

BUSINESS COMBINATIONS

(IFRS 3)

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1. Objective and overview of IFRS 3

IFRS 3 *Business Combinations* sets out how an acquirer accounts for a business combination so that financial statements provide relevant, reliable and comparable information about:

- **Identifiable assets acquired and liabilities assumed**
- **Any non-controlling interest (NCI) in the acquiree**
- **Goodwill or a gain from a bargain purchase**

The standard requires the **acquisition method** for all business combinations within its scope.

2. Scope of IFRS 3

2.1 Transactions covered

IFRS 3 applies to **transactions or events in which an acquirer obtains control of one or more businesses**. Control is assessed using IFRS 10 (power, exposure to variable returns, and ability to affect those returns).

Examples:

- **Purchase of 100% of the shares** of another entity that is a business
- **Purchase of a controlling stake** (e.g. 60%) in a business
- **Step acquisitions** where control is obtained after previously holding a non-controlling interest
- **Reverse acquisitions** (legal subsidiary is the accounting acquirer)

2.2 Transactions excluded from IFRS 3

IFRS 3 does **not** apply to:

- **Combinations of entities or businesses under common control**
- **Formation of a joint arrangement** (IFRS 11)
- **Acquisition of an asset group that is not a business** (treated as asset acquisition)
- **Business combinations involving entities under control of the same ultimate parent** (common control)

In these cases, other IFRS standards or accounting policies (IAS 8) are applied.

3. Key definitions

3.1 Business

A **business** is an integrated set of activities and assets that is capable of being conducted and managed to provide:

- **Returns** in the form of dividends, lower costs, or other economic benefits
- To **investors or other owners, members or participants**

A business generally includes:

- **Inputs:** resources (e.g. assets, employees, intellectual property)
- **Processes:** systems, standards, protocols that create outputs
- **Outputs:** goods or services, investment income, or other returns

The 2018 amendments introduced a **concentration test**: if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar assets, the set is **not** a business.

Example — Asset acquisition vs business combination

- Entity A buys a single investment property with no employees, no processes, and no leases in place.
 - **Likely an asset acquisition**, not a business.
- Entity B buys a hotel with staff, operating systems, customer contracts, and brand.
 - **Likely a business**, so IFRS 3 applies.

3.2 Business combination

A **business combination** is a transaction or event in which an acquirer obtains control of one or more businesses.

Key elements:

- **Acquirer:** the entity that obtains control
- **Acquiree:** the business or entity acquired
- **Acquisition date:** the date the acquirer obtains control

3.3 Goodwill

Goodwill is:

The **excess** of

(a) consideration transferred, plus

(b) NCI, plus

(c) fair value of any previously held interest,

over the **net identifiable assets** acquired (assets minus liabilities at fair value).

If the net identifiable assets exceed the sum above, a **gain from a bargain purchase** is recognised in profit or loss.

4. The acquisition method — core mechanics

IFRS 3 requires the **acquisition method** for all business combinations within its scope.

4.1 Four steps of the acquisition method

1. **Identify the acquirer**
2. **Determine the acquisition date**
3. **Recognise and measure identifiable assets acquired, liabilities assumed, and any NCI**
4. **Recognise and measure goodwill or a gain from a bargain purchase**

We'll walk through each step in detail.

5. Step 1 — Identifying the acquirer

5.1 Control concept

The acquirer is the entity that **obtains control** of the acquiree. Control is assessed using IFRS 10:

- **Power** over the investee (relevant activities)
- **Exposure or rights to variable returns**
- **Ability to use power to affect returns**

Indicators:

- Majority of voting rights
- Rights to appoint/remove key management
- Contractual arrangements giving power over relevant activities

5.2 Reverse acquisitions

A **reverse acquisition** occurs when:

- The **legal parent** (entity issuing shares) is the **accounting acquiree**
- The **legal subsidiary** is the **accounting acquirer**

This often happens when a smaller entity (B) obtains control of a larger listed entity (A) by issuing shares to A's shareholders.

Example — Reverse acquisition

- Entity A (listed) issues shares to acquire Entity B (private).
- After the transaction, former shareholders of B hold 70% of A's shares.
- Although A is the legal parent, B's former shareholders have control.

- **Accounting acquirer: B**
- **Accounting acquiree: A**

The consolidated financial statements are prepared as a continuation of B, with A's assets and liabilities added at fair value.

6. Step 2 — Determining the acquisition date

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

Typically:

- The **closing date** when consideration is transferred and the acquirer obtains rights to the assets and assumes liabilities
- This date is critical because it is the **measurement date** for fair values and classifications

Key points:

- **Fair values** of assets, liabilities and NCI are measured at the acquisition date
- **Classification** of financial instruments and other items is based on conditions at that date
- Subsequent changes in fair value are generally recognised in profit or loss or OCI, not as adjustments to goodwill (except within the measurement period)

7. Step 3 (a) — Recognising and measuring identifiable assets and liabilities

7.1 General principle

At the acquisition date, the acquirer recognises, **separately from goodwill**, all identifiable assets acquired and liabilities assumed that meet the recognition criteria:

- **Probable future economic benefits** (for assets) or outflows (for liabilities)
- **Reliable measurement** of fair value

All identifiable assets and liabilities are measured at **acquisition-date fair value**, with limited exceptions.

7.2 Identifiable assets

An asset is identifiable if:

- It is **separable** (can be sold, transferred, licensed, rented, or exchanged), or
- It arises from **contractual or other legal rights**, regardless of separability.

This includes:

- **Tangible assets:** property, plant and equipment, inventory, investment property
- **Financial assets:** receivables, investments, derivatives
- **Intangible assets:** brands, customer relationships, patents, technology, licences, software, etc.

Important: IFRS 3 requires recognition of **intangible assets** that the acquiree may not have recognised previously (e.g. internally generated brands) if they meet the identifiability criteria.

Example — Recognising intangible assets

Entity X acquires Entity Y, which has:

- A strong brand (internally generated, not recognised in Y's own financial statements)
- Customer contracts and relationships
- Proprietary technology

Under IFRS 3:

- Brand, customer relationships and technology are recognised as **separate intangible assets** at fair value.
- These reduce the amount of goodwill.

