
**SINGAPORE FINANCIAL REPORTING STANDARDS
(INTERNATIONAL)**

**SFRS(I) 3
Business Combinations**

Illustrative Examples

This Guidance is applicable for annual reporting period beginning on
1 January 2024.

CONTENTS

*from paragraph***SFRS(I) 3 BUSINESS COMBINATIONS
ILLUSTRATIVE EXAMPLES**

REVERSE ACQUISITIONS	IE1
Calculating the fair value of the consideration transferred	IE4
Measuring goodwill	IE6
Consolidated statement of financial position at 30 September 20X6	IE7
Earnings per share	IE9
Non-controlling interest	IE11
IDENTIFIABLE INTANGIBLE ASSETS	IE16
Marketing-related intangible assets	IE18
Customer-related intangible assets	IE23
Artistic-related intangible assets	IE32
Contract-based intangible assets	IE34
Technology-based intangible assets	IE39
MEASUREMENT OF NON-CONTROLLING INTEREST (NCI)	IE44A
Measurement of NCI including preference shares	IE44B
First variation	IE44F
Second variation	IE44H
GAIN ON A BARGAIN PURCHASE	IE45
MEASUREMENT PERIOD	IE50
DETERMINING WHAT IS PART OF THE BUSINESS COMBINATION TRANSACTION	IE54
Settlement of a pre-existing relationship	IE54
Contingent payments to employees	IE58
Replacement awards	IE61
DISCLOSURE REQUIREMENTS	IE72
DEFINITION OF A BUSINESS	IE73
Example A—acquisition of real estate	IE74
Example B—acquisition of a drug candidate	IE87
Example C—acquisition of a biotech entity	IE93

Example D–acquisition of a television station	IE98
Example E–acquisition of a closed manufacturing facility	IE101
Example F–licence of distribution rights	IE104
Example G–acquisition of brands	IE107
Example H–acquisition of loan portfolio	IE110
Example I–determining the fair value of the gross assets acquired	IE118
APPENDIX	
Amendments to guidance on other SFRS(I)s	

SFRS(I) 3 *Business Combinations* Illustrative examples

These examples accompany, but are not part of, SFRS(I) 3.

Reverse acquisitions

Illustrating the consequences of recognising a reverse acquisition by applying paragraphs B19–B27 of SFRS(I) 3.

IE1 This example illustrates the accounting for a reverse acquisition in which Entity B, the legal subsidiary, acquires Entity A, the entity issuing equity instruments and therefore the legal parent, in a reverse acquisition on 30 September 20X6. This example ignores the accounting for any income tax effects.

IE2 The statements of financial position of Entity A and Entity B immediately before the business combination are:

	Entity A (legal parent, accounting acquiree) CU^(a)	Entity B (legal subsidiary, accounting acquirer) CU
Current assets	500	700
Non-current assets	<u>1,300</u>	<u>3,000</u>
Total assets	<u><u>1,800</u></u>	<u><u>3,700</u></u>
Current liabilities	300	600
Non-current liabilities	<u>400</u>	<u>1,100</u>
Total liabilities	<u><u>700</u></u>	<u><u>1,700</u></u>
Shareholders' equity		
Retained earnings	800	1,400
Issued equity		
100 ordinary shares	300	
60 ordinary shares		<u>600</u>
Total shareholders' equity	<u><u>1,100</u></u>	<u><u>2,000</u></u>
Total liabilities and shareholders' equity	<u><u>1,800</u></u>	<u><u>3,700</u></u>

(a) In these examples monetary amounts are denominated in 'currency units (CU)'.

IE3 This example also uses the following information:

(a) On 30 September 20X6 Entity A issues 2.5 shares in exchange for each ordinary share of Entity B. All of Entity B's shareholders exchange their shares in Entity B. Therefore, Entity A issues 150 ordinary shares in exchange for all 60 ordinary shares of Entity B.

- (b) The fair value of each ordinary share of Entity B at 30 September 20X6 is CU40. The quoted market price of Entity A's ordinary shares at that date is CU16.
- (c) The fair values of Entity A's identifiable assets and liabilities at 30 September 20X6 are the same as their carrying amounts, except that the fair value of Entity A's non-current assets at 30 September 20X6 is CU1,500.

Calculating the fair value of the consideration transferred

- IE4 As a result of Entity A (legal parent, accounting acquiree) issuing 150 ordinary shares, Entity B's shareholders own 60 per cent of the issued shares of the combined entity (ie 150 of 250 issued shares). The remaining 40 per cent are owned by Entity A's shareholders. If the business combination had taken the form of Entity B issuing additional ordinary shares to Entity A's shareholders in exchange for their ordinary shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholders would then own 60 of the 100 issued shares of Entity B—60 per cent of the combined entity. As a result, the fair value of the consideration effectively transferred by Entity B and the group's interest in Entity A is CU1,600 (40 shares with a fair value per share of CU40).
- IE5 The fair value of the consideration effectively transferred should be based on the most reliable measure. In this example, the quoted price of Entity A's shares in the principal (or most advantageous) market for the shares provides a more reliable basis for measuring the consideration effectively transferred than the fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's shares—100 shares with a fair value per share of CU16.

Measuring goodwill

- IE6 Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in Entity A) over the net amount of Entity A's recognised identifiable assets and liabilities, as follows:

	CU	CU
Consideration effectively transferred		1,600
Net recognised values of Entity A's identifiable assets and liabilities		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	(400)	(1,300)
Goodwill		<u>300</u>

Consolidated statement of financial position at 30 September 20X6

- IE7 The consolidated statement of financial position immediately after the business combination is:

	CU
Current assets [CU700 + CU500]	1,200
Non-current assets [CU3,000 + CU1,500]	4,500
Goodwill	<u>300</u>
Total assets	<u>6,000</u>

	CU
Current liabilities [CU600 + CU300]	900
Non-current liabilities [CU1,100 + CU400]	<u>1,500</u>
Total liabilities	<u>2,400</u>
Shareholders' equity	
Retained earnings	1,400
Issued equity	
250 ordinary shares [CU600 + CU1,600]	<u>2,200</u>
Total shareholders' equity	<u>3,600</u>
Total liabilities and shareholders' equity	<u>6,000</u>

- IE8 The amount recognised as issued equity interests in the consolidated financial statements (CU2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination (CU600) and the fair value of the consideration effectively transferred (CU1,600). However, the equity structure appearing in the consolidated financial statements (ie the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to effect the combination.

Earnings per share

- IE9 Assume that Entity B's earnings for the annual period ended 31 December 20X5 were CU600 and that the consolidated earnings for the annual period ended 31 December 20X6 were CU800. Assume also that there was no change in the number of ordinary shares issued by Entity B during the annual period ended 31 December 20X5 and during the period from 1 January 20X6 to the date of the reverse acquisition on 30 September 20X6. Earnings per share for the annual period ended 31 December 20X6 is calculated as follows:

Number of shares deemed to be outstanding for the period from 1 January 20X6 to the acquisition date (ie the number of ordinary shares issued by Entity A (legal parent, accounting acquiree) in the reverse acquisition)	150
Number of shares outstanding from the acquisition date to 31 December 20X6	<u>250</u>
Weighted average number of ordinary shares outstanding [(150 x 9/12) + (250 x 3/12)]	<u>175</u>
Earnings per share [800/175]	<u>CU4.57</u>

- IE10 Restated earnings per share for the annual period ended 31 December 20X5 is CU4.00 (calculated as the earnings of Entity B of 600 divided by the number of ordinary shares Entity A issued in the reverse acquisition (150)).

Non-controlling interest

- IE11 Assume the same facts as above, except that only 56 of Entity B's 60 ordinary shares are exchanged. Because Entity A issues 2.5 shares in exchange for each ordinary share of Entity B, Entity A issues only 140 (rather than 150) shares. As a result, Entity B's shareholders own 58.3 per cent of the issued shares of the combined entity (140 of 240 issued shares). The fair value of the consideration transferred for Entity A, the accounting acquiree, is calculated by assuming that the combination had been effected by Entity B issuing additional ordinary shares to the shareholders of Entity A in exchange for their ordinary shares in Entity A. That is because Entity B is the accounting acquirer, and

paragraph B20 of SFRS(I) 3 requires the acquirer to measure the consideration exchanged for the accounting acquiree.

