidated financial statements, irrespective of whether that intangible asset has been recognised in the acquiree’s financial statements.

Whether measuring reliably the fair value of an intangible asset would involve undue cost or effort depends on the entity’s specific circumstances, the extent of measurement uncertainty associated with determining the fair value of the intangible asset and management’s judgement of the costs and benefits. To make this judgement, the entity would consider how the decisions of users of its consolidated financial statements could be affected by not having that information. Measuring reliably the fair value of an intangible asset would involve undue cost or effort if the incremental cost (for example, valuers’ fees) or additional effort (for example, endeavours by employees) substantially exceeds the benefits that users would receive from having the information (see paragraph 2.29 of Section 2). Assessing whether measuring reliably the fair value of an intangible asset would involve undue cost or effort should be based on information about the costs and benefits at the time of initial recognition at the date of acquisition. If an entity uses the ‘undue cost or effort’ exemption, it does not recognise intangible assets separately at the acquisition date in a business combination.

Provisions and contingent liabilities

If an acquirer assumes a liability or contingent liability that would have been within the scope of Section 21 *Provisions and Contingencies* of the Standard if incurred separately (that is, outside of a business combination), paragraph 19.17 requires the acquirer to apply paragraph 21.6 in Section 21 to determine whether a present obligation exists at the acquisition date as a result of past events. For example, paragraph 21.6 explains that an entity has an obligation as a result of past events if it has no realistic alternative to settling the obligation. Conversely, an entity does not have an obligation if it can avoid future expenditure by its future actions.

If it is unclear whether a present obligation exists at the acquisition date as a result of past events, the entity could also consider the guidance in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. For example, paragraph 16 of IAS 37 provides guidance on determining whether a present obligation exists in situations involving a dispute about whether particular events have occurred or whether those events result in a present obligation, such as in a lawsuit. An entity applying the IFRS for SMEs Accounting Standard could choose to apply that guidance but is not required to do so (see paragraph 10.6 of Section 10).

The requirement in paragraph 19.17 to determine whether a present obligation exists at the acquisition date applies to both provisions and contingent liabilities. In both cases, if the entity concludes that a present obligation does not exist at the acquisition date, it does not recognise a liability (see Examples 35 and 37).

Section 19 also specifies additional requirements that apply to contingent liabilities. If an acquirer determines that a present obligation exists, paragraph 19.18 requires the acquirer to recognise a contingent liability at the acquisition date if:

- the present obligation meets the definition of a contingent liability in accordance with paragraph 21.12 of Section 21; and
- the fair value of the contingent liability can be measured reliably.

Paragraph 21.12 contains a summarised version of the definition of a ‘contingent liability’, which is defined more fully in the Glossary 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.

In general, Section 21 does not permit an entity to recognise contingent liabilities as liabilities in its statement of financial position (see paragraph 21.12).

However, as an exception to that general prohibition, Section 19 requires, in brief, an acquirer to recognise a contingent liability assumed in a business combination if a present obligation exists and the fair value of the contingent liability can be measured reliably. This exception therefore relates to the type of contingent liabilities described in part (b)(i) of the definition of a contingent liability, in which a present obligation exists but it is not probable that an outflow of resources will be required to settle the obligation.

Accordingly, applying Section 19 could result in the acquirer recognising a contingent liability even though it is not probable that an outflow of resources will be required to settle the obligation (see paragraph 19.19). Therefore, in a business combination, contingent liabilities that are not recognised in the financial statements of the acquiree might be recognised in the consolidated financial statements of the acquirer.

Paragraph 19.35 contains guidance on the subsequent accounting for contingent liabilities recognised applying paragraphs 19.18–19.19 (see pages 60–61).

Deferred tax asset or liability

An acquirer recognises and measures a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with Section 29 *Income Tax* of the Standard (see paragraph 19.20).

An entity recognises deferred tax on the difference between the carrying amount of an asset or liability and its tax base, which is called a temporary difference (see paragraph 29.12 of Section 29). In a business combination, the Section 9 requirement to measure the assets acquired and liabilities assumed at their fair value often results in a difference between the carrying amount of those assets and liabilities in the acquirer's consolidated financial statements and their tax base (see paragraph 29.13(a) of Section 29). For example, the tax base of an asset might remain at its cost to the previous owner, resulting in a temporary difference between the asset's tax base and its carrying amount in the acquirer's consolidated financial statements. Therefore, the acquirer recognises a deferred tax asset or deferred tax liability for those temporary differences.

However, the acquirer does not recognise a deferred tax liability arising from the initial recognition of goodwill in a business combination (see paragraph 29.14(a) of Section 29).

Employee benefits

An acquirer recognises and measures a liability (or asset, if any) relating to the acquiree's employee benefit arrangements in accordance with Section 28 *Employee Benefits* of the Standard, instead of at their acquisition-date fair value (see paragraph 19.21).

Examples—Provisions

Ex 35 SME A acquired all of the equity interests in SME B on 1 January 20X1. SME B is a manufacturing company that has a head office in the city centre and a manufacturing plant in an industrial area. As a part of the acquisition plans, SME A decided to close SME B's head office and move SME B's staff to SME A's head office. SME B will pay for the office closure costs, which is expected to be CU100. SME A plans to start the process of closing the office on 15 January 20X1, including advising SME B's staff of the closure.

Applying paragraph 19.17 of Section 19 and paragraphs 21.6–21.6B of Section 21, SME A concludes that a present obligation for the costs of the office closure did not exist at the acquisition date. Therefore, when recognising the identifiable assets acquired and liabilities assumed from SME B, SME A does not include the restructuring provision because SME B did not have an existing liability for restructuring at the acquisition date. It is irrelevant that SME B will be funding the restructuring. It is also irrelevant that SME A might have decided to close SME B's head office prior to the acquisition date because that decision had not been announced to SME B's staff and the implementation of the plan to close the office had not started. Therefore, the restructuring provision is not a liability that existed at the date of acquisition.

Ex 36 SME A acquired all of the equity interests in SME B on 1 January 20X1. SME B is a manufacturing company that has a head office in the city centre and a manufacturing plant in an industrial area. Before the date of acquisition, SME B had decided to close its head office premises and move its staff and head office function to its manufacturing site, which has surplus office space. SME B had told its staff about these plans, including giving notice of the termination of employment to those members of its staff that will be made redundant when the move is made, and had instructed an agency to market the city centre premises before the approach by SME A. The cost of closing SME B's office premises is expected to be CU100.

Applying paragraph 19.17 of Section 19 and paragraphs 21.6–21.6B of Section 21, SME A concludes that a present obligation exists at the acquisition date for the costs of the office closure and therefore SME B had, at the acquisition date, an existing liability for restructuring. Accordingly, when recognising the identifiable assets acquired and liabilities assumed from SME B, SME A includes the restructuring provision as a recognised liability.

Examples—Contingent liabilities

Ex 37 SME A acquired SME B. In a lawsuit brought against SME B before the acquisition, local community members are seeking compensation for damage to their health, which they claim results from the contamination of the groundwater at SME B's plant. SME B maintains it has complied with all environmental laws and regulations and that any contamination is within legal limits. SME B's lawyers estimated that SME B has only a 25% chance of being found liable and ordered to pay the compensation. Consequently, SME B did not recognise a provision in its statement of financial position and only disclosed a contingent liability.

Applying paragraph 19.17 of Section 19 and paragraph 21.6 of Section 21, together with the guidance in paragraph 16 of IAS 37 on determining whether a present obligation exists in a dispute with other parties, such as in a lawsuit, SME A concludes that a present obligation to pay compensation does not exist at the acquisition date. Based on the information available, SME B has not breached any law or regulation, nor has it undertaken any actions that would create a valid expectation that it would accept liability for the claim by the local community members. Furthermore, legal advice indicates it is not likely that SME B will be found liable. Therefore, SME A does not recognise a liability at the acquisition date for the contingent liability of SME B.

Ex 38 SME A acquired all of the equity interests in SME B on 1 January 20X1. SME B owns a factory located next to a public nature reserve. In August 20X0, an accident caused damage to the factory's waste disposal system, which resulted in pollutants being discharged onto the reserve in breach of environmental regulations. By 31 December 20X0, SME B had fixed the waste disposal system, including putting into place additional safeguards to prevent a similar event occurring in the future, and cleaned up the waste in the reserve. However, SME B could be fined for the breach of regulation. The case is expected to be heard in an environmental court in April 20X1. SME B has received legal advice indicating that, as a result of the circumstances in which the breach occurred and

SME B's subsequent actions, it is unlikely that SME B will be ordered to pay a fine. In SME B's financial statements, it has not recognised a liability for the fine and has instead disclosed a contingent liability.

Applying paragraph 19.17 of Section 19 and paragraph 21.6 of Section 21, SME A concludes that a present obligation exists at the acquisition date. Although it is not probable that SME B will be ordered to pay a fine, a present obligation exists because SME B had breached environmental regulations that make it liable to be fined. Therefore, SME A would recognise the contingent liability in its consolidated financial statements, assuming it can reliably measure the fair value of the contingent liability.

Example—Deferred tax on fair value adjustments

Ex 39 SME A acquired all of the equity interests in SME B on 1 January 20X1. The carrying amounts of the identifiable assets acquired and liabilities assumed, as reported in SME B's financial statements, and their fair values are set out in the example table. The tax base of the assets and liabilities is the same as their carrying amounts in SME B's financial statements. The tax rate is 20%.

	<i>Carrying amount</i> CU	<i>Fair value</i> CU
Assets		
Land	400	600
Equipment	500	550
Inventories	200	250
Cash	100	100
Total assets	1,200	1,500
Liabilities		
Trade payables	80	80
Bank loan	400	420
Total liabilities	480	500

The net deferred tax liability is calculated as follows:

Deferred tax liability on fair value adjustments of assets = $(1,500 - 1,200) \times 20\%$	60
Deferred tax asset on fair value adjustments of liabilities = $(500 - 480) \times 20\%$	(4)
Net deferred tax liability	<u>56</u>

Recognising and measuring goodwill or a gain from a bargain purchase

- 19.22 The acquirer shall recognise goodwill as of the acquisition date measured as the excess of (a) over (b):
- (a) the sum of:
 - (i) the consideration transferred, measured in accordance with paragraph 19.25;
 - (ii) the amount of any non-controlling interest in the acquiree, measured in accordance with paragraph 19.14; and
 - (iii) the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree in the case of a business combination achieved in stages (see paragraphs 19.29–19.30).
 - (b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, measured in accordance with paragraphs 19.13–19.21.