7.3 Liabilities and contingent liabilities

The acquirer recognises:

- **Present obligations** (legal or constructive) that arise from past events and can be measured reliably
- **Contingent liabilities** assumed in the combination if they are present obligations and fair value can be measured reliably

Contingent **assets** are **not** recognised at the acquisition date.

7.4 Leases (IFRS 16 interaction)

For leases where the acquiree is a **lessee**:

- The acquirer recognises **right-of-use assets** and **lease liabilities** as if the lease were a new lease at the acquisition date.

For leases where the acquiree is a **lessor**:

- The acquirer recognises the underlying asset and lease receivables according to IFRS 16 and IFRS 9.

7.5 Exceptions to fair value measurement

Certain items are measured under other standards, not at fair value:

- **Deferred tax assets and liabilities** — IAS 12
- **Employee benefit obligations** — IAS 19
- **Share-based payment awards** — IFRS 2
- **Assets held for sale** — IFRS 5

8. Step 3 (b) — Recognising and measuring Non-Controlling Interest (NCI)

8.1 Measurement options

NCI represents equity in the acquiree not attributable to the acquirer. IFRS 3 allows two measurement options, chosen **per transaction**:

1. **Fair value (full goodwill method)**
2. **Proportionate share of the acquiree's net identifiable assets (partial goodwill method)**

The choice affects the amount of goodwill recognised.

Example — NCI measurement

Assume:

- Consideration transferred: R800
- Fair value of net identifiable assets: R1,000
- NCI: 25%
- NCI fair value: R260

Option 1 — NCI at fair value

- NCI fair value: R260
- Goodwill = $800 + 260 - 1,000 = R60$

Option 2 — NCI at proportionate share

- NCI = $25\% \times 1,000 = R250$
- Goodwill = $800 + 250 - 1,000 = R50$

Goodwill differs depending on the measurement basis.

9. Step 4 — Goodwill and bargain purchase

9.1 Goodwill calculation

General formula:

$$\text{Goodwill} = \text{Consideration transferred} + \text{NCI} + \text{Fair value of previously held interest} \\ - \text{Net identifiable assets}$$

Where:

- **Consideration transferred:** cash, equity instruments, other assets, liabilities incurred, contingent consideration
- **NCI:** measured at fair value or proportionate share
- **Previously held interest:** fair value of any equity interest held before obtaining control
- **Net identifiable assets:** fair value of identifiable assets acquired minus liabilities assumed

9.2 Bargain purchase (negative goodwill)

If:

$$\text{Net identifiable assets} > \text{Consideration} + \text{NCI} + \text{Previously held interest}$$

the difference is a **gain from a bargain purchase**.

Treatment:

- Reassess whether all assets and liabilities have been identified and measured correctly
- Reassess measurement of consideration, NCI and previously held interest
- After reassessment, any remaining excess is recognised **immediately in profit or loss**.

9.3 Example — Basic goodwill calculation

Entity A acquires 80% of Entity B.

- Consideration transferred (cash): R1,600
- NCI (20%) measured at fair value: R400
- Fair value of net identifiable assets: R1,700

Goodwill:

$$\text{Goodwill} = 1,600 + 400 - 1,700 = \text{R300}$$

Journal entry:

- | | | |
|---------------------------------------|--------|--------|
| • Dr Identifiable assets (fair value) | R1,700 | |
| • Dr Goodwill | R300 | |
| • Cr Liabilities assumed (if any) | | |
| • Cr Bank (consideration) | | R1,600 |
| • Cr NCI | | R400 |

10. Consideration transferred

10.1 Components of consideration

Consideration transferred may include:

- **Cash**
- **Other assets** (e.g. property, shares in another entity)
- **Equity instruments** of the acquirer (shares, options)
- **Liabilities incurred** (e.g. assumption of debt)
- **Contingent consideration** (future payments dependent on events or performance)

All components are measured at **fair value** at the acquisition date.

10.2 Contingent consideration

Contingent consideration is:

- An obligation of the acquirer to transfer additional assets or equity instruments if specified future events occur or conditions are met
- Or a right to receive back some consideration if conditions are not met

Measurement:

- At **fair value** at the acquisition date
- Classified as **financial liability, equity, or asset** according to IFRS 9 and IAS 32

Subsequent measurement:

- If classified as a **financial liability**: remeasured at fair value through profit or loss (unless it is a financial instrument measured at amortised cost)
- If classified as **equity: not remeasured**; settlement is accounted for within equity

Example — Contingent consideration

Entity A agrees to pay an additional R500 if Entity B's profit exceeds R200 in the next year.

- At acquisition date, fair value of contingent consideration is estimated at R300.
- Recognise R300 as part of consideration transferred.

Subsequent year:

- If actual fair value of the liability increases to R350, recognise R50 in profit or loss (if liability classification).

11. Step acquisitions and previously held interests

11.1 Step acquisitions

A **step acquisition** occurs when the acquirer:

- Previously held a non-controlling interest in the acquiree, and
- Acquires additional interest to obtain **control**.

Accounting:

- At the acquisition date, **remeasure previously held interest** at fair value
- Recognise any resulting gain or loss in **profit or loss**
- Then apply the acquisition method to recognise assets, liabilities, NCI and goodwill.

Example — Step acquisition

Entity A holds 30% of Entity B (associate). It acquires an additional 40% and obtains control (total 70%).

- Fair value of previously held 30% at acquisition date: R600
- Carrying amount of the 30% interest: R500

Remeasurement:

- $\text{Gain} = 600 - 500 = \text{R}100 \rightarrow$ recognised in profit or loss

Then goodwill is calculated using:

- Consideration for new 40%
- Fair value of previously held 30% (R600)
- NCI (remaining 30%)
- Net identifiable assets at fair value.

12. Measurement period

12.1 Definition

The **measurement period** is the period after the acquisition date during which the acquirer may adjust provisional amounts recognised for a business combination.

- Maximum length: **one year** from the acquisition date

- Used when initial accounting is **provisional** because fair values or other amounts are not yet final.