IE12 In calculating the number of shares that Entity B would have had to issue, the non-controlling interest is excluded from the calculation. The majority shareholders own 56 shares of Entity B. For that to represent a 58.3 per cent equity interest, Entity B would have had to issue an additional 40 shares. The majority shareholders would then own 56 of the 96 issued shares of Entity B and, therefore, 58.3 per cent of the combined entity. As a result, the fair value of the consideration transferred for Entity A, the accounting acquiree, is CU1,600 (ie 40 shares, each with a fair value of CU40). That is the same amount as when all 60 of Entity B's shareholders tender all 60 of its ordinary shares for exchange. The recognised amount of the group's interest in Entity A, the accounting acquiree, does not change if some of Entity B's shareholders do not participate in the exchange.

IE13 The non-controlling interest is represented by the four shares of the total 60 shares of Entity B that are not exchanged for shares of Entity A. Therefore, the non-controlling interest is 6.7 per cent. The non-controlling interest reflects the proportionate interest of the non-controlling shareholders in the pre-combination carrying amounts of the net assets of Entity B, the legal subsidiary. Therefore, the consolidated statement of financial position is adjusted to show a non-controlling interest of 6.7 per cent of the pre-combination carrying amounts of Entity B's net assets (ie CU134 or 6.7 per cent of CU2,000).

IE14 The consolidated statement of financial position at 30 September 20X6, reflecting the non-controlling interest, is as follows:

	CU
Current assets [CU700 + CU500]	1,200
Non-current assets [CU3,000 + CU1,500]	4,500
Goodwill	<u>300</u>
Total assets	<u><u>6,000</u></u>
Current liabilities [CU600 + CU300]	900
Non-current liabilities [CU1,100 + CU400]	<u>1,500</u>
Total liabilities	<u>2,400</u>
Shareholders' equity	
Retained earnings [CU1,400 × 93.3 per cent]	1,306
Issued equity	
240 ordinary shares [CU560 + CU1,600]	2,160
Non-controlling interest	<u>134</u>
Total shareholders' equity	<u>3,600</u>
Total liabilities and shareholders' equity	<u><u>6,000</u></u>

IE15 The non-controlling interest of CU134 has two components. The first component is the reclassification of the non-controlling interest's share of the accounting acquirer's retained earnings immediately before the acquisition (CU1,400 × 6.7 per cent or CU93.80). The second component represents the reclassification of the non-controlling interest's share of the accounting acquirer's issued equity (CU600 × 6.7 per cent or CU40.20).

Identifiable intangible assets

Illustrating the consequences of applying paragraphs 10–14 and B31–B40 of SFRS(I) 3.

- IE16 The following are examples of identifiable intangible assets acquired in a business combination. Some of the examples may have characteristics of assets other than intangible assets. The acquirer should account for those assets in accordance with their substance. The examples are not intended to be all-inclusive.
- IE17 Intangible assets identified as having a contractual basis are those that arise from contractual or other legal rights. Those designated as having a non-contractual basis do not arise from contractual or other legal rights but are separable. Intangible assets identified as having a contractual basis might also be separable but separability is not a necessary condition for an asset to meet the contractual-legal criterion.

Marketing-related intangible assets

- IE18 Marketing-related intangible assets are used primarily in the marketing or promotion of products or services. Examples of marketing-related intangible assets are:

Class	Basis
Trademarks, trade names, service marks, collective marks and certification marks	Contractual
Trade dress (unique colour, shape or package design)	Contractual
Newspaper mastheads	Contractual
Internet domain names	Contractual
Non-competition agreements	Contractual

Trademarks, trade names, service marks, collective marks and certification marks

- IE19 Trademarks are words, names, symbols or other devices used in trade to indicate the source of a product and to distinguish it from the products of others. A service mark identifies and distinguishes the source of a service rather than a product. Collective marks identify the goods or services of members of a group. Certification marks certify the geographical origin or other characteristics of a good or service.
- IE20 Trademarks, trade names, service marks, collective marks and certification marks may be protected legally through registration with governmental agencies, continuous use in commerce or by other means. If it is protected legally through registration or other means, a trademark or other mark acquired in a business combination is an intangible asset that meets the contractual-legal criterion. Otherwise, a trademark or other mark acquired in a business combination can be recognised separately from goodwill if the separability criterion is met, which normally it would be.
- IE21 The terms *brand* and *brand name*, often used as synonyms for trademarks and other marks, are general marketing terms that typically refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise. SFRS(I) 3 does not preclude an entity from recognising, as a single asset separately from goodwill, a group of complementary intangible assets commonly referred to as a brand if the assets that make up that group have similar useful lives.

Internet domain names

- IE22 An Internet domain name is a unique alphanumeric name that is used to identify a particular numeric Internet address. Registration of a domain name creates an association between that name and a designated computer on the Internet for the period of the registration. Those registrations are renewable. A registered domain name acquired in a business combination meets the contractual-legal criterion.

Customer-related intangible assets

- IE23 Examples of customer-related intangible assets are:

Class	Basis
Customer lists	Non-contractual
Order or production backlog	Contractual
Customer contracts and related customer relationships	Contractual
Non-contractual customer relationships	Non-contractual

Customer lists

- IE24 A customer list consists of information about customers, such as their names and contact information. A customer list also may be in the form of a database that includes other information about the customers, such as their order histories and demographic information. A customer list does not usually arise from contractual or other legal rights. However, customer lists are often leased or exchanged. Therefore, a customer list acquired in a business combination normally meets the separability criterion.

Order or production backlog

- IE25 An order or production backlog arises from contracts such as purchase or sales orders. An order or production backlog acquired in a business combination meets the contractual-legal criterion even if the purchase or sales orders can be cancelled.

Customer contracts and the related customer relationships

- IE26 If an entity establishes relationships with its customers through contracts, those customer relationships arise from contractual rights. Therefore, customer contracts and the related customer relationships acquired in a business combination meet the contractual-legal criterion, even if confidentiality or other contractual terms prohibit the sale or transfer of a contract separately from the acquiree.
- IE27 A customer contract and the related customer relationship may represent two distinct intangible assets. Both the useful lives and the pattern in which the economic benefits of the two assets are consumed may differ.
- IE28 A customer relationship exists between an entity and its customer if (a) the entity has information about the customer and has regular contact with the customer and (b) the customer has the ability to make direct contact with the entity. Customer relationships meet the contractual-legal criterion if an entity has a practice of establishing contracts with its customers, regardless of whether a contract exists at the acquisition date. Customer relationships may also arise through means other than contracts, such as through regular contact by sales or service representatives.

- IE29 As noted in paragraph IE25, an order or a production backlog arises from contracts such as purchase or sales orders and is therefore considered a contractual right. Consequently, if an entity has relationships with its customers through these types of contracts, the customer relationships also arise from contractual rights and therefore meet the contractual-legal criterion.

Examples

- IE30 The following examples illustrate the recognition of customer contract and customer relationship intangible assets acquired in a business combination.

- (a) Acquirer Company (AC) acquires Target Company (TC) in a business combination on 31 December 20X5. TC has a five-year agreement to supply goods to Customer. Both TC and AC believe that Customer will renew the agreement at the end of the current contract. The agreement is not separable.

The agreement, whether cancellable or not, meets the contractual-legal criterion. Additionally, because TC establishes its relationship with Customer through a contract, not only the agreement itself but also TC's customer relationship with Customer meet the contractual-legal criterion.

- (b) AC acquires TC in a business combination on 31 December 20X5. TC manufactures goods in two distinct lines of business: sporting goods and electronics. Customer purchases both sporting goods and electronics from TC. TC has a contract with Customer to be its exclusive provider of sporting goods but has no contract for the supply of electronics to Customer. Both TC and AC believe that only one overall customer relationship exists between TC and Customer.