Educational notes

'Goodwill' is defined as an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised (see the Glossary). Goodwill is not measured directly. It is measured as a residual, being the result of:

- the total of the amounts recognised for the consideration transferred, any non-controlling interest in the acquiree and any previously held equity interest in the acquiree; minus
- the net of the amounts recognised for the identifiable assets acquired and liabilities assumed.

Therefore, in order to measure goodwill, an entity measures those amounts. The amounts recognised for the identifiable assets acquired and liabilities assumed and for any non-controlling interest are discussed on pages 34–45. The amounts recognised for the consideration transferred and any previously held interest in the acquiree are discussed on pages 49–52 and 53–54, respectively.

Examples—Recognition and measurement of goodwill⁵

Ex 40 At 1 January 20X5, SME A acquired 100% of the equity interests in SME B in exchange for CU30,000 in cash. The fair value of SME B's identifiable assets acquired and liabilities assumed at the date of acquisition are:

	CU
Equipment	20,000
Inventories	10,000
Trade receivables	7,000
Patents	8,000
Fair value of assets acquired	45,000
Minus: Trade payables at fair value	(18,000)
Fair value of net assets acquired	27,000

SME A recognises goodwill of CU3,000 [CU30,000 (consideration transferred) – CU27,000 (identifiable net assets acquired)].

Ex 41 The facts are the same as in Example 40. However, in this example SME A acquired only 80% of the equity interests in SME B for CU24,000 in cash.

SME A recognises goodwill of CU2,400 [CU24,000 (consideration transferred) + CU5,400 (non-controlling interest (20% of CU27,000)) – CU27,000 (net assets acquired)].

Bargain purchases

- 19.23 Occasionally, an acquirer will make a bargain purchase—a business combination in which the amount in paragraph 19.22(b) exceeds the sum of the amounts specified in paragraph 19.22(a). If an excess remains after an acquirer applies paragraph 19.24, the acquirer shall recognise the resulting gain in **profit or loss** on the acquisition date. The gain shall be attributed to the acquirer.
- 19.24 Before recognising a gain on a bargain purchase, the acquirer shall reassess whether it has correctly identified all the assets acquired and all the liabilities assumed and shall recognise any additional assets or liabilities identified in that reassessment. The acquirer shall then review the procedures used to measure the amounts required to be recognised at the acquisition date for:
- (a) the identifiable assets acquired and the liabilities assumed;
 - (b) the acquirer's previously held equity interest in the acquiree, in the case of a business combination achieved in stages; and
 - (c) the consideration transferred.

⁵ In Examples 40–41, deferred tax is ignored.

Educational notes

An acquirer recognises goodwill if the total of the amounts recognised for the consideration transferred, any non-controlling interest in the acquiree and any previously held equity interest in the acquiree *is greater than* the net of the amounts recognised for the identifiable assets acquired and liabilities assumed (see paragraph 19.22). An entity recognises a gain on a bargain purchase if the total of the amounts recognised for the consideration transferred, any non-controlling interest in the acquiree and any previously held equity interest in the acquiree *is less than* the net of the amounts recognised for the identifiable assets acquired and liabilities assumed.

However, before recognising a gain on a bargain purchase, the acquirer is required to first reassess whether it has correctly identified the assets acquired and liabilities assumed and review the procedures it used to measure the amounts required to be recognised at the acquisition date. This reassessment is required because bargain purchases occur only occasionally (see paragraph 19.23). Therefore, the acquirer first checks for any errors in applying the acquisition method.

The acquirer recognises any excess remaining after that reassessment as a gain in profit or loss on the acquisition date (sometimes referred to as ‘negative goodwill’).

The existence of a gain (or an apparent gain) might be due to one or more factors, such as:

- errors in identifying and measuring the amounts to be recognised, such as the amounts for the assets acquired or the liabilities assumed (the aim of requiring the reassessment in paragraph 19.24 is to mitigate or eliminate such errors).
- the recognition and measurement exceptions in Section 19 leading to an identifiable asset acquired or liability assumed not being recognised, or a recognised asset or liability not being measured at fair value. For example, a contingent liability of the acquiree might not be capable of reliable measurement at the acquisition date and so might not be recognised.
- the seller’s motivation for the sale being other than for economic reasons or if the seller is forced to sell quickly because of specific circumstances, such as financial distress.

Example—Gain on a bargain purchase⁶

Ex 42 At 1 January 20X5, SME A acquired 100% of the equity interests in SME B in exchange for CU25,000 in cash. The fair value of SME B's identifiable assets and liabilities was measured as:

	CU
Equipment	20,000
Inventories	10,000
Trade receivables	7,000
Patents	8,000
Acquired assets at fair value	45,000
Trade payables	(16,000)
Provisions	(2,000)
Net assets acquired at fair value	27,000

Application of the acquisition method initially indicates that the acquirer has made a gain of CU2,000. SME A calculated the gain as CU25,000 (the consideration transferred) minus CU27,000 (the net amount of the identifiable net assets acquired and liabilities assumed at the date of acquisition).

SME A reviews the procedures used to measure the fair value of each of the identifiable assets acquired and liabilities assumed and concludes that the fair value of the equipment is CU19,800, not CU20,000.

The revised assessment gives rise to a gain of CU1,800. SME A calculates this gain as CU25,000 (the consideration transferred) minus CU26,800 (the net amount of the identifiable assets acquired and liabilities assumed at the date of acquisition).

SME A recognises the gain on a bargain purchase of CU1,800 in profit or loss on the acquisition date.

Consideration transferred

- 19.25 An acquirer shall measure the consideration transferred in a business combination at fair value. The acquirer shall calculate the consideration transferred as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to the former owners of the acquiree and the equity instruments issued by the acquirer. Examples of consideration include cash, other assets, a business or a subsidiary of the acquirer, contingent consideration, ordinary or preference equity instruments, options and warrants.

⁶ In this example, deferred tax is ignored.

Educational notes

The acquirer measures the consideration transferred at its fair value. The fair value of consideration in the form of cash might be its nominal value. For example, if an entity agreed to pay CU100,000 in cash to acquire all of the equity in another entity and paid that amount to the former owners immediately on the acquisition date, the fair value would be the nominal value of CU100,000. However, if the CU100,000 in cash is to be paid after the acquisition date, such as one year later, the fair value of the consideration transferred is unlikely to be the same as the nominal value of the cash. For example, assuming the acquirer uses a present value technique and the applicable interest rate is 5%, the fair value of the consideration transferred would be CU95,238 (CU100,000 discounted at 5%).

The consideration transferred in a business combination could include one or more types, such as non-cash monetary assets, non-monetary assets, liabilities incurred or assumed, and equity instruments. Measurement of the acquisition-date fair value of those forms of payment might require significant estimates and judgements.

Section 19 does not provide guidance on how to measure fair value. Section 12 provides guidance on fair value measurement.

Example—Non-monetary assets and equity instruments

Ex 43 SME A acquires 100% of the equity interests in SME B, a company operating a clothing retail business, in exchange for:

- CU10,000 in cash, paid on the acquisition date;
- an office building with an acquisition-date fair value of CU50,000;
- 10% of the equity instruments of SME A (share capital of SME A consists of 10,000 ordinary fully paid shares; the fair value of each share at the acquisition date was CU10); and
- 1,000 shares of a third party (Entity C), with an acquisition-date fair value of CU6 per share.

The fair value of the consideration transferred is CU76,000, calculated as:

	CU
Cash paid immediately	10,000
Office building	50,000
Equity instruments of SME A	10,000
Equity instruments of Entity C	6,000
Total	76,000

Contingent consideration

- 19.26 The consideration an acquirer transfers in exchange for an acquiree includes any asset or liability resulting from a contingent consideration arrangement (see paragraph 19.25). The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree if the fair value of the contingent consideration can be reliably measured without undue cost or effort.
- 19.27 If the acquirer cannot reliably measure the fair value of contingent consideration at the acquisition date without undue cost or effort, it shall measure the contingent consideration at the acquisition date using the most likely amount of consideration. Subsequently, the acquirer shall not reassess whether measuring the fair value of contingent consideration involves undue cost or effort (see paragraph 19.37(b)).
- 19.28 The acquirer shall apply Section 22 *Liabilities and Equity* to classify an obligation to pay contingent consideration that is a **financial instrument** as a **financial liability** or as **equity**. An acquirer shall classify a right to the return of previously transferred consideration as an asset. Paragraphs 19.36–19.37 set out the requirements for accounting for contingent consideration.

Educational notes

‘Contingent consideration’ is defined as (see the Glossary):

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.

Examples of future events or factors that might lead to additional payments are:

- earnings (or particular components of earnings) being above a specified target over a specified period;
- a licence or patent being approved within a specified period;
- completion of specified contract negotiations within a specified period; and
- cash flow arising from specified assets being above a specified target over a specified period.

The arrangement could have a combination of future events and factors.

The acquirer includes contingent consideration as part of the consideration transferred, measured at its fair value, if that fair value can be reliably measured without undue cost or effort (see paragraph 19.26).

Whether reliably measuring the fair value of contingent consideration would involve undue cost or effort depends on the entity's specific circumstances, the extent of measurement uncertainty associated with determining the fair value of the contingent consideration, and management's judgement of the costs and benefits. To make this judgement, the entity considers how the decisions of users of its consolidated financial statements could be affected by not having that information. Measuring reliably the fair value of contingent consideration would involve undue cost or effort if the incremental cost (for example, valuers' fees) or additional effort (for example, endeavours by employees) substantially exceeds the benefits that users would receive from having the information (see paragraph 2.29). Assessing whether reliably measuring the fair value of contingent consideration would involve undue cost or effort should be based on information about the costs and benefits at the time of initial recognition at the date of acquisition.

If the entity concludes that it cannot reliably measure the fair value of the contingent consideration at the acquisition date without undue cost or effort, it measures that contingent consideration using the most likely amount of the consideration (see paragraph 19.27). For example, if an entity concludes that it cannot reliably measure without undue cost or effort the fair value of contingent consideration, for which there is a wide range of possible outcomes, the entity would instead measure the contingent consideration based on the most likely outcome.