12.2 Adjustments during measurement period

Adjustments are made when:

- New information is obtained about facts and circumstances that existed at the acquisition date
- That information would have affected the amounts recognised at that date.

Effects:

- Adjust provisional amounts retrospectively
- Adjust goodwill accordingly
- Comparative information is **restated** as if the new information had been known at acquisition date.

After the measurement period:

- Changes are recognised in profit or loss or OCI, not as adjustments to goodwill (except for error corrections under IAS 8).

13. What is part of the business combination transaction?

IFRS 3 requires distinguishing between:

- **Amounts that are part of the business combination** (included in consideration or assets/liabilities acquired), and
- **Amounts that are separate transactions** (accounted for under other standards).

13.1 Examples of separate transactions

- **Settlement of pre-existing relationships** between acquirer and acquiree (e.g. lawsuit, supply contract)
- **Remuneration for future services** (e.g. contingent payments to employees that are compensation, not consideration)
- **Replacement of share-based payment awards** (IFRS 2)
- **Costs of issuing debt or equity instruments** (IAS 32, IFRS 9)

These are **not** part of the business combination and are accounted for separately.

13.2 Acquisition-related costs

Acquisition-related costs (e.g. legal, advisory, valuation, due diligence) are:

- **Expensed** in profit or loss as incurred

- Not included in consideration transferred

Costs of issuing debt or equity instruments are accounted for under IFRS 9 and IAS 32 (e.g. deducted from equity for share issue costs).

14. Subsequent measurement and accounting

After the acquisition date, the acquirer:

- Measures assets and liabilities according to the relevant IFRS standards (IAS 16, IFRS 9, IAS 38, etc.)
- Does **not** adjust goodwill for subsequent changes in fair value of assets or liabilities (except measurement period adjustments).

14.1 Goodwill subsequent accounting

Goodwill is:

- **Not amortised**
- Tested annually for **impairment** under IAS 36, or more frequently if indicators exist

Impairment:

- Allocate goodwill to cash-generating units (CGUs)
- Compare recoverable amount of CGU with its carrying amount
- Recognise impairment loss if carrying amount exceeds recoverable amount
- Impairment losses on goodwill are **not reversed**.

14.2 Indemnification assets

If the seller indemnifies the acquirer for certain outcomes (e.g. litigation):

- Recognise an **indemnification asset** at the same time and on the same basis as the related liability
- Subsequent measurement follows the relevant standard (often IFRS 9).

14.3 Contingent liabilities

Contingent liabilities recognised at acquisition date:

- Subsequently measured at the **higher of**:
 - Amount that would be recognised under IAS 37, and
 - Amount initially recognised less cumulative amortisation (if applicable).

15. Special topics

15.1 Reacquired rights

A **reacquired right** is a right that the acquirer had previously granted to the acquiree (e.g. licence) and regains through the business combination.

Accounting:

- Recognise an **intangible asset** at fair value
- Amortise over the remaining contractual period, not over the period the right is expected to be used.

15.2 Business combinations achieved without transfer of consideration

Control may be obtained without transferring consideration, for example:

- **Lapse of veto rights**
- **Contractual arrangements** changing
- **Combination by contract alone**

In such cases:

- Recognise assets, liabilities and NCI at fair value
- Goodwill is calculated using the fair value of the acquiree (e.g. using valuation techniques) and NCI.

15.3 Common control transactions (outside IFRS 3)

Business combinations under **common control** are outside IFRS 3. Examples:

- Parent transfers a subsidiary to another subsidiary
- Reorganisation within a group where ultimate parent remains the same

Accounting policy is developed under IAS 8, often using:

- **Predecessor accounting** (carry-over values), or
- **Book value method**, depending on jurisdiction and group policy.

16. Disclosures

IFRS 3 requires extensive disclosures to help users evaluate:

- **Nature of the business combination**
- **Financial effects** on the entity's financial statements

Key disclosure areas:

- **Name and description** of acquiree
- **Acquisition date**
- **Percentage of voting equity interests acquired**
- **Primary reasons for the business combination** and how control was obtained
- **Recognised amounts** of assets acquired and liabilities assumed, by major class
- **Goodwill:** amount, factors that make up goodwill (e.g. synergies, assembled workforce)
- **Bargain purchase gain**, if any, and reasons
- **Revenue and profit or loss** of the acquiree since acquisition date included in consolidated financial statements
- **Pro forma information:** revenue and profit or loss of the combined entity as if the acquisition had occurred at the beginning of the reporting period (if practicable)
- **Contingent consideration:** amount, range of outcomes, key assumptions
- **Measurement period adjustments:** nature and amount

These disclosures are critical for transparency and comparability.

17. Comprehensive numerical example

17.1 Scenario:

Entity P acquires 75% of Entity S on 1 July 20X5.

- **Consideration transferred:**
 - Cash: R2,000
 - Contingent consideration (fair value at acquisition date): R300
- **NCI (25%):** measured at fair value R700
- **Fair value of identifiable assets and liabilities** of S at acquisition date:
 - Tangible assets: R2,100
 - Intangible assets (brand, customer relationships): R900
 - Liabilities: R600

Net identifiable assets:

$$2,100 + 900 - 600 = R2,400$$

17.2 Goodwill calculation

Total consideration:

$$\text{Consideration transferred} = 2,000 + 300 = R2,300$$

Goodwill:

$$\text{Goodwill} = 2,300 + 700 - 2,400 = R600$$

17.3 Journal entries

At acquisition date:

1. Recognise identifiable assets and liabilities at fair value

- | | | |
|------------------------|--------|------|
| • Dr Tangible assets | R2,100 | |
| • Dr Intangible assets | R900 | |
| • Cr Liabilities | | R600 |

2. Recognise NCI

- | | |
|----------|------|
| • Cr NCI | R700 |
|----------|------|

3. Recognise consideration transferred

- | | |
|---|--------|
| • Cr Bank | R2,000 |
| • Cr Contingent consideration liability | R300 |

4. Recognise goodwill (balancing figure)

- | | |
|---------------|------|
| • Dr Goodwill | R600 |
|---------------|------|

Check:

- Debits: $2,100 + 900 + 600 = 3,600$
- Credits: $600 + 700 + 2,000 + 300 = 3,600$

17.4 Subsequent year — contingent consideration remeasurement

Say that at 30 June 20X6, fair value of contingent consideration liability increases to R350.