The contract to be Customer's exclusive supplier of sporting goods, whether cancellable or not, meets the contractual-legal criterion. Additionally, because TC establishes its relationship with Customer through a contract, the customer relationship with Customer meets the contractual-legal criterion. Because TC has only one customer relationship with Customer, the fair value of that relationship incorporates assumptions about TC's relationship with Customer related to both sporting goods and electronics. However, if AC determines that the customer relationships with Customer for sporting goods and for electronics are separate from each other, AC would assess whether the customer relationship for electronics meets the separability criterion for identification as an intangible asset.

- (c) AC acquires TC in a business combination on 31 December 20X5. TC does business with its customers solely through purchase and sales orders. At 31 December 20X5, TC has a backlog of customer purchase orders from 60 per cent of its customers, all of whom are recurring customers. The other 40 per cent of TC's customers are also recurring customers. However, as of 31 December 20X5, TC has no open purchase orders or other contracts with those customers.

Regardless of whether they are cancellable or not, the purchase orders from 60 per cent of TC's customers meet the contractual-legal criterion. Additionally, because TC has established its relationship with 60 per cent of its customers through contracts, not only the purchase orders but also TC's customer relationships meet the contractual-legal criterion. Because TC has a practice of establishing contracts with the remaining 40 per cent of its customers, its relationship with those customers also arises through contractual rights and therefore meets the contractual-legal criterion even though TC does not have contracts with those customers at 31 December 20X5.

- (d) AC acquires TC, an insurer, in a business combination on 31 December 20X5. TC has a portfolio of one-year motor insurance contracts that are cancellable by policyholders.

Because TC establishes its relationships with policyholders through insurance contracts, the customer relationship with policyholders meets the contractual-legal criterion. SFRS(I) 1-36 *Impairment of Assets* and SFRS(I) 1-38 *Intangible Assets* apply to the customer relationship intangible asset.

Non-contractual customer relationships

- IE31 A customer relationship acquired in a business combination that does not arise from a contract may nevertheless be identifiable because the relationship is separable. Exchange transactions for the same asset or a similar asset that indicate that other entities have sold or otherwise transferred a particular type of non-contractual customer relationship would provide evidence that the relationship is separable.

Artistic-related intangible assets

- IE32 Examples of artistic-related intangible assets are:

Class	Basis
Plays, operas and ballets	Contractual
Books, magazines, newspapers and other literary works	Contractual
Musical works such as compositions, song lyrics and advertising jingles	Contractual
Pictures and photographs	Contractual
Video and audiovisual material, including motion pictures or films, music videos and television programmes	Contractual

- IE33 Artistic-related assets acquired in a business combination are identifiable if they arise from contractual or legal rights such as those provided by copyright. The holder can transfer a copyright, either in whole through an assignment or in part through a licensing agreement. An acquirer is not precluded from recognising a copyright intangible asset and any related assignments or licence agreements as a single asset, provided they have similar useful lives.

Contract-based intangible assets

- IE34 Contract-based intangible assets represent the value of rights that arise from contractual arrangements. Customer contracts are one type of contract-based intangible asset. If the terms of a contract give rise to a liability (for example, if the terms of a customer contract are unfavourable relative to market terms), the acquirer recognises it as a liability assumed in the business combination. Examples of contract-based intangible assets are:

Class	Basis
Licensing, royalty and standstill agreements	Contractual
Advertising, construction, management, service or supply contracts	Contractual
Construction permits	Contractual
Franchise agreements	Contractual
Operating and broadcast rights	Contractual
Servicing contracts, such as mortgage servicing contracts	Contractual
Employment contracts	Contractual
Use rights, such as drilling, water, air, timber cutting and route authorities	Contractual

Servicing contracts, such as mortgage servicing contracts

- IE35 Contracts to service financial assets are one type of contract-based intangible asset. Although servicing is inherent in all financial assets, it becomes a distinct asset (or liability) by one of the following:
- when contractually separated from the underlying financial asset by sale or securitisation of the assets with servicing retained;
 - through the separate purchase and assumption of the servicing.
- IE36 If mortgage loans, credit card receivables or other financial assets are acquired in a business combination with servicing retained, the inherent servicing rights are not a separate intangible asset because the fair value of those servicing rights is included in the measurement of the fair value of the acquired financial asset.

Employment contracts

- IE37 Employment contracts that are beneficial contracts from the perspective of the employer because the pricing of those contracts is favourable relative to market terms are one type of contract-based intangible asset.

Use rights

- IE38 Use rights include rights for drilling, water, air, timber cutting and route authorities. Some use rights are contract-based intangible assets to be accounted for separately from goodwill. Other use rights may have characteristics of tangible assets rather than of intangible assets. An acquirer should account for use rights on the basis of their nature.

Technology-based intangible assets

- IE39 Examples of technology-based intangible assets are:

Class	Basis
Patented technology	Contractual
Computer software and mask works	Contractual
Unpatented technology	Non-contractual
Databases, including title plants	Non-contractual
Trade secrets, such as secret formulas, processes and recipes	Contractual

Computer software and mask works

- IE40 Computer software and program formats acquired in a business combination that are protected legally, such as by patent or copyright, meet the contractual-legal criterion for identification as intangible assets.
- IE41 Mask works are software permanently stored on a read-only memory chip as a series of stencils or integrated circuitry. Mask works may have legal protection. Mask works with legal protection that are acquired in a business combination meet the contractual-legal criterion for identification as intangible assets.

Databases, including title plants

- IE42 Databases are collections of information, often stored in electronic form (such as on computer disks or files). A database that includes original works of authorship may be

entitled to copyright protection. A database acquired in a business combination and protected by copyright meets the contractual-legal criterion. However, a database typically includes information created as a consequence of an entity's normal operations, such as customer lists, or specialised information, such as scientific data or credit information. Databases that are not protected by copyright can be, and often are, exchanged, licensed or leased to others in their entirety or in part. Therefore, even if the future economic benefits from a database do not arise from legal rights, a database acquired in a business combination meets the separability criterion.

- IE43 Title plants constitute a historical record of all matters affecting title to parcels of land in a particular geographical area. Title plant assets are bought and sold, either in whole or in part, in exchange transactions or are licensed. Therefore, title plant assets acquired in a business combination meet the separability criterion.

Trade secrets, such as secret formulas, processes and recipes

- IE44 A trade secret is 'information, including a formula, pattern, recipe, compilation, program, device, method, technique, or process that (a) derives independent economic value, actual or potential, from not being generally known and (b) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.'¹ If the future economic benefits from a trade secret acquired in a business combination are legally protected, that asset meets the contractual-legal criterion. Otherwise, trade secrets acquired in a business combination are identifiable only if the separability criterion is met, which is likely to be the case.

Measurement of non-controlling interest (NCI)

Illustrating the consequences of applying paragraph 19 of SFRS(I) 3.

- IE44A The following examples illustrate the measurement of components of NCI at the acquisition date in a business combination.

Measurement of NCI including preference shares

- IE44B TC has issued 100 preference shares, which are classified as equity. The preference shares have a nominal value of CU1 each. The preference shares give their holders a right to a preferential dividend in priority to the payment of any dividend to the holders of ordinary shares. Upon liquidation of TC, the holders of the preference shares are entitled to receive out of the assets available for distribution the amount of CU1 per share in priority to the holders of ordinary shares. The holders of the preference shares do not have any further rights on liquidation.
- IE44C AC acquires all ordinary shares of TC. The acquisition gives AC control of TC. The acquisition-date fair value of the preference shares is CU120.
- IE44D Paragraph 19 of SFRS(I) 3 states that for each business combination, the acquirer shall measure at the acquisition date components of non-controlling interest in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either fair value or the present ownership instruments' proportionate share in the acquiree's recognised amounts of the identifiable net assets. All other components of non-controlling interest must be measured at their acquisition-date fair value, unless another measurement basis is required by SFRS(I)s.

¹ Melvin Simensky and Lanning Bryer, *The New Role of Intellectual Property in Commercial Transactions* (New York: John Wiley & Sons, 1998), page 293.

IE44E The non-controlling interests that relate to TC's preference shares do not qualify for the measurement choice in paragraph 19 of SFRS(I) 3 because they do not entitle their holders to a proportionate share of the entity's net assets in the event of liquidation. The acquirer measures the preference shares at their acquisition-date fair value of CU120.