The entity applies Section 22 of the Standard to classify an obligation to pay contingent consideration that is a financial instrument as a financial liability or as equity (see paragraph 19.28).

Paragraphs 19.36–19.37 set out the requirements for the subsequent accounting for contingent consideration (see pages 61–63).

Example—Contingent consideration

Ex 44 On 1 January 20X3, SME A acquired 100% of the equity interests in SME B in exchange for CU30,000 in cash. SME A agreed to pay a further:

- CU7,000 if the weighted average return on assets (ROA) of SME B for the following three years was higher than 14%;
- CU4,000 if the weighted average ROA was between 6% and 14%;
- CU1,000 if the weighted average ROA was positive but lower than 6%; and
- nothing if the weighted average ROA was nil or negative.

Any contingent consideration due will be paid on 1 January 20X7. Based on budgets for 20X3, 20X4 and 20X5 and other information, SME A concludes that the most likely outcome is that the weighted average ROA will be between 6% and 14% and therefore the most likely amount to be paid is CU4,000.

If SME A can reliably measure the acquisition-date fair value of the contingent consideration, it recognises a liability measured at that amount. If SME A concludes that it cannot reliably measure the acquisition-date fair value of the contingent consideration, it recognises a liability that is measured using the most likely amount of CU4,000, discounted to its present value at the acquisition date.

A business combination achieved in stages

- 19.29 An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date. In such cases, 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.
- 19.30 If a party to a joint arrangement obtains control of a business that is a jointly controlled operation or a jointly controlled asset immediately before the acquisition date, the transaction is a business combination achieved in stages (a step acquisition). The acquirer shall apply the requirements for a business combination achieved in stages in accordance with paragraph 19.29, including remeasuring its entire previously held interest in the jointly controlled operation or the jointly controlled asset.

Educational notes

In some cases, an entity might obtain control over another entity in which it already held shares (or other type of equity interest), such as when an entity obtains control over an associate. This type of transaction is called a business combination achieved in stages or a step acquisition.

In such cases, the entity:

- remeasures the previously held equity interest at its acquisition-date fair value; and
- recognises any difference between the fair value and the carrying amount of the previously held equity interest as a gain or loss in profit or loss (see paragraph 19.29).

The fair value of the previously held equity interest is included in the calculation of goodwill (see paragraph 19.22(a)(iii)).

Examples—Business combination achieved in stages

Ex 45 On 30 June 20X1, SME A held 400 ordinary shares in SME B, which was 10% of SME B's ordinary shares. SME A accounted for the shares as financial instruments and measured them at cost less impairment, in accordance with paragraph 11.14(c)(ii) of Section 11 *Financial Instruments* of the Standard. The carrying amount of the investment was CU3,000. On 1 July 20X1, SME A acquired the remaining 90% of the ordinary shares in SME B. In a valuer's report, the acquisition-date fair value of SME B's ordinary shares is estimated at CU10 per share.

On 1 July 20X1, SME A:

- remeasures the previously held equity interest at its acquisition-date fair value of CU4,000 (CU10 × 400 shares);

- recognises a gain of CU1,000 in profit or loss for the difference between the fair value (CU4,000) and the carrying amount (CU3,000) of the previously held equity interest; and
- includes CU4,000 for the acquisition-date fair value of the previously held equity interest in the calculation of goodwill.

Ex 46 On 30 June 20X1, SME A held 1,200 ordinary shares in SME B, which was 30% of SME B's ordinary shares. SME A accounted for the shares as an investment in an associate by applying the equity method in accordance with paragraph 14.4(b) of Section 14 *Investments in Associates of the Standard*. The carrying amount of the investment was CU9,500. On 1 July 20X1, SME A acquired the remaining 70% of the ordinary shares in SME B. In a valuer's report, the acquisition-date fair value of SME B's ordinary shares is estimated at CU10 per share.

On 1 July 20X1, SME A:

- remeasures the previously held equity interest at its acquisition-date fair value of CU12,000 (CU10 × 1,200 shares);
- recognises a gain of CU2,500 in profit or loss for the difference between the fair value (CU12,000) and the carrying amount (CU9,500) of the previously held equity interest; and
- includes CU12,000 for the fair value of the previously held equity interest in the calculation of goodwill.

Measurement period

- 19.31 If an acquirer's initial accounting for a business combination is incomplete by the end of the **reporting period** in which the combination occurs, the acquirer shall recognise in its **financial statements** provisional amounts for the items for which its accounting is incomplete. Within twelve months after the acquisition date, the acquirer shall retrospectively adjust the provisional amounts it recognised as assets and liabilities, and recognise any additional assets and liabilities, to reflect new information it obtained about any relevant facts and circumstances that existed at the acquisition date. Any adjustments affect the goodwill acquired or any gain from a bargain purchase. After more than twelve months have passed since the acquisition date, the acquirer shall recognise adjustments to the initial accounting for a business combination only if correcting an **error** in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

Educational notes

The initial accounting for a business combination requires determining the fair value of the consideration transferred, any previously held equity interest and the identifiable assets acquired and liabilities assumed in the business combination. The initial accounting might not be complete by the end of the reporting period. For example, the acquisition-date fair values of the acquiree's assets and liabilities might not be finalised by the end of the financial period in which the business combination took place. In other words, these amounts might only have been provisionally determined by that date. Additional information that relates to those assets and liabilities might be obtained by the acquirer after that date. If the additional information relates to facts and circumstances that existed at the acquisition date and that information became known to the acquirer within the measurement period (which can be a maximum of one year from the date of acquisition), the provisional amounts are adjusted to reflect that additional information.

To determine whether to adjust the provisional amounts recognised in the initial accounting for the business combination, the acquirer would need to consider whether the information obtained after the acquisition date relates to facts and circumstances that existed at the acquisition date or whether it relates to subsequent events that occurred after that date. For example, 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 is likely to indicate that the acquirer should adjust the provisional fair value, unless the acquirer can identify an intervening event that changed the asset's fair value.

Any adjustments made will affect the amount recognised for goodwill or a gain from a bargain purchase. No adjustments are made after the measurement period has elapsed, except when correcting an error in accordance with Section 10.

Example—Adjustments to initial accounting⁷

Ex 47 On 30 September 20X5, SME A acquired 100% of the equity interests in SME B in exchange for CU50,000 in cash. The valuation of an item of property, plant and equipment of SME B was incomplete at the date that SME A authorised for issue its consolidated financial statements for the year ended 31 December 20X5. In its 20X5 financial statements, SME A recognised a provisional fair value for the item of property, plant and equipment of CU10,000. At the acquisition date, the item of property, plant and equipment had an estimated remaining useful life of five years and an estimated residual value of nil.

At the date of acquisition, SME A recognised goodwill of CU5,000. Goodwill is amortised on a straight-line basis over a period of 10 years.

Six months after the acquisition date, SME A received an independent valuation, which estimated the fair value of the item of property, plant and equipment at the acquisition date as CU13,000. No change was made to the asset's estimated useful life and estimated residual value.

⁷ In this example, deferred tax is ignored.

In its financial statements for the year ended 31 December 20X6, SME A retrospectively adjusts prior year information. The necessary adjustments comprise:

- an increase in the depreciation expense of CU150. This increase is the additional depreciation for three months, assuming an initial cost to the group of CU13,000 (an increase in the cost of CU3,000).
- an increase in the carrying amount of property, plant and equipment at 31 December 20X5 of CU2,850. The adjustment is measured as the increased fair value at the acquisition date of CU3,000 minus the additional depreciation (CU150) that would have been recognised if the asset's fair value at the acquisition date had been recognised from that date.
- a decrease in the amortisation expense for goodwill of CU75 ($\text{CU3,000} \div 10 \text{ years} \div 12 \text{ months} \times 3$ (for three months' amortisation)).
- a decrease in the carrying amount of goodwill of CU2,925. This adjustment is measured as the fair value adjustment (of the property, plant and equipment) at the acquisition date of CU3,000 minus the decrease in goodwill amortisation of CU75.

Acquisition-related costs

- 19.32 Acquisition-related costs are costs an acquirer incurs to effect a business combination. The acquirer shall account for acquisition-related costs separately from the business combination, as expenses in the periods in which the costs are incurred and the services are received, with two exceptions: the acquirer shall recognise the cost to issue debt in accordance with Section 11 *Other Financial Instrument Issues* and the cost to issue equity securities in accordance with Section 22.

Educational notes

An entity will often incur costs to effect a business combination. Such costs include payments to external parties for services—such as legal, accounting, valuation and other professional or consulting fees—and internal staff costs. These costs are not part of the exchange between the acquirer and the former owners of the business and therefore are accounted for as separate transactions.

Accordingly, acquisition-related costs are recognised as expenses when incurred, except for costs to issue debt or equity instruments, which are accounted for in accordance with the requirements in Section 11 and Section 22, respectively.

Example—Acquisition-related costs

Ex 48 SME A acquires 100% of the equity interests in SME B in exchange for CU30,000 in cash. Also, SME A paid costs related to the business combination, specifically:

- advisory: CU1,250;
- legal: CU500;
- accounting: CU150; and
- valuation: CU100.

SME A recognises all of the costs as expenses when incurred.

Subsequent measurement and accounting

19.33 After initial recognition, an acquirer shall apply the applicable sections of this Standard to assets acquired, liabilities assumed or incurred, and equity instruments issued in a business combination. After initial recognition, paragraphs 19.34–19.37 apply to:

- (a) goodwill;
- (b) contingent liabilities recognised as of the acquisition date; and
- (c) contingent consideration.

Educational notes

After the acquisition date, an acquirer applies the applicable sections of the Standard to the assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination. For example, the acquirer applies Section 17 *Property, Plant and Equipment* to property, plant and equipment acquired in the business combination. The amounts recognised at the acquisition date are treated as the cost of those assets for the purpose of their subsequent accounting, such as when calculating depreciation.