- | | | |
|---|-----|-----|
| • Dr Loss on acquisition (P&L) | R50 | |
| • Cr Contingent consideration liability | | R50 |

Goodwill is **not** adjusted.

18. Common pitfalls and exam-style focus points

18.1 Distinguishing business vs asset acquisition

- **Pitfall:** Treating acquisition of a single property with no processes as a business combination.
- **Focus:** Apply the **definition of a business** and the **concentration test**.

18.2 Misclassifying contingent consideration

- **Pitfall:** Treating all contingent consideration as equity.
- **Focus:** Classify under IFRS 9/IAS 32; remember subsequent remeasurement for liabilities.

18.3 Forgetting to recognise intangible assets separately

- **Pitfall:** Putting all value into goodwill.
- **Focus:** Identify brands, customer relationships, technology, licences, etc., and recognise at fair value.

18.4 Measurement period vs error correction

- **Pitfall:** Adjusting goodwill for changes that relate to events after acquisition date.
- **Focus:** Only adjust goodwill for new information about conditions existing at acquisition date, within one year.

18.5 Step acquisitions

- **Pitfall:** Ignoring remeasurement of previously held interest.
- **Focus:** Remeasure at fair value; recognise gain or loss in profit or loss.

19. 20 Multiple-Choice Questions (with Answers)

1. What method must be applied to all business combinations within the scope of IFRS 3?

- A. Pooling of interests
- B. Equity method
- C. Acquisition method
- D. Consolidation exemption method

➤ **Answer: C** (From Par. 1: “The standard requires the acquisition method for all business combinations within its scope.”)

2. Which of the following is *not* within the scope of IFRS 3?

- A. Purchase of 100% of a business
- B. Step acquisition resulting in control
- C. Reverse acquisition
- D. Common control transaction

➤ **Answer: D** (From Par. 2.2: “IFRS 3 does not apply to... Combinations of entities or businesses under common control.”)

3. A business must include inputs and processes capable of producing outputs. Which amendment introduced the concentration test?

- A. 2010 amendment
- B. 2018 amendment
- C. 2020 amendment
- D. 2022 amendment

➤ **Answer: B** (From Par. 3.2: “The 2018 amendments introduced a concentration test...”)

4. Which of the following indicates that an asset is identifiable?

- A. It is internally generated
- B. It is separable or arises from contractual/legal rights
- C. It is measured at cost
- D. It is expected to generate future cash flows

➤ **Answer: B** (From Par. 7.2: “An asset is identifiable if...”)

5. Which of the following must be recognised separately from goodwill at fair value?

- A. Internally generated brands
- B. Assembled workforce
- C. Future synergies
- D. Deferred tax assets

➤ **Answer: A** (From Par. 7.2: “Brand, customer relationships and technology are recognised as separate intangible assets at fair value.”)

6. Which of the following is *not* recognised at the acquisition date?

- A. Contingent liabilities
- B. Contingent assets
- C. Customer relationships
- D. Right-of-use assets

➤ **Answer: B** (From Par. 7.3: “Contingent assets are not recognised at the acquisition date.”)

7. Under IFRS 3, acquisition-related costs (legal, advisory, due diligence) are:

- A. Capitalised as part of consideration
- B. Added to goodwill
- C. Expensed in profit or loss
- D. Deducted from equity

- **Answer: C** (From Par. 13.2: “Acquisition-related costs... are expensed in profit or loss as incurred.”)

8. Which of the following is a key indicator of control under IFRS 10?

- A. Ability to veto dividends
- B. Exposure to variable returns
- C. Ownership of more than 20%
- D. Ability to appoint auditors

- **Answer: B** (From Par. 2.1: “Control is assessed using IFRS 10...”)

9. In a reverse acquisition, which entity is the accounting acquirer?

- A. The legal parent
- B. The legal subsidiary
- C. The entity issuing shares
- D. The entity with fewer assets

- **Answer: B** (From Par. 5.2: “The legal subsidiary is the accounting acquirer.”)

10. Goodwill is calculated as:

- A. Net identifiable assets minus consideration
- B. Consideration plus NCI plus fair value of previously held interest minus net identifiable assets
- C. Total assets minus total liabilities
- D. Fair value of equity instruments issued

- **Answer: B** (From Par. 9.1: “General formula...”)

11. A bargain purchase gain must be:

- A. Deferred
- B. Added to goodwill
- C. Recognised in OCI
- D. Recognised immediately in profit or loss

- **Answer: D** (From Par. 9.2: “Any remaining excess is recognised immediately in profit or loss.”)

12. When an acquirer previously held an equity interest and obtains control, that interest must be:

- A. Kept at carrying amount
- B. Eliminated against goodwill
- C. Remeasured at fair value

D. Transferred to NCI

- **Answer: C** (From Par. 11.1: “Remeasure previously held interest at fair value.”)

13. Contingent consideration classified as a financial liability is:

- A. Not remeasured
- B. Remeasured through profit or loss
- C. Remeasured through OCI
- D. Added to equity

- **Answer: B** (From Par. 10.2: “Subsequent measurement...”)

14. Which of the following is measured under IAS 12 rather than fair value at acquisition?

- A. Deferred tax assets
- B. Customer relationships
- C. Brand names
- D. Lease liabilities

- **Answer: A** (From Par. 7.5: “Certain items are measured under other standards...”)

15. Goodwill must be:

- A. Amortised over 10 years
- B. Tested annually for impairment
- C. Revalued annually
- D. Allocated to inventory

- **Answer: B** (From Par. 14.1: “Goodwill is... tested annually for impairment under IAS 36.”)

16. Which of the following is a separate transaction, not part of the business combination?

- A. Contingent consideration
- B. Settlement of a pre-existing lawsuit
- C. Customer relationships
- D. Tangible assets acquired

- **Answer: B** (From Par. 13.1: “Settlement of pre-existing relationships... are not part of the business combination.”)