First variation

IE44F Suppose that upon liquidation of TC, the preference shares entitle their holders to receive a proportionate share of the assets available for distribution. The holders of the preference shares have equal right and ranking to the holders of ordinary shares in the event of liquidation. Assume that the acquisition-date fair value of the preference shares is now CU160 and that the proportionate share of TC's recognised amounts of the identifiable net assets that is attributable to the preference shares is CU140.

IE44G The preference shares qualify for the measurement choice in paragraph 19 of SFRS(I) 3. AC can choose to measure the preference shares either at their acquisition-date fair value of CU160 or at their proportionate share in the acquiree's recognised amounts of the identifiable net assets of CU140.

Second variation

IE44H Suppose also that TC has issued share options as remuneration to its employees. The share options are classified as equity and are vested at the acquisition date. They do not represent present ownership interest and do not entitle their holders to a proportionate share of TC's net assets in the event of liquidation. The market-based measure of the share options in accordance with SFRS(I) 2 *Share-based Payment* at the acquisition date is CU200. The share options do not expire on the acquisition date and AC does not replace them.

IE44I Paragraph 19 of SFRS(I) 3 requires such share options to be measured at their acquisition-date fair value, unless another measurement basis is required by SFRS(I)s. Paragraph 30 of SFRS(I) 3 states that the acquirer shall measure an equity instrument related to share-based payment transactions of the acquiree in accordance with the method in SFRS(I) 2.

IE44J The acquirer measures the non-controlling interests that are related to the share options at their market-based measure of CU200.

Gain on a bargain purchase

Illustrating the consequences of recognising and measuring a gain from a bargain purchase by applying paragraphs 32–36 of SFRS(I) 3.

IE45 The following example illustrates the accounting for a business combination in which a gain on a bargain purchase is recognised.

IE46 On 1 January 20X5 AC acquires 80 per cent of the equity interests of TC, a private entity, in exchange for cash of CU150. Because the former owners of TC needed to dispose of their investments in TC by a specified date, they did not have sufficient time to market TC to multiple potential buyers. The management of AC initially measures the separately recognisable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirements of SFRS(I) 3. The identifiable assets are measured at CU250 and the liabilities assumed are measured at CU50. AC engages an independent consultant, who determines that the fair value of the 20 per cent non-controlling interest in TC is CU42.

IE47 The amount of TC's identifiable net assets (CU200, calculated as CU250 – CU50) exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in TC. Therefore, AC reviews the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non-controlling interest in TC and the consideration transferred. After that review, AC decides that the

procedures and resulting measures were appropriate. AC measures the gain on its purchase of the 80 per cent interest as follows:

		CU
Amount of the identifiable net assets acquired (CU250 – CU50)		200
Less: Fair value of the consideration transferred for AC's 80 per cent interest in TC; plus	150	
Fair value of non-controlling interest in TC	42	
		192
Gain on bargain purchase of 80 per cent interest		8

IE48 AC would record its acquisition of TC in its consolidated financial statements as follows:

	CU	CU
Dr Identifiable assets acquired	250	
Cr Cash		150
Cr Liabilities assumed		50
Cr Gain on the bargain purchase		8
Cr Equity—non-controlling interest in TC		42

IE49 If the acquirer chose to measure the non-controlling interest in TC on the basis of its proportionate interest in the identifiable net assets of the acquiree, the recognised amount of the non-controlling interest would be CU40 (CU200 × 0.20). The gain on the bargain purchase then would be CU10 (CU200 – (CU150 + CU40)).

Measurement period

Illustrating the consequences of applying paragraphs 45–50 of SFRS(I) 3.

IE50 If the initial accounting for a business combination is not complete at the end of the financial reporting period in which the combination occurs, paragraph 45 of SFRS(I) 3 requires the acquirer to recognise in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer recognises adjustments to the provisional amounts needed to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date. Paragraph 49 of SFRS(I) 3 requires the acquirer to recognise such adjustments as if the accounting for the business combination had been completed at the acquisition date. Measurement period adjustments are not included in profit or loss.

IE51 Suppose that AC acquires TC on 30 September 20X7. AC seeks an independent valuation for an item of property, plant and equipment acquired in the combination, and the valuation was not complete by the time AC authorised for issue its financial statements for the year ended 31 December 20X7. In its 20X7 annual financial statements, AC recognised a provisional fair value for the asset of CU30,000. At the acquisition date, the item of property, plant and equipment had a remaining useful life of five years. Five months after the acquisition date, AC received the independent valuation, which estimated the asset's acquisition-date fair value as CU40,000.

- IE52 In its financial statements for the year ended 31 December 20X8, AC retrospectively adjusts the 20X7 prior year information as follows:
- (a) The carrying amount of property, plant and equipment as of 31 December 20X7 is increased by CU9,500. That adjustment is measured as the fair value adjustment at the acquisition date of CU10,000 less the additional depreciation that would have been recognised if the asset's fair value at the acquisition date had been recognised from that date (CU500 for three months' depreciation).
 - (b) The carrying amount of goodwill as of 31 December 20X7 is decreased by CU10,000.
 - (c) Depreciation expense for 20X7 is increased by CU500.
- IE53 In accordance with paragraph B67 of SFRS(I) 3, AC discloses:
- (a) in its 20X7 financial statements, that the initial accounting for the business combination has not been completed because the valuation of property, plant and equipment has not yet been received.
 - (b) in its 20X8 financial statements, the amounts and explanations of the adjustments to the provisional values recognised during the current reporting period. Therefore, AC discloses that the 20X7 comparative information is adjusted retrospectively to increase the fair value of the item of property, plant and equipment at the acquisition date by CU9,500, offset by a decrease to goodwill of CU10,000 and an increase in depreciation expense of CU500.

Determining what is part of the business combination transaction

Settlement of a pre-existing relationship

Illustrating the consequences of applying paragraphs 51, 52 and B50–B53 of SFRS(I) 3.

- IE54 AC purchases electronic components from TC under a five-year supply contract at fixed rates. Currently, the fixed rates are higher than the rates at which AC could purchase similar electronic components from another supplier. The supply contract allows AC to terminate the contract before the end of the initial five-year term but only by paying a CU6 million penalty. With three years remaining under the supply contract, AC pays CU50 million to acquire TC, which is the fair value of TC based on what other market participants would be willing to pay.
- IE55 Included in the total fair value of TC is CU8 million related to the fair value of the supply contract with AC. The CU8 million represents a CU3 million component that is 'at market' because the pricing is comparable to pricing for current market transactions for the same or similar items (selling effort, customer relationships and so on) and a CU5 million component for pricing that is unfavourable to AC because it exceeds the price of current market transactions for similar items. TC has no other identifiable assets or liabilities related to the supply contract, and AC has not recognised any assets or liabilities related to the supply contract before the business combination.
- IE56 In this example, AC calculates a loss of CU5 million (the lesser of the CU6 million stated settlement amount and the amount by which the contract is unfavourable to the acquirer) separately from the business combination. The CU3 million 'at-market' component of the contract is part of goodwill.
- IE57 Whether AC had recognised previously an amount in its financial statements related to a pre-existing relationship will affect the amount recognised as a gain or loss for the effective settlement of the relationship. Suppose that SFRS(I)s had required AC to recognise a CU6 million liability for the supply contract before the business combination. In that situation, AC recognises a CU1 million settlement gain on the contract in profit or loss at the acquisition date (the CU5 million measured loss on the contract less the CU6 million loss previously

recognised). In other words, AC has in effect settled a recognised liability of CU6 million for CU5 million, resulting in a gain of CU1 million.

Contingent payments to employees

Illustrating the consequences of applying paragraphs 51, 52, B50, B54 and B55 of SFRS(I) 3.

- IE58 TC appointed a candidate as its new CEO under a ten-year contract. The contract required TC to pay the candidate CU5 million if TC is acquired before the contract expires. AC acquires TC eight years later. The CEO was still employed at the acquisition date and will receive the additional payment under the existing contract.
- IE59 In this example, TC entered into the employment agreement before the negotiations of the combination began, and the purpose of the agreement was to obtain the services of CEO. Thus, there is no evidence that the agreement was arranged primarily to provide benefits to AC or the combined entity. Therefore, the liability to pay CU5 million is included in the application of the acquisition method.
- IE60 In other circumstances, TC might enter into a similar agreement with CEO at the suggestion of AC during the negotiations for the business combination. If so, the primary purpose of the agreement might be to provide severance pay to CEO, and the agreement may primarily benefit AC or the combined entity rather than TC or its former owners. In that situation, AC accounts for the liability to pay CEO in its post-combination financial statements separately from application of the acquisition method.