Because the amounts recognised in the acquirer's consolidated financial statements for the assets acquired and liabilities assumed are likely to differ from the amounts reported in the acquiree's financial statements, those acquisition-date differences will result in ongoing differences between the two sets of financial statements, including differences in the related income and expenses recognised in the post-combination period. For example, the amount of depreciation expense recognised in the acquirer's consolidated financial statements on property, plant and equipment acquired in the business combination is likely to differ from the amount recognised in the acquiree's financial statements. Such differences result from adjustments made in the acquirer's consolidated financial statements when recognising the assets acquired and liabilities assumed, such as adjustments made to measure those assets and liabilities at their acquisition-date fair value.

Therefore, the adjustments made at the acquisition date will necessitate ongoing consolidation adjustments when preparing the entity's consolidated financial statements in the post-combination period, until such time as the assets acquired and liabilities assumed in the business combination have been derecognised.

See Section 9 and its related educational module for further information on the preparation of consolidated financial statements.

Example—Effect of differences in measurements

Ex 49 SME A acquired all of the equity interests in SME B on 1 January 20X1. At the date of the acquisition, SME B owned a plot of land that was recognised in its statement of financial position at a cost of CU100. The fair value of the land at the date of the acquisition was CU150. In December 20X1, the land was sold to a third party. The net sale proceeds were CU180.

The gain from the sale of the land included in SME A's consolidated statement of comprehensive income is calculated as the difference between the net sale proceeds and the carrying amount of the land, which is based on the fair value of the land at the acquisition date. Consequently, the consolidated statement of comprehensive income for the year ended 31 December 20X1 includes a gain of CU30 (CU180 net sale proceeds minus CU150 fair value of the land at the date of the acquisition).

The gain on disposal of the land recognised in SME B's statement of comprehensive income is CU80 (CU180 net sale proceeds minus CU100 carrying amount in SME B's statement of financial position). On consolidation, an adjusting entry would be made to reduce this gain to CU30 (the group profit on sale).

Plot of land:	Consolidated financial statements	Individual entities' financial statements		Difference
		SME A	SME B	
	CU	CU	CU	CU
1 January 20X1—carrying amount	150	—	100	50
December 20X1—sales proceeds	(180)	—	(180)	—
Profit on sale	(30)	—	(80)	50

Goodwill

19.34 After an acquirer initially recognises goodwill acquired in a business combination, the acquirer shall measure it at cost less accumulated **amortisation** and accumulated **impairment losses**. The acquirer shall apply:

- paragraphs 18.19–18.24 for amortisation of goodwill. If the acquirer cannot reliably establish the **useful life** of goodwill, it shall use its best estimate of the life, but that estimate shall not exceed ten years.
- Section 27 *Impairment of Assets* to recognise and measure any impairment of goodwill.

Educational notes

Amortisation

In accordance with the Standard, all intangible assets, including goodwill, are considered to have a finite useful life. An acquirer amortises goodwill on a systematic basis over its estimated useful life, recognising amortisation for each period as an expense in that period. An acquirer chooses the amortisation method that reflects the pattern in which it expects to consume the future economic benefits of the goodwill. If an acquirer cannot determine that pattern reliably, it is required to use the straight-line method (see paragraph 18.22 of Section 18).

If the acquirer cannot reliably establish the useful life of goodwill, the acquirer uses its best estimate of the life, but that estimate must not exceed 10 years (see paragraph 19.34(a)).

Whenever the expected useful life of goodwill has changed from original estimates, the acquirer adjusts the amortisation period accordingly. The acquirer accounts for such changes as changes in accounting estimates in accordance with Section 10 (see paragraph 18.24 of Section 18).

Impairment

Goodwill cannot be sold, nor does it generate cash flows to an entity that are independent of the cash flows of other assets. As a consequence, the recoverable amount of goodwill cannot be measured directly and must be derived from the measurement of the recoverable amount of the cash-generating unit(s) of which the goodwill is a part.

Section 27 *Impairment of Assets* of the Standard requires that, for the purpose of impairment testing, an acquirer allocate, from the date of acquisition, goodwill acquired in a business combination to each of the acquirer's cash-generating units or to a group of cash-generating units expected to benefit from the synergies of the combination (see paragraph 27.25).

For more information, see Section 27 and its related educational module, which includes examples on impairment of goodwill.

Examples—Amortisation of goodwill

Ex 50 On 1 January 20X5, SME A acquired 100% of the shares in SME B in exchange for CU30,000 in cash. SME A recognised the identifiable assets acquired and liabilities assumed in the business combination, which had a net acquisition-date fair value of CU27,000. SME A also recognised goodwill of CU3,000. Further, SME A determines it can reliably establish that the useful life of goodwill is 15 years.

The amortisation of goodwill for the year ended 20X5 is CU200 ($\text{CU3,000} \div 15 \text{ years}$). Provided the acquirer can establish the useful life reliably, the acquirer is permitted to amortise goodwill over a useful life that exceeds 10 years.

Ex 51 The facts are the same as in Example 50. However, in this example, SME A cannot establish reliably the goodwill's useful life. SME A's best estimate is 15 years.

Amortisation of goodwill for the year ended 20X5 is CU300 (CU3,000 ÷ 10 years). If the useful life cannot be established reliably, the life of the goodwill is based on the acquirer's best estimate, but that estimate cannot exceed 10 years. If the acquirer's best estimate is less than 10 years, say five years, the amortisation of the goodwill would be based on five years (that is, CU600 = CU3,000 ÷ 5 years).

Contingent liabilities

- 19.35 After an acquirer initially recognises a contingent liability in a business combination and until the liability is settled, cancelled or expires, it shall measure the liability at the higher of:
- (a) the amount that the acquirer would have recognised in accordance with Section 21; or
 - (b) the amount the acquirer initially recognised minus, if appropriate, the cumulative amount of **income** recognised in accordance with the principles of Section 23 *Revenue from Contracts with Customers*.

Educational notes

As discussed on page 41, an acquirer recognises a contingent liability assumed in a business combination if a present obligation exists (which is determined by applying paragraph 21.6 of Section 21) and the fair value of the contingent liability at the acquisition date can be measured reliably.

After the acquisition date, the acquirer measures the contingent liability at the higher of two amounts, namely:

- the amount that the acquirer would have recognised in accordance with Section 21; or
- the amount the acquirer initially recognised minus, if appropriate, the cumulative amount of income recognised in accordance with the principles of Section 23 *Revenue from Contracts with Customers* of the Standard.

Example—Measurement of contingent liability assumed after initial recognition

Ex 52 SME A acquired all of the equity interests in SME B in May 20X0. At the date of acquisition, SME B was being sued by a third party for breach of contract. A contingent liability of CU100 was recognised at the date of acquisition. At 31 December 20X1, SME A reassesses the claim. Management now determines the best estimate of the amount required to settle the claim is CU180.⁸

Applying paragraphs 19.17–19.19 of Section 19, SME A recognised a contingent liability at its acquisition-date fair value of CU100 as a result of the business combination.

⁸ In this example, the effect of the time value of money is ignored.

At 31 December 20X1, SME A measures the contingent liability in SME A's consolidated financial statements at CU180 because this amount is higher than the original amount recognised at the time of the business combination. SME A recognises the increase in the contingent liability of CU80 as an expense in profit or loss for the period.

Contingent consideration

- 19.36 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—except for the changes in the amount of contingent consideration that are measurement-period adjustments in accordance with paragraph 19.31. An acquirer shall account for changes in the amount of contingent consideration that are not measurement-period adjustments in accordance with paragraph 19.37.
- 19.37 If the contingent consideration is:
- (a) classified as equity the acquirer shall not remeasure that contingent consideration and shall account for its subsequent settlement within equity.
 - (b) other contingent consideration:
 - (i) whose fair value can be measured reliably without undue cost or effort at the acquisition date—the acquirer shall measure that contingent consideration at fair value at each **reporting date** and shall recognise in profit or loss any changes in fair value.
 - (ii) whose fair value cannot be measured reliably without undue cost or effort at the acquisition date (see paragraph 19.27)—the acquirer shall review that contingent consideration at each reporting date and adjust it to reflect the current estimate of the most likely amount of the contingent consideration at that reporting date. The acquirer shall recognise in profit or loss any adjustments to the amounts it previously recognised.

Educational notes

As explained on pages 40–42, an acquirer recognises contingent consideration at the acquisition date, measured either:

- at its fair value, if fair value can be reliably measured without undue cost or effort (see paragraph 19.26); or
- using the most likely amount, if fair value cannot be reliably measured without undue cost or effort (see paragraph 19.27).

An acquirer assesses whether measuring the fair value of contingent consideration involves undue cost or effort at the acquisition date and does not subsequently reassess it (see paragraph 19.27).

The acquirer classifies the obligation to pay contingent consideration either as a liability or equity (see paragraph 19.28).

If the acquirer classifies the contingent consideration as equity, it does not subsequently remeasure the contingent consideration and recognises the subsequent settlement within equity (see paragraph 19.37(a)).

If the acquirer classifies the contingent consideration as a liability, it subsequently remeasures the contingent consideration using the same measurement approach as it used at the acquisition date. That is:

- if the acquirer measured the contingent consideration at fair value, the acquirer subsequently measures it at fair value, determined at each reporting date; and
- if the acquirer measured the contingent consideration using the most likely amount, the acquirer subsequently measures it using the most likely amount, determined at each reporting date (see paragraph 19.37(b)).

Examples—Accounting for contingent consideration after the acquisition date

Ex 53 On 1 January 20X3, SME A acquired 100% of the equity interests in SME B in exchange for CU30,000 in cash. SME A agreed to pay a further:

- CU7,000 if the weighted average return on assets (ROA) of SME B for the following three years was higher than 14%;
- CU4,000 if the weighted average ROA was between 6% and 14%;
- CU1,000 if the weighted average ROA was positive but lower than 6%; and
- nothing if the weighted average ROA was nil or negative.

Any contingent consideration due will be paid on 1 January 20X7.

Furthermore, SME A determines it can reliably measure the acquisition-date fair value of the contingent consideration without undue cost or effort. On 1 January 20X3 (the acquisition date), the fair value of the contingent consideration is CU3,500. At SME A's reporting date on 31 December 20X3, the fair value of the contingent consideration is CU3,750.

On 31 December 20X3, SME A remeasures the liability for contingent consideration at CU3,750 and recognises an expense in profit or loss for the change in fair value of CU250 (CU3,750 – CU3,500).