17. The measurement period cannot exceed:

- A. 3 months

- B. 6 months
- C. 1 year
- D. 2 years

➤ **Answer: C** (From Par. 12.1: “The measurement period is the period after the acquisition date...”)

18. Which of the following is true regarding reacquired rights?

- A. They are included in goodwill
- B. They are measured at cost
- C. They are amortised over the remaining contractual period
- D. They are not recognised

➤ **Answer: C** (From Par. 15.1: “Accounting: ... Amortise over the remaining contractual period...”)

19. In a business combination achieved without transferring consideration, goodwill is measured using:

- A. Carrying amounts
- B. Fair value of acquiree and NCI
- C. Cost model
- D. Equity method

➤ **Answer: B** (From Par. 15.2: “Control may be obtained without transferring consideration...”)

20. Which disclosure is required under IFRS 3?

- A. Future expected synergies quantified
- B. Detailed valuation models
- C. Pro forma revenue and profit information
- D. Names of all employees acquired

➤ **Answer: C** (From Par. 16: “Key disclosure areas...”)

20. Calculation-Focused Exam Set (20 Questions + Answers)

1. Calculate net identifiable assets

Entity A acquires Entity B. Fair value of identifiable assets = R1,500. Fair value of liabilities = R400.

Required: Net identifiable assets.

Answer: R1,100 ($1,500 - 400$) [Net identifiable assets: assets minus liabilities at fair value]

2. Goodwill calculation — basic

- Consideration transferred = R2,000
- NCI (fair value) = R500
- Net identifiable assets = R2,300

Required: Goodwill.

Answer: R200 ($2,000 + 500 - 2,300$) [Goodwill = consideration + NCI – net identifiable assets.]

3. Goodwill — partial goodwill method

- Consideration = R900
- Net identifiable assets = R1,200
- NCI = 30%, measured at proportionate share

Required: Goodwill.

- $\text{NCI} = 30\% \times 1,200 = 360$
- $\text{Goodwill} = 900 + 360 - 1,200 = \mathbf{R60}$

4. Goodwill — full goodwill method

- Consideration = R900
 - Net identifiable assets = R1,200
 - NCI fair value = R420
- $\text{Goodwill} = 900 + 420 - 1,200 = \mathbf{R120}$

5. Bargain purchase gain

- Consideration = R1,000
 - NCI = R200
 - Net identifiable assets = R1,400
- $\text{Gain} = 1,400 - (1,000 + 200) = \mathbf{R200}$ (Recognised in profit or loss.)

6. Step acquisition — remeasurement gain

- Previously held interest carrying amount = R500
 - Fair value at acquisition date = R650
- $\text{Gain} = 650 - 500 = \mathbf{R150}$ [“Remeasure previously held interest at fair value... gain recognised in profit or loss.”]

7. Step acquisition — goodwill calculation

- Fair value of previously held interest = R650
- Consideration for additional stake = R900
- NCI fair value = R300
- Net identifiable assets = R1,600

➤ Goodwill = $900 + 650 + 300 - 1,600 = \text{R250}$

8. Contingent consideration — initial recognition

Fair value of contingent consideration at acquisition = R280

Required: Amount included in consideration transferred.

Answer: R280 (From Par. 10.2 example: “Recognise X as part of consideration transferred.”)

9. Contingent consideration — remeasurement

- Initial fair value = R280
- Year-end fair value = R330

➤ Increase = $330 - 280 = \text{R50}$ (Recognised in profit or loss.)

10. NCI — proportionate share method

- Net identifiable assets = R2,000
- NCI = 40%

➤ NCI = $40\% \times 2,000 = \text{R800}$

11. NCI — fair value method

NCI fair value = R950

Required: Amount recognised as NCI.

Answer: R950 (“NCI measured at fair value or proportionate share.”)

12. Reacquired rights — amortisation

- Fair value of reacquired right = R300
- Remaining contractual period = 3 years

Annual amortisation = $300 \div 3 = \text{R100}$ (From Par. 15.1: “Amortise over remaining contractual period.”)

13. Lease recognition — lessee

Acquiree has a lease with:

- Remaining lease payments (PV) = R700
- Right-of-use asset fair value = R680

Recognise:

- ROU asset = R680
- Lease liability = R700

(“Recognise right-of-use assets and lease liabilities as if new lease.”)

14. Indemnification asset

Liability recognised for litigation = R500. Seller indemnifies 100%

- Indemnification asset = **R500** (“Recognise indemnification asset on same basis as related liability.”)

15. Measurement period adjustment

Provisional net identifiable assets = R1,900. New information shows correct amount = R2,000

- Increase = R100
- Goodwill decreases by R100.

(“Adjust provisional amounts retrospectively... adjust goodwill accordingly.”)

16. Reverse acquisition — identify acquirer

Legal parent issues shares; legal subsidiary’s shareholders obtain 80% of voting rights.

- Accounting acquirer = **legal subsidiary**

(“Legal subsidiary is the accounting acquirer.”)

17. Asset vs business — concentration test

Gross assets acquired = R5,000. Single identifiable asset = R4,900.

- Concentration = $4,900 \div 5,000 = 98\%$
- Result: **Not a business** (From Par. 3.1: “The 2018 amendments ... If substantially all fair value is concentrated in a single asset... not a business.”)

18. Goodwill allocation to CGU

- Goodwill = R600
- CGU assets = R2,400
- CGU liabilities = R300
- CGU carrying amount = $2,400 - 300 + 600 = \mathbf{R2,700}$ (Used for IAS 36 impairment testing.)

19. Bargain purchase — reassessment

- Net identifiable assets = R3,000
- Consideration + NCI + previously held interest = R2,600
- Difference = R400
- After reassessment, gain = **R400**

(“Any remaining excess is recognised immediately in profit or loss.”)

20. Full goodwill vs partial goodwill — difference

- Net identifiable assets = R1,500
- NCI = 30%
- Fair value of NCI = R550
- Proportionate share NCI = $30\% \times 1,500 = \mathbf{R450}$
- Difference = $550 - 450 = \mathbf{R100}$

This difference increases goodwill under the full goodwill method.