Replacement awards

Illustrating the consequences of applying paragraphs 51, 52 and B56–B62 of SFRS(I) 3.

- IE61 The following examples illustrate replacement awards that the acquirer was obliged to issue in the following circumstances:

		Acquiree awards	
		Has the vesting period been completed before the business combination?	
		Completed	Not completed
Replacement awards Are employees required to provide additional service after the acquisition date?	Not required	Example 1	Example 4
	Required	Example 2	Example 3

IE62 The examples assume that all awards are classified as equity.

Example 1

<i>Acquiree awards</i>	<i>Vesting period completed before the business combination</i>
<i>Replacement awards</i>	<i>Additional employee services are not required after the acquisition date</i>

IE63 AC issues replacement awards of CU110 (market-based measure) at the acquisition date for TC awards of CU100 (market-based measure) at the acquisition date. No post-combination services are required for the replacement awards and TC's employees had rendered all of the required service for the acquiree awards as of the acquisition date.

IE64 The amount attributable to pre-combination service is the market-based measure of TC's awards (CU100) at the acquisition date; that amount is included in the consideration transferred in the business combination. The amount attributable to post-combination service is CU10, which is the difference between the total value of the replacement awards (CU110) and the portion attributable to pre-combination service (CU100). Because no post-combination service is required for the replacement awards, AC immediately recognises CU10 as remuneration cost in its post-combination financial statements.

Example 2

<i>Acquiree awards</i>	<i>Vesting period completed before the business combination</i>
<i>Replacement awards</i>	<i>Additional employee services are required after the acquisition date</i>

IE65 AC exchanges replacement awards that require one year of post-combination service for share-based payment awards of TC, for which employees had completed the vesting period before the business combination. The market-based measure of both awards is CU100 at the acquisition date. When originally granted, TC's awards had a vesting period of four years. As of the acquisition date, the TC employees holding unexercised awards had rendered a total of seven years of service since the grant date.

IE66 Even though TC employees had already rendered all of the service, AC attributes a portion of the replacement award to post-combination remuneration cost in accordance with paragraph B59 of SFRS(I) 3, because the replacement awards require one year of post-combination service. The total vesting period is five years—the vesting period for the original acquiree award completed before the acquisition date (four years) plus the vesting period for the replacement award (one year).

IE67 The portion attributable to pre-combination services equals the market-based measure of the acquiree award (CU100) multiplied by the ratio of the pre-combination vesting period (four years) to the total vesting period (five years). Thus, CU80 ($CU100 \times 4/5$ years) is attributed to the pre-combination vesting period and therefore included in the consideration transferred in the business combination. The remaining CU20 is attributed to the post-combination vesting period and is therefore recognised as remuneration cost in AC's post-combination financial statements in accordance with SFRS(I) 2.

Example 3

<i>Acquiree awards</i>	<i>Vesting period not completed before the business combination</i>
<i>Replacement awards</i>	<i>Additional employee services are required after the acquisition date</i>

IE68 AC exchanges replacement awards that require one year of post-combination service for share-based payment awards of TC, for which employees had not yet rendered all of the service as of the acquisition date. The market-based measure of both awards is CU100 at the acquisition date. When originally granted, the awards of TC had a vesting period of four years. As of the acquisition date, the TC employees had rendered two years' service, and they would have been required to render two additional years of service after the acquisition date for their awards to vest. Accordingly, only a portion of the TC awards is attributable to pre-combination service.

IE69 The replacement awards require only one year of post-combination service. Because employees have already rendered two years of service, the total vesting period is three years. The portion attributable to pre-combination services equals the market-based measure of the acquiree award (CU100) multiplied by the ratio of the pre-combination vesting period (two years) to the **greater of** the total vesting period (three years) or the original vesting period of TC's award (four years). Thus, CU50 ($CU100 \times 2/4$ years) is attributable to pre-combination service and therefore included in the consideration transferred for the acquiree. The remaining CU50 is attributable to post-combination service and therefore recognised as remuneration cost in AC's post-combination financial statements.

Example 4

<i>Acquiree awards</i>	<i>Vesting period not completed before the business combination</i>
<i>Replacement awards</i>	<i>Additional employee services are not required after the acquisition date</i>

IE70 Assume the same facts as in Example 3 above, except that AC exchanges replacement awards that require no post-combination service for share-based payment awards of TC for which employees had not yet rendered all of the service as of the acquisition date. The terms of the replaced TC awards did not eliminate any remaining vesting period upon a change in control. (If the TC awards had included a provision that eliminated any remaining vesting period upon a change in control, the guidance in Example 1 would apply.) The market-based measure of both awards is CU100. Because employees have already rendered two years of service and the replacement awards do not require any post-combination service, the total vesting period is two years.

IE71 The portion of the market-based measure of the replacement awards attributable to pre-combination services equals the market-based measure of the acquiree award (CU100) multiplied by the ratio of the pre-combination vesting period (two years) to the **greater of** the total vesting period (two years) or the original vesting period of TC's award (four years). Thus, CU50 ($CU100 \times 2/4$ years) is attributable to pre-combination service and therefore included in the consideration transferred for the acquiree. The remaining CU50 is attributable to post-combination service. Because no post-combination service is required to vest in the replacement award, AC recognises the entire CU50 immediately as remuneration cost in the post-combination financial statements.

Disclosure requirements

Illustrating the consequences of applying the disclosure requirements in paragraphs 59–63 and B64–B67 of SFRS(I) 3.

IE72 The following example illustrates some of the disclosure requirements of SFRS(I) 3; it is not based on an actual transaction. The example assumes that AC is a listed entity and that TC is an unlisted entity. The illustration presents the disclosures in a tabular format that refers to the specific disclosure requirements illustrated. An actual footnote might present many of the disclosures illustrated in a simple narrative format.

Footnote X: Acquisitions

Paragraph reference

B64(a)–(d) On 30 June 20X0 AC acquired 15 per cent of the outstanding ordinary shares of TC. On 30 June 20X2 AC acquired 60 per cent of the outstanding ordinary shares of TC and obtained control of TC. TC is a provider of data networking products and services in Canada and Mexico. As a result of the acquisition, AC is expected to be the leading provider of data networking products and services in those markets. It also expects to reduce costs through economies of scale.

B64(e) The goodwill of CU2,500 arising from the acquisition consists largely of the synergies and economies of scale expected from combining the operations of AC and TC.

B64(k) None of the goodwill recognised is expected to be deductible for income tax purposes. The following table summarises the consideration paid for TC and the amounts of the assets acquired and liabilities assumed recognised at the acquisition date, as well as the fair value at the acquisition date of the non-controlling interest in TC.