Ex 54 The facts are the same as in Example 53. However, in this example, SME A determines it cannot reliably measure the acquisition-date fair value of the contingent consideration without undue cost or effort. On 1 January 20X3 (the acquisition date), SME A measures the contingent liability at CU3,290, which is the present value of the most likely amount of CU4,000. At SME A's reporting date on 31 December 20X3, SME A reviews its assessment of the most likely amount and concludes that, because of an unexpected decline in the performance of SME B, the most likely amount of contingent consideration is now only CU1,000. The present value of CU1,000 at 31 December 20X3 is CU780.

On 31 December 20X3, SME A remeasures the liability for contingent consideration at CU780 and recognises income of CU2,510 in profit or loss for the change in the amount recognised (CU3,290 – CU780).

Ex 55 On 1 January 20X3, SME A acquired 100% of the equity interests in SME B in exchange for 2,000 ordinary shares in SME A. Also, SME A agreed to issue an additional 400 shares to the former owners of SME B if the weighted average return on assets (ROA) of SME B in the following three years is 12% or more. SME A will issue no additional shares if the weighted average ROA is less than 12%. Furthermore, SME A determines it can reliably measure the acquisition-date fair value of the contingent consideration without undue cost or effort and measures it at CU3,500. SME A classifies the obligation to pay contingent consideration as equity. On 1 January 20X7, SME A determines the weighted average ROA was 15% and therefore issues 400 additional shares to the former owners of SME B.

At the acquisition date (1 January 20X3), SME A recognises the contingent consideration, measured at its fair value of CU3,500, within equity. SME A does not subsequently remeasure the contingent consideration when it prepares its consolidated financial statements at each reporting date in between the acquisition date and the settlement date. On the settlement date (1 January 20X7), SME A recognises the issue of 400 ordinary shares and settlement of the contingent consideration obligation within equity. It does not recognise any gain or loss in profit or loss on settlement.

Section 19 does not address which components of equity should be debited or credited when recognising amounts within equity, such as the issue of shares on the settlement date. For more information on accounting for equity transactions, refer to Section 22 and its related educational module.

Disclosures

For business combination(s) during the reporting period

- 19.38 For each business combination that occurs during the reporting period, the acquirer shall disclose:
- (a) the name and a description of the acquiree;
 - (b) the acquisition date;
 - (c) the percentage of voting-equity instruments acquired;
 - (d) the acquisition-date fair value of the total consideration transferred and a description of the components of that consideration (such as cash, equity instruments and debt instruments);
 - (e) for contingent consideration arrangements:
 - (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) if applicable, the fact that the acquirer cannot reliably measure the acquisition-date fair value of contingent consideration without undue cost or effort (see paragraph 19.27) and the reasons it would involve undue cost or effort;

- (f) the amounts recognised at the acquisition date for each class of the acquiree's assets and liabilities;
- (g) for a bargain purchase, the amount of any gain recognised in profit or loss in accordance with paragraph 19.23 and the line item in the statement of comprehensive income (and in the **income statement**, if presented) in which the gain is recognised;
- (h) a qualitative description of the factors that make up the goodwill recognised—for example, expected synergies from combining operations of the acquiree and the acquirer, or intangible assets not recognised in accordance with paragraph 19.16; and
- (i) the information required by paragraph 21.15 for each contingent liability that the acquirer does not recognise in accordance with paragraph 19.18 (because its fair value cannot be measured reliably).

Example—Disclosures on business combinations during the period⁹

Ex 56 This example illustrates one way of satisfying the disclosure requirements in paragraph 19.38. The example disclosure presented is an extract from the consolidated financial statements of SME A for the year ended 31 December 20X0. At 31 December 20X0 SME A has two subsidiaries, SME B and SME C.

Notes to the consolidated financial statements (extract)

...

Note X. Acquisition of a business

Paragraph
reference

- | | |
|-----------------------|--|
| 19.38(a),
(b), (c) | On 1 August 20X0, SME A acquired 100% of the voting equity in SME C through its subsidiary, SME B. Like SME B, SME C is a solar technology company focusing on the concentrated solar power market. SME C develops, designs, manufactures and installs equipment for solar thermal power plants. |
| 19.38(d),
(e) | To acquire the voting equity in SME C, SME B paid cash consideration of CU10,000 on 1 August 20X0. Additional consideration is payable on 1 March 20X2, based on 5% of the revenue of SME C for the year ended 31 December 20X1, up to a maximum of CU1,000 (undiscounted). The acquisition-date fair value of the contingent consideration was estimated at CU500 using the income approach. The fair value measurement is based on significant inputs not observable in the market, which the <i>IFRS for SMEs Accounting Standard</i> refers to as Level 3 inputs. Key assumptions include a discount rate of 10% and estimated revenues of CU8,000–CU15,000. |

⁹ In this example, deferred tax is ignored.

- 19.25(h) The goodwill of CU2,000 arising from the acquisition consists of the synergies and economies of scale expected from combining the operations of SME B and SME C, and an intangible asset arising from customer relationships of SME C that is not recognised separately because its acquisition-date fair value cannot be measured reliably without undue cost or effort.
- 19.25(f) The amounts recognised at the acquisition date for each class of SME C's assets and liabilities, together with the fair value of the consideration transferred and the resulting balance of goodwill, are:

	<i>Fair value</i> CU
Intangible assets	5,000
Property, plant and equipment	15,000
Inventories	5,000
Trade receivables	3,500
	<u>28,500</u>
Provisions	(14,000)
Trade payables	(6,000)
	<u>8,500</u>
Fair value of identifiable net assets acquired	8,500
Goodwill	2,000
	<u>10,500</u>
Consideration transferred, including contingent consideration	<u>10,500</u>

For all business combinations

- 19.39 An acquirer shall disclose the useful lives used to amortise goodwill and a reconciliation of the **carrying amount** of goodwill at the beginning and end of the reporting period. The acquirer shall disclose separately:
- (a) additional goodwill it recognised during the reporting period arising from new business combinations;
 - (b) impairment losses it recognised during the reporting period in accordance with Section 27;
 - (c) goodwill relating to previously acquired businesses the acquirer derecognised during the reporting period; and
 - (d) other changes.
- 19.40 The reconciliation set out in paragraph 19.39 need not be presented for prior periods.

Example—Disclosures for all business combinations

Ex 57 This example illustrates the disclosure requirements in paragraphs 19.39–19.40.

Notes to the consolidated financial statements (extract)

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Note Y. Goodwill

	Cost CU	Accumulated amortisation and impairment CU	Carrying amount CU
1 January 20X0	9,500	(4,200)	5,300
Acquired in a business combination	2,500	—	2,500
Amortisation—20X0	—	(300)	(300)
Impairment loss	—	(150)	(150)
Disposal of subsidiary	(1,600)	—	(1,600)
Translation differences	(50)	20	(30)
31 December 20X0	10,350	(4,630)	5,720

Amortisation is calculated by applying the straight-line method over the estimated useful lives of goodwill of 5–10 years.¹⁰

For reporting periods after the acquisition date

- 19.41 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, the entity shall disclose for each **material** business combination and in aggregate for business combinations that are individually immaterial but collectively material:
- (a) any changes in the recognised amounts of contingent consideration, including any differences arising upon settlement; and
 - (b) the valuation techniques and key model inputs the acquirer used to measure contingent consideration.

¹⁰ This information could also be disclosed in the accounting policy for intangible assets.

Example—Disclosures for reporting periods after the acquisition date

Ex 58 This example illustrates the disclosure requirements in paragraph 19.41.

Notes to the consolidated financial statements (extract)

...

Note Y. Contingent consideration on acquisition of a business¹¹

As disclosed in Note X, on 1 August 20X0, SME A recognised a liability for contingent consideration on acquisition of SME C, measured at its estimated fair value of CU500 at the acquisition date. On 31 December 20X0, the liability was measured at its estimated fair value of CU475 using the income approach and Level 3 inputs. Key assumptions include a discount rate of 10% and estimated revenues of CU7,000–CU14,000.¹²

¹¹ For contingent consideration arising from a business combination that occurred during the reporting period, the information required to be disclosed by paragraph 19.41 of Section 19 might be included in the same note as the information required to be disclosed by paragraph 19.38 of Section 19 on business combination(s) during the reporting period.

¹² Because the liability for contingent consideration is measured at fair value, the entity would also need to apply the disclosure requirements in Section 12 *Fair Value Measurement* of the Standard. For more information, refer to Section 12 and its related educational module.

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs Accounting Standard* (Standard) to transactions and events often requires an entity to use its judgement. Information about significant judgements made by an entity's management and key sources of estimation uncertainty are useful to a user of the entity's financial statements when assessing the entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6 of Section 8 *Notes to the Financial Statements* of the Standard, an entity discloses the judgements management has made when applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.

Furthermore, in accordance with paragraph 8.7 of Section 8, an entity discloses information that explains key assumptions about the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Other sections of the Standard require disclosure of information about particular judgements and estimation uncertainties.

Identifying a business combination

Section 19 applies to a transaction or other event that meets the definition of a business combination (subject to some exceptions). The acquisition of an asset or group of assets that does not constitute a business is outside the scope of Section 19. In many cases, it will be clear whether a transaction involves the acquisition of a business or is instead an asset acquisition. However, in some cases, significant judgement might be required, for example, to determine whether an integrated set of activities and assets acquired includes the minimum elements to be considered a business.

Identifying the acquirer

The acquisition method requires the identification of an acquirer in a business combination. The acquirer is the entity that obtains control of the acquiree. In many cases, identifying the acquirer is straightforward. However, in some cases, significant judgement is required. Factors to consider in identifying the acquirer include:

- the relative voting rights in the combined entity after the business combination;
- the existence of a large minority voting interest in the combined entity, if no other owner or group of owners has a significant voting interest;
- the composition of the governing body of the combined entity;
- the composition of the senior management of the combined entity;
- the terms of the exchange of equity interests;
- the relative size of the combining entities; and
- the formation of a new entity to effect a business combination (because that new entity is not necessarily the acquirer).

All facts and circumstances must be considered in identifying the acquirer.