21. Comprehensive Question Bank (30 Questions + Full Solutions)

1. Define a business under IFRS 3 and explain the concentration test.

Solution: A business is an integrated set of activities and assets capable of being conducted and managed to provide returns to investors or owners. It includes **inputs**, **processes**, and **outputs**. (Par. 3.1)

The **2018 concentration test** states that if substantially all of the fair value of gross assets acquired is concentrated in a single identifiable asset or group of similar assets, the set is **not a business**. (From Par. 3.1: “The 2018 amendments introduced a concentration test...”)

2. Distinguish between a business combination and an asset acquisition. Provide an example.

Solution: A business combination involves acquiring a business (inputs + processes). An asset acquisition involves acquiring assets without processes.

Example: Buying a hotel with staff and systems = business; buying a single investment property with no processes = asset acquisition.

3. List the four steps of the acquisition method.

Solution:

1. Identify the acquirer
2. Determine the acquisition date
3. Recognise and measure identifiable assets and liabilities and NCI
4. Recognise and measure goodwill or bargain purchase gain (From Par. 4.1: "Four steps of the acquisition method...")

4. Identify the acquirer in a reverse acquisition and explain why.

Solution: In a reverse acquisition, the **legal subsidiary** is the accounting acquirer because its shareholders obtain control of the combined entity. ("The legal subsidiary is the accounting acquirer.")

5. Determine the acquisition date and explain why it matters.

Solution: The acquisition date is when the acquirer obtains control. It determines the fair value measurement date for assets, liabilities, and NCI. (From Par. 6: "This date is critical because it is the measurement date for fair values...")

6. Calculate net identifiable assets.

Assets = R2,400; Liabilities = R700

Solution: Net identifiable assets = 2,400 – 700 = **R1,700**.

7. Calculate goodwill (full goodwill method).

- Consideration = R1,800
- NCI fair value = R500
- Net identifiable assets = R2,000

Solution: Goodwill = 1,800 + 500 – 2,000 = **R300**.

8. Calculate goodwill (partial goodwill method).

- Consideration = R1,800
 - Net identifiable assets = R2,000
 - NCI = 25%
- $\text{NCI} = 25\% \times 2,000 = 500$
- $\text{Goodwill} = 1,800 + 500 - 2,000 = \text{R300}$ (Here both methods coincidentally gave the same result.)

9. Calculate a bargain purchase gain.

- Consideration = R1,000
- NCI = R200
- Net identifiable assets = R1,400

Solution: $\text{Gain} = 1,400 - (1,000 + 200) = \text{R200}$, recognised in profit or loss. ("Any remaining excess is recognised immediately in profit or loss.")

10. Explain how intangible assets are recognised separately from goodwill.

Solution: Intangible assets are recognised if they are separable or arise from contractual/legal rights. Examples: brands, customer relationships, technology. ("Brands, customer relationships and technology are recognised as separate intangible assets...")

11. Explain why contingent assets are not recognised at acquisition.

Solution: Contingent assets do not meet recognition criteria because inflows are not sufficiently probable.

12. Calculate contingent consideration remeasurement.

Initial fair value = R300. Year-end fair value = R360.

Solution: $\text{Increase} = 360 - 300 = \text{R60}$, recognised in profit or loss.

13. Explain how leases are recognised when the acquiree is a lessee.

Solution: The acquirer recognises right-of-use assets and lease liabilities as if the lease were a new lease at acquisition date. (Par. 7.4)

14. Explain why deferred tax assets and liabilities are not measured at fair value.

Solution: They are measured under IAS 12, not IFRS 3 fair value rules. (From Par. 7.5: “Deferred tax assets and liabilities — IAS 12.”)

15. Calculate NCI using proportionate share method.

Net identifiable assets = R1,600. NCI = 30%.

Solution: $\text{NCI} = 30\% \times 1,600 = \text{R480}$.

16. Calculate NCI using fair value method.

NCI fair value = R520.

Solution: NCI = R520.

17. Explain the treatment of acquisition-related costs.

Solution: They are expensed in profit or loss and not included in consideration. (From Par. 13.2: “Acquisition-related costs... are expensed in profit or loss.”)

18. Explain how previously held interests are treated in step acquisitions.

Solution: They are remeasured at fair value, with gains or losses recognised in profit or loss. (From Par. 11.1: “Remeasure previously held interest at fair value.”)

19. Calculate remeasurement gain in a step acquisition.

Carrying amount = R700. Fair value = R820.

Solution: $\text{Gain} = 820 - 700 = \text{R120}$.

20. Explain the measurement period and its purpose.

Solution: The measurement period (max 1 year) allows adjustments to provisional amounts based on new information about conditions at acquisition date. (From Par. 12.1 & 12.2: “Maximum length: one year... adjust provisional amounts retrospectively.”)

21. Calculate measurement period adjustment to goodwill.

- Provisional net assets = R1,900
- Correct amount = R2,000

- Goodwill originally = R300

Solution: Increase in net assets = R100. Goodwill decreases by R100 to **R200**.

22. Explain what constitutes a separate transaction.

Solution: Separate transactions include settlement of pre-existing relationships, remuneration for future services, and replacement of share-based payments. ("Settlement of pre-existing relationships... are not part of the business combination.")

23. Explain subsequent measurement of contingent liabilities.

Solution: Measured at the higher of:

- IAS 37 amount
 - Initial amount less cumulative amortisation
- (From Par. 4.3: "Measured at the higher of...")

24. Explain goodwill impairment testing.

Solution: Goodwill is allocated to CGUs and tested annually. Impairment = carrying amount > recoverable amount. Losses are not reversed. ("Goodwill is... tested annually... impairment losses are not reversed.")

25. Calculate CGU carrying amount including goodwill.

- CGU assets = R3,000
- CGU liabilities = R500
- Goodwill = R400

Solution: Carrying amount = 3,000 – 500 + 400 = **R2,900**.

26. Explain reacquired rights and their amortisation.

Solution: Reacquired rights are recognised as intangible assets and amortised over the remaining contractual period. (From Par. 15.1: "Amortise over the remaining contractual period.")