At 30 June 20X2

	Consideration	CU
B64(f)(i)	Cash	5,000
B64(f)(iv)	Equity instruments (100,000 ordinary shares of AC)	4,000
B64(f)(iii); B64(g)(i)	Contingent consideration arrangement	<u>1,000</u>
B64(f)	Total consideration transferred	10,000
B64(p)(i)	Fair value of AC's equity interest in TC held before the business combination	<u>2,000</u>
		<u>12,000</u>
B64(m)	Acquisition-related costs (included in selling, general and administrative expenses in AC's statement of comprehensive income for the year ended 31 December 20X2)	1,250

**Paragraph
reference**

B64(i)	Recognised amounts of identifiable assets acquired and liabilities assumed	
	Financial assets	3,500
	Inventory	1,000
	Property, plant and equipment	10,000
	Identifiable intangible assets	3,300
	Financial liabilities	(4,000)
	Contingent liability	<u>(1,000)</u>
	Total identifiable net assets	12,800
B64(o)(i)	Non-controlling interest in TC	(3,300)
	Goodwill	<u>2,500</u>
		<u>12,000</u>
B64(f)(iv)	The fair value of the 100,000 ordinary shares issued as part of the consideration paid for TC (CU4,000) was measured using the closing market price of AC's ordinary shares on the acquisition date.	
B64(f)(iii)	The contingent consideration arrangement requires AC to pay the former owners of TC 5 per cent of the revenues of XC, an unconsolidated equity investment owned by TC, in excess of CU7,500 for 20X3, up to a maximum amount of CU2,500 (undiscounted).	
B64(g)		
B67(b)	The potential undiscounted amount of all future payments that AC could be required to make under the contingent consideration arrangement is between CU0 and CU2,500.	
	The fair value of the contingent consideration arrangement of CU1,000 was estimated by applying the income approach. The fair value measurement is based on significant inputs that are not observable in the market, which SFRS(I) 13 <i>Fair Value Measurement</i> refers to as Level 3 inputs. Key assumptions include a discount rate range of 20–25 per cent and assumed probability-adjusted revenues in XC of CU10,000–20,000.	
	As of 31 December 20X2, neither the amount recognised for the contingent consideration arrangement, nor the range of outcomes or the assumptions used to develop the estimates had changed.	
B64(h)	The fair value of the financial assets acquired includes receivables under finance leases of data networking equipment with a fair value of CU2,375. The gross amount due under the contracts is CU3,100, of which CU450 is expected to be uncollectible.	
B67(a)	The fair value of the acquired identifiable intangible assets of CU3,300 is provisional pending receipt of the final valuations for those assets.	
B64(j)	A contingent liability of CU1,000 has been recognised for expected warranty claims on products sold by TC during the last three years. We expect that the majority of this expenditure will be incurred in 20X3 and that all will be incurred by the end of 20X4. The potential undiscounted amount of all future payments that AC could be required to make under the warranty arrangements is estimated to be between CU500 and CU1,500. As of 31 December 20X2, there has been no change since 30 June 20X2 in the amount recognised for the liability or any change in the range of outcomes or assumptions used to develop the estimates.	
B67(c)		
IAS 37.84, 85		

Paragraph reference

- B64(o) The fair value of the non-controlling interest in TC, an unlisted company, was estimated by applying a market approach and an income approach. The fair value measurements are based on significant inputs that are not observable in the market and thus represent a fair value measurement categorised within Level 3 of the fair value hierarchy as described in SFRS(I) 13. Key assumptions include the following:
- (a) a discount rate range of 20–25 per cent;
 - (b) a terminal value based on a range of terminal EBITDA multiples between 3 and 5 times (or, if appropriate, based on long-term sustainable growth rates ranging from 3 to 6 per cent);
 - (c) financial multiples of companies deemed to be similar to TC; and
 - (d) adjustments because of the lack of control or lack of marketability that market participants would consider when measuring the fair value of the non-controlling interest in TC.
- B64(p)(ii) AC recognised a gain of CU500 as a result of measuring at fair value its 15 per cent equity interest in TC held before the business combination. The gain is included in other income in AC's statement of comprehensive income for the year ending 31 December 20X2.
- B64(q)(i) The revenue included in the consolidated statement of comprehensive income since 30 June 20X2 contributed by TC was CU4,090. TC also contributed profit of CU1,710 over the same period.
- B64(q)(ii) Had TC been consolidated from 1 January 20X2 the consolidated statement of comprehensive income would have included revenue of CU27,670 and profit of CU12,870.

Definition of a business

- IE73 The examples in paragraphs IE74–IE123 illustrate application of the guidance in paragraphs B7–B12D on the definition of a business.

Example A—acquisition of real estate*Scenario 1—Background*

- IE74 An entity (Purchaser) purchases 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 (eg 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.

Scenario 1—Application of requirements

- IE75 Purchaser elects to apply the optional concentration test set out in paragraph B7B and concludes that:
- (a) each single-family home is considered a single identifiable asset in accordance with paragraph B7B for the following reasons:
 - (i) the building and property improvements are attached to the land and cannot be removed without incurring significant cost; and

- (ii) 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 (see paragraph B42).
 - (b) the group of 10 single-family homes is a group of similar identifiable assets because the assets (all single-family homes) are similar in nature and the risks associated with managing and creating outputs are not significantly different. This is because the types of homes and classes of customers are not significantly different.
 - (c) consequently, substantially all of the fair value of the gross assets acquired is concentrated in a group of similar identifiable assets.
- IE76 Therefore, Purchaser concludes that the acquired set of activities and assets is not a business.

Scenario 2—Background

- IE77 Assume the same facts as in Scenario 1 except that Purchaser also purchases 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. No employees, other assets, other processes or other activities are transferred. The aggregate fair value associated with the office park is similar to the aggregate fair value associated with the 10 single-family homes. The processes performed through the contracts for outsourced cleaning and security are ancillary or minor within the context of all the processes required to create outputs.

Scenario 2—Application of requirements

- IE78 Purchaser elects to apply the optional concentration test set out in paragraph B7B and 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, the fair value of the gross assets acquired is not substantially all concentrated in a group of similar identifiable assets, because the fair value of the office park is similar to the aggregate fair value of the 10 single-family homes. Thus Purchaser assesses whether the set meets the minimum requirements to be considered a business in accordance with paragraphs B8–B12D.
- IE79 The set of activities and assets has outputs because it generates revenue through the in-place leases. Consequently, Purchaser applies the criteria in paragraph B12C to determine whether any processes acquired are substantive.
- IE80 Purchaser concludes that the criterion in paragraph B12C(a) is not met because:
- (a) the set does not include an organised workforce; and
 - (b) Purchaser considers that the processes performed by the outsourced cleaning, security and maintenance personnel (the only processes acquired) are ancillary or minor within the context of all the processes required to create outputs (see paragraph B12D(c)) and, therefore, are not critical to the ability to continue producing outputs.
- IE81 After considering the only processes acquired, those performed by the outsourced cleaning, security and maintenance personnel, Purchaser also concludes that the criteria in paragraph B12C(b) are not met. Either of the following reasons justifies that conclusion:

- (a) the processes do not significantly contribute to the ability to continue producing outputs.
- (b) the processes are readily accessible in the marketplace. Thus, they are not unique or scarce. In addition, they could be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

IE82 Because none of the criteria in paragraph B12C is met, Purchaser concludes that the acquired set of activities and assets is not a business.

Scenario 3—Background

IE83 Assume the same facts as in Scenario 2, except that the acquired set of activities and assets also includes the employees responsible for leasing, tenant management, and managing and supervising all operational processes.

Scenario 3—Application of requirements

IE84 Purchaser elects not to apply the optional concentration test set out in paragraph B7B and therefore assesses whether the set meets the minimum requirements to be considered a business in accordance with paragraphs B8–B12D.

IE85 The acquired set of activities and assets has outputs because it generates revenue through the in-place leases. Consequently, Purchaser applies the criteria in paragraph B12C.

IE86 Purchaser concludes that the criterion in paragraph B12C(a) is met because the set includes an organised workforce with the necessary skills, knowledge or experience to perform processes (ie leasing, tenant management, and managing and supervising the operational processes) that are substantive because they are critical to the ability to continue producing outputs when applied to the acquired inputs (ie the land, buildings and in-place leases). Furthermore, Purchaser concludes that the criterion in paragraph B8 is met because those substantive processes and inputs together significantly contribute to the ability to create output. Consequently, Purchaser concludes that the acquired set of activities and assets is a business.

Example B—acquisition of a drug candidate

Scenario 1—Background

IE87 An entity (Purchaser) purchases a legal entity that contains:

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

No employees, other assets, other processes or other activities are transferred.

Scenario 1—Application of requirements

IE88 Purchaser elects to apply the optional concentration test set out in paragraph B7B and concludes that:

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

IE89 Consequently, Purchaser concludes that the acquired set of activities and assets is not a business.

Scenario 2—Background

IE90 Assume the same facts as in Scenario 1 except that the acquired set of activities and assets also includes another in-process research and development project that is developing a compound to treat Alzheimer’s disease and is in its final testing phase (Project 2). Project 2 includes the historical know-how, formula protocols, designs, and procedures expected to be needed to complete the final phase of testing. The fair value associated with Project 2 is similar to the fair value associated with Project 1. No employees, other assets, processes or other activities are transferred.