Identifying the acquisition date

The acquirer must identify the acquisition date, which is the date on which the acquirer obtains control of the acquiree. In many cases, the acquisition date is the closing date of the transaction, when the acquirer becomes the legal owner of the acquiree and legally transfers the consideration to the former owners of the acquiree. However, in some cases, other facts and circumstances might suggest that the acquisition date was before or after the closing date. In such cases, significant judgement might be required to determine when the acquirer obtained control of the acquiree.

Recognising and measuring particular assets acquired and liabilities assumed

At the date of acquisition, the acquirer must recognise, separately from goodwill, the identifiable assets acquired and liabilities assumed as a result of the business combination (subject to some exceptions). In most cases, these items are measured at their respective fair values. Significant judgements might be required in determining whether to recognise particular assets or liabilities and in measuring the fair value of the items to be recognised—for example, contingent liabilities and unique intangible assets.

Measuring the consideration transferred

The consideration transferred is measured at its fair value (except for any contingent consideration that cannot be reliably measured at fair value without undue cost or effort, which is instead measured using the most likely amount). Consideration paid for the acquiree might comprise several items, such as cash and other monetary assets, non-monetary assets, equity instruments and liabilities incurred, among others. Furthermore, payment or part of the payment is sometimes deferred or includes a component that is contingent on future events. Significant judgements might be required in measuring some forms of the consideration (for example, shares of the acquirer, assets for which there is not an active market and contingent consideration).

Goodwill

Significant judgement is often required in determining the amortisation method and estimating the useful life of goodwill. Significant judgements and estimates might also be required in applying the impairment requirements in Section 27 *Impairment of Assets* of the Standard.

TRANSITION REQUIREMENTS

The third edition of the *IFRS for SMEs* Accounting Standard is effective for annual reporting periods beginning on or after 1 January 2027. Early application is permitted. Changes made to Section 19 *Business Combinations and Goodwill* from the second edition of the Standard are summarised on page 7.

Business combinations and goodwill

- A21 An entity shall prospectively apply the revised Section 19 *Business Combinations and Goodwill* to **business combinations** for which the acquisition date is on or after the date of initial application and to asset acquisitions that occur on or after the date of initial application. The entity is not required to apply the disclosure requirements in the revised Section 19 to comparative information provided for periods before the date of initial application.
- A22 An entity shall leave unadjusted on the date of initial application assets and liabilities from business combinations whose acquisition dates preceded the date of initial application.
- A23 The revised Section 19 amended paragraph 11.49(g), added paragraph 21.1(e) and deleted paragraph 22.2(c). An entity shall prospectively apply those amendments to business combinations for which the acquisition date is on or after the date of initial application and to asset acquisitions that occur on or after the date of initial application.
- A24 An entity shall not adjust on the date of initial application any **contingent consideration** balances arising from business combinations whose acquisition dates preceded the date of initial application. An entity shall omit these balances from the information it discloses in accordance with paragraph 19.41. An entity shall prospectively apply paragraphs A25–A26 from the date of initial application. Paragraphs A25–A26 refer exclusively to business combinations whose acquisition dates precede the date of initial application.
- A25 If a business combination agreement provides for an adjustment to the cost of the combination contingent on future events and the adjustment is **probable** and can be measured reliably, the **acquirer** shall include the amount of that adjustment in the cost of the business combination at the acquisition date.
- A26 However, if a business combination agreement provides for such an adjustment and the adjustment either is not probable or cannot be measured reliably, an entity shall not include the adjustment in the cost of the combination at the time of initially accounting for the combination. If that adjustment subsequently becomes probable and can be measured reliably, the entity shall treat the additional consideration as an adjustment to the cost of the combination.

Educational notes

As noted on page 7, in the third edition of the *IFRS for SMEs Accounting Standard*, Section 19 has been updated to align with the current version of IFRS 3 *Business Combinations*. The transition requirements in Appendix A of the *IFRS for SMEs Accounting Standard* require that those updated requirements be applied prospectively to business combinations with an acquisition date that is on or after the date of initial application of the third edition of the *IFRS for SMEs Accounting Standard* (see paragraph A21).

Given the prospective application of the updated requirements, no changes are made to the accounting treatment applied to business combinations that occurred before the date of initial application of the third edition of the *IFRS for SMEs Accounting Standard*. For example, no adjustments are made to the amounts previously recognised for assets acquired and liabilities assumed in earlier business combinations (see paragraph A22).

The transition requirements include specific requirements for any contingent consideration arising from earlier business combinations. In effect, those transition requirements ensure that no change is made to the previous accounting treatment of any such contingent consideration. For example, no adjustment is made to any contingent consideration balances arising from earlier business combinations (see paragraph A24). This transition requirement ensures that no change is made to contingent consideration previously recognised but not yet settled by the date of initial application of the third edition of the *IFRS for SMEs Accounting Standard*. Additionally:

- if a business combination agreement provides for an adjustment to the cost of the combination contingent on future events and the adjustment is probable and can be measured reliably, the acquirer includes the amount of that adjustment in the cost of the business combination at the acquisition date (see paragraph A25). This transition requirement carries forward for earlier business combinations the requirement in paragraph 19.12 of the second edition of the *IFRS for SMEs Accounting Standard*.
- if the amount of that adjustment is not included in the cost of the business combination at the time of initially accounting for the combination and the adjustment subsequently becomes probable and can be measured reliably, the entity recognises the additional consideration as an adjustment to the cost of the combination (see paragraph A26). This transition requirement carries forward for earlier business combinations the requirement in paragraph 19.13 of the second edition of the *IFRS for SMEs Accounting Standard*.

COMPARISON WITH FULL IFRS ACCOUNTING STANDARDS

Some requirements in full IFRS Accounting Standards (see IFRS 3 *Business Combinations*) and those in the *IFRS for SMEs Accounting Standard* (see Section 19 *Business Combinations and Goodwill*) differ as at February 2025. The main differences are that:

- Section 19 requires an acquirer to recognise an intangible asset acquired in a business combination only if its fair value can be measured reliably without undue cost or effort at the acquisition date (see paragraph 19.16 of Section 19 and paragraph 18.8 of Section 18 *Intangible Assets other than Goodwill* of the *IFRS for SMEs Accounting Standard*). IAS 38 *Intangible Assets* requires that the reliable measurement criterion is always considered to be satisfied for intangible assets acquired in a business combination (see paragraph 33 of IAS 38) and does not provide an exemption for undue cost or effort.
- Section 19 requires an acquirer to measure contingent consideration at its fair value if that fair value can be measured reliably without undue cost or effort (see paragraph 19.26 of Section 19). If fair value cannot be measured reliably without undue cost or effort, the entity measures contingent consideration using the most likely amount (see paragraph 19.27 of Section 19). IFRS 3 requires an acquirer to measure contingent consideration at its fair value, regardless of measurement uncertainties or the cost or effort involved (see paragraph 39 of IFRS 3).
- Section 19 requires an acquirer, after initial recognition, to measure goodwill at cost less accumulated amortisation and any accumulated impairment losses, with goodwill amortised over its useful life (see paragraph 19.34 of Section 19). Furthermore, the cash-generating units to which goodwill has been allocated are subject to an impairment test only if there is an indication of impairment (see paragraph 27.7 of Section 27 *Impairment of Assets* of the *IFRS for SMEs Accounting Standard*). After initial recognition, IFRS 3 requires an acquirer to measure goodwill at the amount recognised at the acquisition date less any accumulated impairment losses (see paragraph B63 of IFRS 3) and therefore does not permit goodwill to be amortised. Furthermore, the cash-generating units to which goodwill has been allocated are subject to an impairment test annually and whenever there is an indication of impairment (see paragraphs 10(b) and 90 of IAS 36 *Impairment of Assets*).
- Section 19 requires an acquirer to measure any non-controlling interest at the non-controlling interest's proportionate share of the recognised amounts of acquiree's identifiable net assets (see paragraph 19.14 of Section 19). Therefore, the acquirer does not recognise goodwill attributable to the non-controlling interest. IFRS 3 requires an acquirer to measure any non-controlling interest either at its fair value or at the non-controlling interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets (see paragraph 19 of IFRS 3). Therefore, if the acquirer measures non-controlling interest at its fair value, goodwill recognised in the acquirer's consolidated financial statements includes goodwill attributable to the non-controlling interest.

IFRS 3 and Section 19 have other differences, including:

- IFRS 3 contains additional exceptions to the recognition and measurement principles for particular types of identifiable assets acquired and liabilities assumed, including indemnification assets, leases, reacquired rights and share-based payments;
- IFRS 3 contains additional guidance for some specific areas that are not covered in Section 19—for example, reverse acquisitions, business combinations achieved without the transfer of consideration and the identification of intangible assets; and
- Section 19 is drafted in simpler language than that used in IFRS 3.

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements in Section 19 *Business Combinations and Goodwill* of the *IFRS for SMEs Accounting Standard* (Standard) by answering the questions provided.

Assume all amounts mentioned are material.

Once you have completed the test, check your answers against those supplied on page 77.

Mark the box next to the most correct statement.

Question 1

SME A acquires 100% of the voting shares of SME B. SME B has only two assets: a piece of land where SME A will construct a building in the future and an empty building. SME B has no employees and no managerial, operational or resource management processes. This transaction:

- ☐ (a) is a business combination.
- ☐ (b) could be a business combination.
- ☐ (c) is not a business combination.

Question 2

To be considered a business, an integrated set of activities and assets must include, as a minimum:

- ☐ (a) an input, a process applied to that input and outputs resulting from the input and process applied.
- ☐ (b) an input and a process applied to that input that together could result in outputs.
- ☐ (c) an input and a substantive process that together significantly contribute to the ability to create outputs.

Question 3

If an entity applying Section 9 *Consolidated and Separate Financial Statements* of the Standard is able to clearly identify the acquirer, the acquirer would be the combining entity:

- ☐ (a) whose relative size is significantly greater than that of the other combining entity or entities.
- ☐ (b) that obtains control of the other combining entity or entities.
- ☐ (c) that obtains more than 50% of the voting equity of the other combining entity or entities.
- ☐ (d) that initiated the combination.

Question 4

The acquisition date is the date on which:

- ☐ (a) the acquirer obtains control of the acquiree.
- ☐ (b) more than 50% of the consideration is paid.
- ☐ (c) a substantive agreement between the combining parties is reached.