27. Explain business combinations achieved without transferring consideration.

Solution: Control may be obtained through contractual changes or lapse of rights. Assets, liabilities, and NCI are recognised at fair value; goodwill is based on fair value of acquiree and NCI. (From Par. 15.2: "Control may be obtained without transferring consideration...")

28. Explain why common control transactions fall outside IFRS 3.

Solution: They do not represent acquisitions by an unrelated party; instead, they are group reorganisations. IAS 8 is used to develop policy. (“Business combinations under common control are outside IFRS 3.”)

29. Provide three key disclosure requirements under IFRS 3.

Solution: Examples:

- Acquisition date
- Primary reasons for the business combination
- Recognised amounts of assets and liabilities
- Goodwill and factors contributing to it
- *Pro forma* revenue and profit (From: “Key disclosure areas...”)

30. Full goodwill vs partial goodwill — explain the difference.

Solution:

- Full goodwill: NCI measured at fair value → higher goodwill.
- Partial goodwill: NCI measured at proportionate share → lower goodwill.

(“Choice affects the amount of goodwill recognised.”)

Integrated Exam — IFRS 3 + IFRS 10 + IAS 36

Combined business combinations, control, consolidation and goodwill impairment

Part A — Big Case 1 (IFRS 3 + IFRS 10)

Question 1

On 1 July 20X5, Parent P acquires 80% of Subsidiary S.

- Consideration (cash): R2,400
- Fair value of NCI (20%): R600
- Fair value of identifiable assets of S: R3,000
- Fair value of liabilities of S: R800

Required:

- (a) Determine net identifiable assets.
- (b) Calculate goodwill.

(c) Show the key acquisition-date journal entries in P's consolidated records.

Solution 1

(a) Net identifiable assets = 3,000 – 800 = **R2,200**

(b) Goodwill = Consideration + NCI – Net identifiable assets = 2,400 + 600 – 2,200 = **R800**

(c) Key journal entries:

- Recognise assets and liabilities at fair value:

➤ Dr Identifiable assets (S)	3,000	
➤ Cr Liabilities (S)		800

- Recognise NCI:

➤ Cr NCI	600
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- Record consideration paid:

➤ Cr Bank	2,400
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- Recognise goodwill (balancing figure):

➤ Dr Goodwill	800
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Question 2

Explain how IFRS 10's definition of control justifies P consolidating S in Question 1.

Solution 2

Under IFRS 10, control exists when an investor has:

- Power over the investee (relevant activities)
- Exposure or rights to variable returns
- Ability to use power to affect returns

P holds 80% of voting rights in S, giving power over relevant activities and exposure to returns. P can use its power to affect those returns. Therefore, P controls S and must consolidate S.

Question 3

Assume that before 1 July 20X5, P held 25% of S as an associate (equity-accounted). Carrying amount of the 25% interest: R500. Fair value of that 25% interest at acquisition date: R650.

Required:

- (a) Calculate the remeasurement gain.
- (b) Explain how it is recognised.
- (c) State how this affects goodwill calculation.

Solution 3

- (a) Remeasurement gain = Fair value – Carrying amount = 650 – 500 = **R150**
- (b) The gain is recognised in **profit or loss** at the acquisition date (step acquisition).
- (c) Effect on goodwill: In the goodwill formula, the fair value of previously held interest (R650) is included as part of “deemed consideration”:
Goodwill = Consideration for new shares + FV of previously held interest + NCI – Net identifiable assets.

Part B — Big Case 2 (IFRS 3 + IAS 36)

Question 4

Using Question 1, assume the goodwill of R800 is allocated to a single CGU that includes S.

At 30 June 20X6:

- Carrying amount of CGU assets (excluding goodwill): R2,500
- Carrying amount of CGU liabilities: R400
- Goodwill: R800
- Recoverable amount of CGU: R2,600

Required:

- (a) Determine the CGU’s carrying amount including goodwill.
- (b) Calculate the impairment loss (if any).
- (c) Allocate the impairment loss.

Solution 4

- (a) CGU carrying amount = Assets – Liabilities + Goodwill = 2,500 – 400 + 800 = **R2,900**
- (b) Impairment loss = Carrying amount – Recoverable amount = 2,900 – 2,600 = **R300**
- (c) Allocation: Under IAS 36, impairment is first allocated to goodwill. Goodwill (R800) is reduced by R300 → new goodwill = **R500**. No further allocation needed if impairment is fully absorbed by goodwill.

Question 5

Explain why impairment losses on goodwill are not reversed under IAS 36.

Solution 5

IAS 36 prohibits reversal of goodwill impairment because subsequent increases in recoverable amount are likely to reflect internally generated goodwill, which cannot be recognised. Therefore, once goodwill is impaired, the loss is permanent.

Question 6

Assume instead that:

- CGU carrying amount (including goodwill) = R2,900
- Recoverable amount = R2,300

Required:

- (a) Impairment loss.
- (b) New goodwill balance if goodwill was R800.
- (c) Briefly explain how this affects future depreciation/amortisation of other assets.

Solution 6

(a) Impairment loss = $2,900 - 2,300 = \text{R}600$

(b) Allocation: First to goodwill: $\text{R}800 - \text{R}600 = \text{R}200$ remaining goodwill.

(c) Effect on other assets *If* impairment exceeds goodwill: the excess is allocated to other assets pro rata. Their carrying amounts decrease, reducing future depreciation/amortisation charges.

Part C — Control, NCI and Changes in Ownership (IFRS 10 + IFRS 3)

Question 7

P initially acquires 60% of S. NCI is measured at fair value. Later, P buys an additional 20% from NCI, increasing its interest to 80%. Control existed from the initial acquisition.

Required: Explain how the subsequent purchase of 20% is accounted for under IFRS 10 and IFRS 3.

Solution 7

Once control exists, changes in ownership interests that do not result in loss of control are treated as **equity transactions**:

- No new goodwill is recognised.
- Difference between consideration paid and adjustment to NCI is recognised directly in equity.
- Assets and liabilities of S are not remeasured.

IFRS 3 applies only at the date control is first obtained; IFRS 10 governs subsequent changes in ownership.

Question 8

Assume:

- Carrying amount of NCI (40%) = R800
- P buys 20% (half of NCI) for R500

Required: Show the equity transaction.