Scenario 2—Application of requirements

IE91 Purchaser elects to apply the optional concentration test set out in paragraph B7B and concludes that:

- (a) Project 1 and Project 2 are identifiable intangible assets that would each be recognised and measured as a separate identifiable asset in a business combination.
- (b) Project 1 and Project 2 are not similar identifiable assets because significantly different risks are associated with managing and creating outputs from each asset. Each project has significantly different risks associated with developing, completing and marketing the compound to customers. The compounds are intended to treat significantly different medical conditions, and each project has a significantly different potential customer base.
- (c) consequently, the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets. Therefore, Purchaser assesses whether the set meets the minimum requirements to be considered a business in accordance with paragraphs B8–B12D.

IE92 The acquired set of activities and assets does not have outputs because it has not started generating revenue. Thus, Purchaser applies the criteria in paragraph B12B. Purchaser concludes that those criteria are not met for the following reasons:

- (a) the set does not include an organised workforce; and
- (b) although the contract that provides outsourced clinical trials might give access to an organised workforce that has the necessary skills, knowledge or experience to perform processes needed to carry out the clinical trials, that organised workforce cannot develop or convert the inputs acquired by Purchaser into outputs. Successful clinical trials are a pre-condition for producing output, but carrying out those trials will not develop or convert the acquired inputs into outputs.

Consequently, Purchaser concludes that the acquired set of activities and assets is not a business.

Example C—acquisition of a biotech entity

Background

IE93 An entity (Purchaser) purchases a legal entity (Entity Biotech). Entity Biotech's operations include: research and development activities on several drug compounds that it is developing (in-process research and development projects); 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). Entity Biotech does not yet have a marketable product and has not yet generated revenue. Each of the assets acquired has a similar fair value.

Application of requirements

IE94 It is evident that the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets. Thus, the optional concentration test set out in paragraph B7B would not be met. Consequently, Purchaser assesses whether the set meets the minimum requirements to be considered a business in accordance with paragraphs B8–B12D.

IE95 Purchaser first assesses whether it has acquired any processes. No process is documented. Nevertheless, the acquired organised workforce has proprietary knowledge of Biotech's ongoing projects and experience with them. Applying paragraph B7(b), Purchaser concludes that the intellectual capacity of the acquired organised workforce having the necessary skills and experience following rules and conventions provides the necessary processes that are capable of being applied to inputs to create outputs.

IE96 Purchaser next assesses whether the acquired processes are substantive. The set of activities and assets does not have outputs. Thus, Purchaser applies the criteria in paragraph B12B. Purchaser concludes that those criteria are met because:

- (a) the acquired processes are critical to the ability to develop or convert the acquired inputs into outputs; and
- (b) the inputs acquired include both:
 - (i) an organised workforce that has the necessary skills, knowledge, or experience to perform the acquired processes; and
 - (ii) other inputs that the organised workforce could develop or convert into outputs. Those inputs include the in-process research and development projects.

IE97 Finally, applying the criteria in paragraph B8, Purchaser concludes that the acquired substantive processes and the acquired inputs together significantly contribute to the ability to create output. Consequently, Purchaser concludes that the acquired set of activities and assets is a business.

Example D—acquisition of a television station

Background

IE98 An entity (Purchaser) purchases broadcasting assets from another entity (Seller). The acquired set of activities and assets includes only the communications licence, the broadcasting equipment and an office building. Each of the assets acquired has a similar fair value. Purchaser does not purchase the processes needed to broadcast programmes and it does not acquire any employees, other assets, other processes or other activities. Before the acquisition date, Seller stopped broadcasting using the set of activities and assets acquired by Purchaser.

Application of requirements

IE99 Purchaser elects to apply the optional concentration test set out in paragraph B7B and concludes that:

- (a) the broadcasting equipment and building are not a single identifiable asset because the equipment is not attached to the building and can be removed without significant cost or diminution in utility or fair value of either asset.
- (b) the licence is an intangible asset, whereas the broadcasting equipment and building are tangible assets in different classes. Consequently, in accordance with paragraph B7B(f), the assets are not considered similar to each other.
- (c) each of the single identifiable assets has similar fair value. Thus, the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets.

Consequently, Purchaser assesses whether the set of activities and assets meets the minimum requirements to be considered a business in accordance with paragraphs B8–B12D.

IE100 The set of activities and assets does not have outputs, because Seller has stopped broadcasting. Thus, Purchaser applies the criteria in paragraph B12B. The set does not include an organised workforce, so it does not meet those criteria. Consequently, Purchaser concludes that the acquired set of activities and assets is not a business.

Example E—acquisition of a closed manufacturing facility*Background*

IE101 An entity (Purchaser) purchases a closed manufacturing facility—the land and the building—as well as the related equipment. The fair value of the equipment and the fair value of the facility are similar. To comply with local laws, Purchaser must take over the employees who worked in the facility. No other assets, processes or other activities are transferred. The acquired set of activities and assets stopped producing outputs before the acquisition date.

Application of requirements

IE102 Purchaser elects to apply the optional concentration test set out in paragraph B7B and concludes that:

- (a) the equipment and the facility are not a single identifiable asset because the equipment could be removed from the facility without significant cost or diminution in utility or fair value of either the equipment or the facility—the equipment is not attached to the facility and can be used in many other types of manufacturing facilities.
- (b) the equipment and facility are not similar identifiable assets because they are in different classes of tangible assets.
- (c) the fair values of the equipment and the facility are similar. Therefore, the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets.

Consequently, Purchaser assesses whether the set of activities and assets meets the minimum requirements to be considered a business in accordance with paragraphs B8–B12D.

IE103 The acquired set of activities and assets does not have outputs at the acquisition date because it stopped producing outputs before then. Consequently, Purchaser applies the criteria in paragraph B12B. The set includes an organised workforce that has 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, Purchaser concludes that the acquired set of activities and assets is not a business.

Example F—licence of distribution rights

Background

IE104 An entity (Purchaser) purchases from another entity (Seller) the exclusive sublicense to distribute Product X in a specified jurisdiction. Seller has the licence to distribute Product X worldwide. As part of this transaction, Purchaser also purchases the existing customer contracts in the jurisdiction and takes over a supply contract to purchase Product X from the producer at market rates. None of the identifiable assets acquired has a fair value that constitutes substantially all of the fair value of the gross assets acquired. No employees, other assets, processes, distribution capabilities or other activities are transferred.

Application of requirements

IE105 Purchaser elects to apply the optional concentration test set out in paragraph B7B and concludes that:

- (a) the identifiable assets that could be recognised in a business combination include the sublicense to distribute Product X, customer contracts and the supply contract;
- (b) the sublicense and customer contracts are in different classes of intangible assets, so they are not similar identifiable assets; and
- (c) consequently, the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets.

Consequently, Purchaser assesses whether the set of activities and assets meets the minimum requirements to be considered a business in accordance with paragraphs B8–B12D.

IE106 The set of activities and assets has outputs because at the acquisition date the licence was generating revenue from customers in the jurisdiction specified in the sublicense. Consequently, Purchaser applies the criteria in paragraph B12C. As explained in paragraph B12D(a), acquired contracts are an input and not a substantive process. Purchaser considers next whether the acquired supply contract provides access to an organised workforce that performs a substantive process. Because the supply contract is not providing a service that applies a process to another acquired input, Purchaser concludes that the substance of the supply contract is only that of buying Product X, without acquiring the organised workforce, processes and other inputs needed to produce Product X. Furthermore, the acquired sublicense is an input, not a process. Purchaser concludes that the set is not a business because it does not include an organised workforce and Purchaser has acquired no substantive process that could meet the criteria in paragraph B12C.

Example G—acquisition of brands

Background

IE107 Assume the same facts as in Example F, except that Purchaser purchases the worldwide rights to Product X, including all related intellectual property. The acquired set of activities and assets includes all customer contracts and customer relationships, finished goods inventories, marketing materials, customer incentive programmes, raw material supply contracts, specialised equipment specific to manufacturing Product X and documented manufacturing processes and protocols to produce Product X. No employees, other assets, other processes or other activities are transferred. None of the identifiable assets acquired has a fair value that constitutes substantially all of the fair value of the gross assets acquired.