Question 5

An identifiable intangible asset acquired in a business combination is recognised, separately from goodwill, if:

- ☐ (a) the asset was recognised in the acquiree's financial statements and its acquisition-date fair value can be measured reliably.
- ☐ (b) the asset was recognised by the acquiree's financial statements and its acquisition-date fair value can be measured reliably without undue cost or effort.
- ☐ (c) the asset's acquisition-date fair value can be measured reliably, regardless of whether it was recognised in the acquiree's financial statements.
- ☐ (d) the asset's acquisition-date fair value can be measured reliably without undue cost or effort, regardless of whether it was recognised in the acquiree's financial statements.

Question 6

An acquirer recognises a contingent liability (as defined in the Glossary and paragraph 21.12 of Section 21 *Provisions and Contingencies* of the Standard) assumed in a business combination if:

- ☐ (a) the acquisition-date fair value of the contingent liability can be measured reliably.
- ☐ (b) the acquisition-date fair value of the contingent liability can be measured reliably without undue cost or effort.
- ☐ (c) a present obligation exists as a result of past events and the acquisition-date fair value of the contingent liability can be measured reliably.
- ☐ (d) a present obligation exists as a result of past events and the acquisition-date fair value of the contingent liability can be measured reliably without undue cost or effort.

Question 7

An acquirer recognises contingent consideration at its fair value as part of the consideration transferred in exchange for the acquiree if:

- ☐ (a) the acquisition-date fair value of the contingent consideration can be measured reliably. If not, the acquirer recognises contingent consideration at the amount paid on settlement as an adjustment to the cost of the combination (and therefore goodwill).
- ☐ (b) the acquisition-date fair value fair value of the contingent consideration can be measured reliably without undue cost or effort. If not, the acquirer recognises contingent consideration at the amount paid on settlement as an adjustment to the cost of the combination (and therefore goodwill).
- ☐ (c) the acquisition-date fair value of the contingent consideration can be measured reliably without undue cost or effort. If not, the acquirer measures contingent consideration using the most likely amount.
- ☐ (d) the acquisition-date fair value of the contingent consideration can be measured reliably. If not, the acquirer measures contingent consideration using the most likely amount.

Question 8

In general, advisory, legal, tax, due diligence and valuation costs relating to a business combination:

- ☐ (a) are part of the cost of the business combination.
- ☐ (b) are recognised as expenses in the period in which the costs are incurred.

Question 9

After initial recognition, the acquirer is required to measure goodwill acquired in a business combination:

- ☐ (a) at cost less accumulated amortisation and accumulated impairment.
- ☐ (b) at cost less accumulated amortisation.
- ☐ (c) at cost less accumulated impairment.
- ☐ (d) at fair value.

Question 10

Goodwill is amortised:

- ☐ (a) over its estimated useful life, which can be indefinite.
- ☐ (b) over 10 years.
- ☐ (c) over its estimated useful life. If an entity cannot establish reliably the useful life of goodwill, the entity determines it based on management's best estimate but that estimate is not permitted to exceed 10 years.
- ☐ (d) over its estimated useful life. If an entity cannot establish reliably the useful life of goodwill, no amortisation is required.

Question 11

On 18 February 20X1, SME A purchased all of the equity interests in SME B. The consideration payable was CU100,000 at the date of acquisition and a further amount that was dependent upon post-acquisition sales; either zero, CU5,000 or CU10,000, depending on the sales recognised by SME B during the three years to 31 December 20X3. At the date of acquisition, SME A determined it could not measure reliably without undue cost or effort the fair value of the contingent consideration and that the most likely amount payable is CU5,000. Also, at the date of acquisition, SME B was being sued by a third party for breach of contract. In accounting for the acquisition of SME B in its consolidated financial statements, SME A concluded that, based on legal advice and other information, SME B had breached the contract with the third party and therefore had a present obligation as a result of a past event, it was more likely than not that SME B will lose the court case and the estimated acquisition-date fair value of the liability was CU2,000.

On 31 December 20X2, SME A:

- revised upwards its estimate of the most likely amount of further consideration payable to CU10,000; and
- concluded that the best estimate to settle the court case at 31 December 20X2 is CU2,500.

In its consolidated financial statements for the year ended 31 December 20X2, SME A:

- ☐ (a) adjusts goodwill for the change in estimate of contingent consideration and for the change in estimate for the provision for the court case.
- ☐ (b) adjusts goodwill for the change in estimate of contingent consideration and recognises the change in estimate for the provision for the court case as an expense in arriving at profit or loss.
- ☐ (c) recognises the change in estimate for the contingent consideration as an expense in arriving at profit or loss and adjusts goodwill for the change in estimate for the provision for the court case.
- ☐ (d) recognises as an expense in arriving at profit or loss the change in estimate for the contingent consideration and the change in estimate for the provision for the court case.

Answers

- Q1 (c)—see paragraph 19.3.
The assets purchased in the transaction do not constitute a business as defined.
- Q2 (c)—see paragraph 19A.4.
- Q3 (b)—see paragraph 19.9.
- Q4 (a)—see paragraph 19.11.
- Q5 (d)—see paragraphs 19.16 and 18.8.
- Q6 (c)—see paragraphs 19.17–19.19.
- Q7 (c)—see paragraphs 19.26–19.27.
- Q8 (b)—see paragraph 19.32.
- Q9 (a)—see paragraph 19.34.
- Q10 (c)—see paragraph 19.34(a).
- Q11 (d)—see paragraph 19.37(b)(ii) for contingent consideration and paragraph 19.33 and paragraph 21.11 of Section 21 for the provision for the court case.

APPLY YOUR KNOWLEDGE

You can apply your knowledge of the requirements in Section 19 *Business Combinations and Goodwill* of the *IFRS for SMEs* Accounting Standard by completing the case studies provided.

Once you have completed a case study, check your answers against those on pages 81–83 and 86–91.

Case study 1

SME A's major business is in the children's food industry. It makes baby food and drinks. On 20 February 20X1, SME A began negotiations with the owners of SME B, which makes sweets, to acquire 100% of the issued capital of SME B. An agreement was reached on 25 August 20X1. In accordance with the agreement, legal ownership of SME B passes to SME A on 30 September 20X1. However, from 1 September 20X1, SME A has the power to remove and appoint all of SME B's directors, who are in charge of governance. 1 September 20X1 is also the date on which SME A has the power to direct the activities of SME B that significantly affect its returns. All profits earned (or losses incurred) by SME B accrue to SME A from 1 September 20X1. On 15 September 20X1, SME A appointed new directors to replace the majority of SME B's directors.

The carrying amount and fair value of the assets and liabilities recognised in SME B's statement of financial position at the date of acquisition were:

	<i>Carrying amount</i>	<i>Fair value</i>
	CU	CU
Plant and equipment	1,000	1,300
Land	1,500	2,000
Motor vehicles	300	320
Inventories	200	280
Trade receivables	150	130
Total assets	3,150	4,030
Trade payables	700	700
Bank loan	1,200	1,150
Provisions (short term)	250	270
Total liabilities	2,150	2,120

At the date of acquisition, SME B had unrecorded recipes for sweet making. The fair value of the recipes at the date of acquisition is estimated to be CU800.

At the date of acquisition, SME B was being sued for damages relating to a claim by a parent of a child that had food poisoning that the illness possibly came from consuming the sweets made by SME B. If SME B loses the court case, it is expected that damages of CU1,000 will be awarded to the plaintiff. Lawyers estimated that the chance of losing the case is small, possibly around 5–10%. SME A estimates that the fair value of the potential liability is CU100.

The consideration SME A agreed to provide in exchange for the issued capital of SME B comprises:

- 100 shares in SME A. The fair value at the date of acquisition is estimated to be CU14 per share.
- CU1,000 in cash, half to be paid at the date of acquisition and half to be paid one year later. The fair value of the half to be paid one year later is CU455.
- a further payment of CU500 after two years if SME B's profit before interest and tax (PBIT) for the first year following the acquisition exceeds CU2,500, or a further payment of CU700 after two years if SME B's PBIT for the first year following the acquisition exceeds CU4,000. At the date of the acquisition, SME A estimated that it was probable that SME B's PBIT will be higher than CU2,500 but lower than CU4,000 and therefore the most likely amount of contingent consideration is CU500. SME A also estimated that the fair value of the contingent consideration at the acquisition date was CU405, which SME A determined could be reliably measured without undue cost or effort.
- a patent that had a fair value of CU500 at the date of acquisition.

The costs paid by SME A in relation to the acquisition (including the costs of issuing the shares of CU20) amounted to CU60.

Required:

Ignore income tax effects when answering Parts A–D of this case study. The income tax effects are the subject of Part E of this case study.

Part A

Determine the date of acquisition.

Part B

Determine the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed by SME A.

Part C

Determine the total amount of consideration transferred.

Part D

Determine the amount, if any, of goodwill to be recognised as a result of the business combination.

Part E

Recalculate the amount, if any, of goodwill to be recognised as a result of the business combination assuming:

- the applicable income tax rate is 20%;
- the tax base of each of the assets and liabilities recognised by SME B in its individual accounting records is equal to their respective carrying amounts; and
- the amortisation of goodwill is not tax deductible in determining taxable profit.

Answer to Case study 1

Part A

The date of acquisition is the date on which the acquirer obtains control of the acquiree.

In this case, although SME A did not appoint new directors until 15 September 20X1 and legal ownership did not occur until 30 September 20X1, in the absence of further facts or circumstances that might indicate otherwise, the date of acquisition is 1 September 20X1. SME A obtains control from 1 September 20X1 because it is the date from which SME A has the power to appoint all the directors of SME B and it has the power to direct the activities of SME B that significantly affect its returns. Furthermore, from that date, the operating results of SME B—whether profit or loss—accrue to SME A.

Part B

The net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed by SME A is CU2,710 [CU4,830 (fair value of assets acquired) – CU2,120 (fair value of liabilities assumed)].

Calculation of identifiable net assets:

	CU
Intangible assets (recipes)	800
Plant and equipment	1,300
Land	2,000
Motor vehicles	320
Inventories	280
Trade receivables	130
Total assets	<u>4,830</u>
Trade payables	700
Bank loan	1,150
Provisions (short term)	270
Total liabilities	<u>2,120</u>
Identifiable net assets acquired	<u>2,710</u>

The contingent liability of CU100 relating to the court case is not included in the liabilities assumed because, based on all the available evidence, SME B did not have a present obligation as a result of past events at the acquisition date to pay any such damages.