Solution 8

- NCI reduction = 40% → 20% Carrying amount of NCI reduced = $800 \times (20/40) = \mathbf{R400}$
- Difference between consideration and NCI reduction = $500 - 400 = \mathbf{R100}$

Journal entry:

- | | | |
|---------------------------------|-----|-----|
| ➤ Dr NCI | 400 | |
| ➤ Dr Equity (parent's reserves) | 100 | |
| ➤ Cr Bank | | 500 |

No goodwill, no P&L impact.

Part D — Business vs Asset, Separate Transactions (IFRS 3 + IFRS 10)

Question 9

Entity A acquires a single office building with no employees, no processes, and no leases in place. Explain why this is likely an asset acquisition, not a business combination.

Solution 9

A business requires inputs and processes capable of producing outputs. A single building with no processes and no organised activities fails the definition of a business. The concentration test may also show substantially all fair value in one asset. Therefore, IFRS 3 does not apply; it is an asset acquisition.

Question 10

In a business combination, A and B had a pre-existing lawsuit. As part of the deal, the lawsuit is settled. Explain why this settlement is a separate transaction and how it is accounted for.

Solution 10

Settlement of a pre-existing relationship is not part of the business combination; it is a separate transaction. The settlement is accounted for under relevant standards (e.g. IAS 37), with any gain or loss recognised in profit or loss, not in goodwill or consideration.

Part E — Measurement Period and Adjustments (IFRS 3 + IAS 36 [link](#))

Question 11

At acquisition, P recognises provisional fair values for S's assets and liabilities. Net identifiable assets are provisionally R2,000. Within the measurement period, new information shows the correct fair value is R2,100. Goodwill initially recognised was R500.

Required:

- (a) Adjusted goodwill.
- (b) Explain how comparative figures are treated.

Solution 11

(a) Increase in net assets = $2,100 - 2,000 = R100$ Goodwill decreases by R100 → new goodwill = $500 - 100 = \mathbf{R400}$

(b) Comparative figures are restated as if the new information had been known at acquisition date. The adjustment is retrospective within the measurement period.

Question 12

After the measurement period, P discovers further changes in fair value due to events after acquisition date. Explain how these are treated.

Solution 12

Changes relating to events that occurred after the measurement period are not measurement period adjustments. They are recognised in profit or loss or OCI under relevant standards (e.g. IFRS 9, IAS 16), not as adjustments to goodwill, unless they are error corrections under IAS 8.

Part F — Integrated Scenario (IFRS 3 + IFRS 10 + IAS 36)

Question 13

On 1 January 20X5, P acquires 75% of S.

- Consideration: R3,000
- NCI (25%) at fair value: R900
- Fair value of S's identifiable assets: R4,000
- Fair value of S's liabilities: R1,200

At 31 December 20X5:

- CGU (including S) assets (excluding goodwill): R3,500
- CGU liabilities: R1,000
- Goodwill (from acquisition): as calculated at acquisition
- Recoverable amount of CGU: R3,000

Required:

- Calculate net identifiable assets at acquisition.
- Calculate goodwill.
- Determine CGU carrying amount at year-end.
- Calculate impairment loss (if any) and allocate it.

Solution 13

(a) Net identifiable assets at acquisition = $4,000 - 1,200 = \mathbf{R2,800}$

(b) Goodwill = Consideration + NCI – Net identifiable assets = $3,000 + 900 - 2,800 = \mathbf{R1,100}$

(c) CGU carrying amount at 31 Dec 20X5 = Assets – Liabilities + Goodwill = $3,500 - 1,000 + 1,100 = \mathbf{R3,600}$

(d) Impairment Loss = $3,600 - 3,000 = \mathbf{R600}$

Allocate first to goodwill: Goodwill $1,100 - 600 = \mathbf{R500}$ remaining goodwill. No further allocation needed if impairment fully absorbed by goodwill.

Question 14

Explain how control is assessed in Question 13 and why P consolidates S.

Solution 14

P holds 75% of voting rights in S, giving power over relevant activities, exposure to variable returns, and ability to affect those returns. Under IFRS 10, P has control and must consolidate S.

Question 15

Assume that in Question 13, P had previously held 20% of S as an associate with carrying amount R400 and fair value R600 at acquisition date.

Required:

- (a) Remeasurement gain/loss.
- (b) Briefly show how goodwill formula changes.

Solution 15

(a) **Gain** = $600 - 400 = \text{R}200$, recognised in profit or loss.

(b) Goodwill formula becomes: $\text{Goodwill} = \text{Consideration for new shares} + \text{FV of previously held interest} + \text{NCI} - \text{Net identifiable assets} = 3,000 + 600 + 900 - 2,800 = \text{R}1,700$ (before any measurement period adjustments).

Part G — Short Integrated Questions (Concepts)

Question 16

Explain why acquisition-related costs are expensed and not included in goodwill.

Solution 16

Acquisition-related costs do not represent consideration paid for the acquiree; they are service costs. IFRS 3 requires them to be expensed in profit or loss to avoid overstating goodwill and assets.

Question 17

Give two examples of intangible assets that must be recognised separately from goodwill in a business combination.

Solution 17

Examples:

- Brand names

- Customer relationships
- Proprietary technology
- Licences

They are recognised at fair value if identifiable (separable or arising from contractual/legal rights).

Question 18

Explain how contingent consideration classified as equity is treated after acquisition.

Solution 18

Contingent consideration classified as equity is **not remeasured** after acquisition. Settlement is accounted for within equity; no subsequent profit or loss impact.

Question 19

Explain how contingent consideration classified as a financial liability is treated after acquisition.

Solution 19

It is remeasured at fair value at each reporting date, with changes recognised in profit or loss (unless measured at amortised cost under IFRS 9).

Question 20

Explain the link between IFRS 3 goodwill and IAS 36 impairment testing in consolidated financial statements.

Solution 20

Goodwill arising from IFRS 3 is recognised in the consolidated statement of financial position and allocated to CGUs under IAS 36. It is tested annually for impairment, ensuring that the value attributed to synergies and future benefits is recoverable.