Application of requirements

IE108 As noted in paragraphs IE105 and IE107, the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets. Thus, the optional concentration test set out in paragraph B7B would not be met. Consequently, Purchaser assesses whether the set of activities and assets meets the minimum requirements to be considered a business in accordance with paragraphs B8–B12D.

IE109 The set of activities and assets has outputs, so Purchaser applies the criteria in paragraph B12C. The set does not include an organised workforce and, therefore, does not meet the criterion in paragraph B12C(a). However, Purchaser concludes that the acquired manufacturing processes are substantive because, when applied to acquired inputs, such as the intellectual property, raw material supply contracts and specialised equipment, those processes significantly contribute to the ability to continue producing outputs and because they are unique to Product X. Consequently, the criterion in paragraph B12C(b) is met. Furthermore, Purchaser concludes that the criterion in paragraph B8 is met because those substantive processes and inputs together significantly contribute to the ability to create output. As a result, Purchaser concludes that the acquired set of activities and assets is a business.

Example H—acquisition of loan portfolio

Scenario 1—Background

IE110 An entity (Purchaser) purchases a loan portfolio from another entity (Seller). The portfolio consists of residential mortgage loans with terms, sizes and risk ratings that are not significantly different. No employees, other assets, processes or other activities are transferred.

Scenario 1—Application of requirements

IE111 Purchaser elects to apply the optional concentration test set out in paragraph B7B and concludes that:

- (a) the assets (residential mortgage loans) are similar in nature;
- (b) the risks associated with managing and creating outputs are not significantly different because the terms, sizes and risk ratings of the loans are not significantly different;
- (c) the acquired loans are similar assets; and
- (d) consequently, substantially all of the fair value of the gross assets acquired is concentrated in a group of similar identifiable assets.

Consequently, Purchaser concludes that the acquired set of activities and assets is not a business.

Scenario 2—Background

- IE112 Assume the same facts as in Scenario 1 except that the portfolio of loans consists of commercial loans with terms, sizes and risk ratings that are significantly different. None of the acquired loans, and no group of loans with similar terms, sizes and risk ratings, has a fair value that constitutes substantially all of the fair value of the acquired portfolio. No employees, other assets, processes or other activities are transferred.

Scenario 2—Application of requirements

- IE113 Purchaser elects to apply the optional concentration test set out in paragraph B7B and concludes that:
- (a) the assets (commercial loans) are similar in nature;
 - (b) the risks associated with managing and creating outputs from the loans are significantly different because the terms, sizes and risk ratings of the loans are significantly different;
 - (c) the acquired loans are not similar identifiable assets; and
 - (d) consequently, the fair value of the gross assets acquired is not substantially all concentrated in a group of similar identifiable assets.

Consequently, Purchaser assesses whether the set meets the minimum requirements to be considered a business in accordance with paragraphs B8–B12D.

- IE114 The portfolio of loans has outputs because it generates interest income. Consequently, Purchaser applies the criteria in paragraph B12C. Acquired contracts are not a substantive process, as explained in paragraph B12D(a). Moreover, the acquired set of activities and assets does not include an organised workforce and there are no acquired processes that could meet the criteria in paragraph B12C(b). Consequently, Purchaser concludes that the acquired set of activities and assets is not a business.

Scenario 3—Background

- IE115 Assume the same facts as in Scenario 2 but Purchaser also takes over the employees of Seller (such as brokers, vendors, and risk managers) who managed the credit risk of the portfolio and the relationship with the borrowers. The consideration transferred to Seller is significantly higher than the fair value of the acquired portfolio of loans.

Scenario 3—Application of requirements

- IE116 As noted in paragraph IE113, the fair value of the gross assets acquired is not substantially all concentrated in a group of similar identifiable assets. Thus, the optional concentration test set out in paragraph B7B would not be met. Consequently, Purchaser assesses whether the set meets the minimum requirements to be considered a business in accordance with paragraphs B8–B12D.
- IE117 The portfolio of loans has outputs because it generates interest income. Consequently, Purchaser applies the criteria in paragraph B12C and concludes that the criterion in paragraph B12C(a) is met because the set includes an organised workforce with the necessary skills, knowledge or experience to perform processes (customer relationship management and credit risk management) critical to the ability to continue producing outputs. Furthermore, Purchaser concludes that the criterion in paragraph B8 is met because those

substantive processes and the acquired inputs (the portfolio of loans) together significantly contribute to the ability to create output. Consequently, Purchaser concludes that the acquired set is a business.

Example I—determining the fair value of the gross assets acquired

Background

- IE118 An entity (Purchaser) holds a 20% interest in another entity (Entity A). At a subsequent date (the acquisition date), Purchaser acquires a further 50% interest in Entity A and obtains control of it. Entity A's assets and liabilities on the acquisition date are the following:
- (a) a building with a fair value of CU500;
 - (b) an identifiable intangible asset with a fair value of CU400;
 - (c) cash and cash equivalents with a fair value of CU100;
 - (d) financial liabilities with a fair value of CU700; and
 - (e) deferred tax liabilities of CU160 arising from temporary differences associated with the building and the intangible asset.
- IE119 Purchaser pays CU200 for the additional 50% interest in Entity A. Purchaser determines that at the acquisition date the fair value of Entity A is CU400, that the fair value of the non-controlling interest in Entity A is CU120 (30% x CU400) and that the fair value of the previously held interest is CU80 (20% x CU400).

Application of requirements

- IE120 To perform the optional concentration test set out in paragraph B7B, Purchaser needs to determine the fair value of the gross assets acquired. Applying paragraph B7B, Purchaser determines that the fair value of the gross assets acquired is CU1,000, calculated as follows:
- (a) the fair value of the building (CU500); plus
 - (b) the fair value of the identifiable intangible asset (CU400); plus
 - (c) the excess (CU100) of:
 - (i) the sum (CU400) of the consideration transferred (CU200), plus the fair value of the non-controlling interest (CU120), plus the fair value of the previously held interest (CU80); over
 - (ii) the fair value of the net identifiable assets acquired (CU300 = CU500 + CU400 + CU100 – CU700).
- IE121 The excess referred to in paragraph IE120(c) is determined in a manner similar to the initial measurement of goodwill in accordance with paragraph 32 of SFRS(I) 3. Including this amount in determining the fair value of the gross assets acquired means that the concentration test is based on an amount that is affected by the value of any substantive processes acquired.
- IE122 The fair value of gross assets acquired is determined after making the following exclusions specified in paragraph B7B(a) of SFRS(I) 3 for items that are independent of whether any substantive process was acquired:

SFRS(I) 3 IE

- (a) the fair value of the gross assets acquired does not include the fair value of the cash and cash equivalents acquired (CU100) and does not include deferred tax assets (nil in this example); and
- (b) for the calculation specified in paragraph IE120(c)(ii), the deferred tax liability is not deducted in determining the fair value of the net assets acquired (CU300) and does not need to be determined. As a result, the excess (CU100) calculated by applying paragraph IE120(c) does not include goodwill resulting from the effects of deferred tax liabilities.

IE123 The fair value of the gross assets acquired (CU1,000) may also be determined as follows:

- (a) the total (CU1,100) obtained by adding:
 - (i) the amount paid (CU200) (plus the fair value of the non-controlling interest (CU120) plus the fair value of the previously held interest (CU80)); to
 - (ii) the fair value of the liabilities assumed (other than deferred tax liabilities) (CU700); less
- (b) the cash and cash equivalents acquired (CU100); less
- (c) deferred tax assets acquired (nil in this example). In practice, it would be necessary to determine the amount of deferred tax assets to be excluded only if including the deferred tax assets could lead to the concentration test not being met.

Appendix

Amendments to guidance on other SFRS(I)s

IFRS. *The following amendments to guidance on other IFRSs are necessary in order to ensure consistency with IFRS 3 (as revised in 2008) and the related amendments to other IFRSs. In the amended paragraphs, new text is underlined and deleted text is struck through.*

* * * * *

The amendments contained in this appendix have been incorporated into the text of the guidance on the relevant SFRS(I)s.