Part C

The total amount of consideration transferred is CU3,260.

Calculation:

		CU
Shares	100 SME A shares × CU14	1,400
Cash paid on the date of acquisition		500
Deferred cash payment		455
Contingent consideration (PBIT targets)		405
Patent		500
Total consideration transferred		3,260

The contingent consideration is included in the total consideration transferred at its acquisition-date fair value of CU405. If that fair value could not be reliably measured without undue cost or effort, contingent consideration would have been based on its most likely amount of CU500, discounted to its present value at the acquisition date.

The acquisition-related costs of CU60 are not included in the total consideration transferred. The costs of CU20 to issue shares are recognised as a deduction from equity. The remaining costs of CU40 are recognised as an expense in profit or loss in the period in which those costs were incurred.

Part D:

The amount of goodwill recognised as an asset as a result of the business combination is CU550.

Calculation: CU3,260 (total consideration transferred—see Part C) – CU2,710 (net assets acquired—see Part B) = CU550.

Part E:

After taking account of income tax effects, the amount of goodwill recognised as an asset as a result of the business combination is CU892.

Calculation: CU3,260 (total consideration transferred) – CU2,368 (identifiable net assets acquired—see calculation) = CU892.

Calculation of the identifiable net assets acquired:

	Fair value CU
Identifiable net assets acquired before tax effects (Part B)	2,710
Deferred tax liability (see calculation)	(342)
Identifiable net assets acquired	2,368

Calculation for the deferred tax liability:

	<i>Tax base (SME B carrying amount)</i>	<i>Group acquisition date carrying amount (fair value)</i>	<i>Difference</i>	<i>Deferred tax asset (liability)</i>
	CU	CU	CU	CU
Intangible assets (recipes)	–	800	800	(160)
Plant and equipment	1,000	1,300	300	(60)
Land	1,500	2,000	500	(100)
Motor vehicles	300	320	20	(4)
Inventories	200	280	80	(16)
Trade receivables	150	130	(20)	4
Trade payables	(700)	(700)	–	–
Bank loan	(1,200)	(1,150)	50	(10)
Provisions (short term)	(250)	(270)	(20)	4
Total	1,000	2,710	1,710	
Total deferred tax liability				(342)

Note: () indicates a liability and a positive amount indicates an asset.

Although the group carrying amount of goodwill (CU1,020) exceeds its tax base (nil), no deferred taxation arises from this temporary difference because it is exempt from deferred tax (see paragraph 29.14(a) of Section 29 *Income Tax* of the *IFRS for SMEs Accounting Standard*).

Case study 2

On 1 June 20X1, SME A, a retail company supplying women's clothing, acquired 75% of the issued share capital and control of SME B, another retail company specialising in casual clothes for children and teenagers. The consideration for the business combination was CU3,795 in cash. At the date of acquisition, the statements of financial position of SME A and SME B and the fair values of the assets and liabilities recognised in SME B's statement of financial position were:

	<i>SME A</i>	<i>SME B</i>	
	<i>Carrying amount</i>	<i>Carrying amount</i>	<i>Fair value</i>
	CU	CU	CU
Assets			
Non-current assets			
Land	4,000	1,800	2,500
Equipment	2,000	500	550
Investment in SME B	3,795	—	—
	<u>9,795</u>	<u>2,300</u>	
Current assets			
Inventories	500	300	400
Cash	700	100	100
	<u>1,200</u>	<u>400</u>	
Total assets	<u>10,995</u>	<u>2,700</u>	
Liabilities and equity			
Equity			
Share capital	5,000	1,500	
Retained earnings	4,195	600	
Total equity	<u>9,195</u>	<u>2,100</u>	
Liabilities			
Non-current liabilities			
Provisions	800	200	210
	<u>800</u>	<u>200</u>	
Current liabilities			
Trade payables	600	180	180
Provisions	400	220	220
	<u>1,000</u>	<u>400</u>	
Total liabilities	<u>1,800</u>	<u>600</u>	
Total liabilities and equity	<u>10,995</u>	<u>2,700</u>	

At the date of acquisition, SME B had an unrecorded customer-relationship intangible asset with a fair value of CU2,000.

To reflect the tax effects, assume:

- the applicable income tax rate is 20%;
- the tax bases of the assets and liabilities of SME B are equal to their respective carrying amounts in SME B's financial statements; and
- the amortisation of goodwill is not tax deductible in determining taxable profit.

Required:

Part A

Calculate the goodwill, if any, to be recognised.

Part B

Prepare SME A's consolidated statement of financial position at the date of acquisition (1 June 20X1).

Part C

Prepare the necessary disclosures relating to the business combination that would be included in SME A's consolidated financial statements for the year ended 31 December 20X1 as required by Section 19 of the *IFRS for SMEs* Accounting Standard. Assume that SME A uses the straight-line method to amortise goodwill over an estimated useful life of 10 years.

Answer to Case study 2

Part A

SME A recognises goodwill of CU516 [CU3,795 (consideration transferred) + CU1,093 (non-controlling interest (25% of identifiable net assets acquired)) – CU4,372 (identifiable net assets acquired)].

Identifiable net assets acquired:

	<i>Fair value</i>
	CU
Intangible assets (customer relationships)	2,000
Land	2,500
Equipment	550
Inventories	400
Cash	100
Total assets	5,550
Provisions (long-term)	210
Trade payables	180
Provisions (short-term)	220
Deferred tax liability (see calculation)	568
Total liabilities	1,178
Identifiable net assets acquired	4,372

Calculation for the deferred tax liability:

	<i>Tax base (carrying amount SME B)</i>	<i>Carrying amount Group (fair value)</i>	<i>Difference</i>	<i>Deferred tax asset (liability)</i>
	CU	CU	CU	CU
Intangible assets (patent)	–	2,000	2,000	(400)
Land	1,800	2,500	700	(140)
Equipment	500	550	50	(10)
Inventories	300	400	100	(20)
Cash	100	100	–	–
Provisions (long-term)	(200)	(210)	(10)	2
Trade payables	(180)	(180)	–	–
Provisions (short-term)	(220)	(220)	–	–
Total	2,100	4,940	2,840	
Total deferred tax liability				(568)

Note:

Although the carrying amount of goodwill (CU516) exceeds its tax base (nil), no deferred taxation arises from this temporary difference because it is exempt from deferred tax (see paragraph 29.14(a) of Section 29 *Income Tax* of the *IFRS for SMEs Accounting Standard*).

Part B

SME A's consolidated statement of financial position at 1 June 20X1

	CU	CU
Assets		
Non-current assets		
Goodwill	516	
Intangible assets (customer relationships)	2,000	
Land	6,500	
Equipment	2,550	
	<u>9,795</u>	
		11,566
Current assets		
Inventories	900	
Cash	800	
	<u>1,700</u>	
Total assets		<u>13,266</u>
Liabilities and equity		
Equity attributable to owners of the parent		
Share capital	5,000	
Retained earnings	4,195	
	<u>9,195</u>	
Non-controlling interests	<u>1,093^(a)</u>	
Total equity		10,288
Liabilities		
Non-current liabilities		
Provisions (long-term)	1,010	
Deferred tax liability	568	
	<u>1,578</u>	
Current liabilities		
Trade payables	780	
Provisions (short-term)	620	
	<u>1,400</u>	
Total liabilities		<u>2,978</u>
Total liabilities and equity		<u>13,266</u>

(a) 25% of the CU4,372 identifiable net assets of SME B (see Part A).

Workings:

	<i>SME A</i>	<i>SME B</i>	<i>Adjustments</i>	<i>Consolidation</i>
	CU	CU	CU	CU
Assets				
Goodwill	–	–	516	516
Intangible assets (customer relationships)	–	–	2,000	2,000
Land	4,000	1,800	700	6,500
Equipment	2,000	500	50	2,550
Investment in SME B	3,795	–	(3,795)	–
Inventories	500	300	100	900
Cash	700	100	–	800
Total assets	10,995	2,700	(429)	13,266
Liabilities and equity				
Equity				
Share capital	5,000	1,500	(1,500)	5,000
Retained earnings	4,195	600	(600)	4,195
Non-controlling interests	–	–	1,093	1,093
Liabilities				
Provisions (long-term)	800	200	10	1,010
Deferred tax liability	–	–	568	568
Trade payables	600	180	–	780
Provisions (short-term)	400	220	–	620
Total liabilities and equity	10,995	2,700	(429)	13,266

Part C

Disclosures to be included in SME A's consolidated financial statements for the year ended 31 December 20X1:

J. Goodwill

	<i>Note</i>	Cost	<i>Accumulated amortisation and impairment</i>	<i>Carrying amount</i>
		CU	CU	CU
Acquired in the business combination	Z	516	—	516
Annual amortisation		—	(30)	(30)
31 December 20X0		516	(30)	486

SME A estimated that the goodwill has a 10-year useful life.

Working for goodwill amortisation:

Amortisation = $(\text{CU}516 \div 10 \text{ years}) \times (7 \text{ months} \div 12 \text{ months})$

Z. Acquisitions during the year ended 31 December 20X1

On 1 June 20X1, SME A acquired 75% of the issued share capital and control of SME B, in a cash transaction. This acquisition has been accounted for under the acquisition method and has been included in the consolidated financial statements from the date of acquisition, 1 June 20X1.

SME B is a retailer specialising in casual clothes for children and teenagers, which complements SME A's retail business supplying women's clothing. The goodwill of CU516 arising from the acquisition consists largely of the synergies and economies of scale expected from combining the operations of SME A and SME B.

The amounts recognised as a result of the business combination at the acquisition date are:

Identifiable net assets acquired:	CU	CU
Intangible assets (customer relationships)	2,000	
Land	2,500	
Equipment	550	
Inventories	400	
Cash	100	
		5,550
Trade payables	(180)	
Provisions (short-term)	(220)	
Provisions (long-term)	(210)	
Deferred tax liability	(568)	
		(1,178)
Identifiable net assets		4,372
Non-controlling interest		(1,093)
Goodwill	J	516
Consideration transferred		3,795



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