ASSURANCE AND ACCOUNTING

ASPE - IFRS: A Comparison

Business Combinations

In this publication we will examine the key differences between Accounting Standards for Private Enterprises (ASPE) and International Financial Reporting Standards (IFRS) related to business combinations with a focus on:

- Scope and identifying a business combination;
- Applying the acquisition method;
- The measurement period;
- Subsequent measurement and accounting; and
- Disclosure.

ASPE-IFRS differential rating scale

References

ASPE	IFRS
• Section 1582 – *Business Combinations* • Section 1591 – *Subsidiaries* • Section 3840 – *Related Party Transactions*	• IFRS 3 – *Business Combinations* • IFRS 10 – *Consolidated Financial Statements*

Overview of Major Differences

ASPE and IFRS are significantly converged in the treatment of business combinations. However, there is a difference in the definition of a business under IFRS which was revised in November 2018 with an effective date of January 1, 2020. Other minor differences between the frameworks are:

- Both Section 1582 and IFRS 3 scope out a combination between entities or business under common control, however ASPE provides additional guidance on this topic in Section 3840, *Related Party Transactions*, while IFRS does not provide any additional guidance.

- Under Section 1582 specific guidance in provided for determining the fair value of assets and liabilities when the taxes payable method is used. No such guidance in provided under IFRS 3 as the taxes payable method is not an allowable accounting policy under IFRS. Refer to our ASPE-IFRS Comparison publication on income taxes for more details.

- Under ASPE contingent consideration liabilities are not remeasured until it is resolved, while under IFRS it is required to be remeasured at each reporting date.

- The disclosure requirements under IFRS 3 are much more extensive than what is required by Section 1582.

- IFRS 3 was amended to make it explicit that an acquirer applies IAS 37 or IFRIC 21 to identify liabilities assumed in a business combination. The amendment also makes it clear that an acquirer does not recognize contingent assets in a business combination. Amendments not mandatorily applicable until 1 January 2022.

Scope and Definition of a Business

A business combination is defined as a transaction or other event in which an acquirer obtains control of one or more businesses. Both Section 1582 and IFRS 3 provide detailed guidance on identifying a business combination and on determining whether the definition of a business has been met.

The scope of Section 1582 and IFRS 3 are substantially the same. Both standards provide guidance on accounting for transactions or events that meet the definition of a business combination, but do not apply to the formation of a joint arrangement, the acquisition of an asset or group of assets that does not constitute a business, or to a combination between entities or businesses under common control. However, ASPE provides further guidance on accounting for a combination between businesses under common control in paragraph .44 of Section 3840, *Related Party Transactions,* while IFRS does not provide further guidance on this topic. Additionally, IFRS 3 scopes out the acquisition by an investment entity (as defined in IFRS 10, *Consolidated Financial Statements*) of an investment in a subsidiary that is required to be measured at fair value through profit or loss. Under ASPE, an investment company follows the guidance provided in AcG-18, *Investment Companies,* on accounting for its investments.

An entity must determine whether a transaction is a business combination, by first determining if the assets, liabilities and liabilities acquired in a transaction constitute a business. If they do not, then the entity accounts for the transaction as an asset acquisition.

Prior to the IASB revising the definition of a business in October 2018, the definition under the two frameworks was the same. Since the revision that became effective on January 1, 2020, there is a difference between the definition of a business under ASPE and IFRS. The revised definition should result in more transactions being treated as asset acquisitions instead of business combinations under IFRS. As such, they would be scoped out of the requirements of IFRS 3.

The definition of a business is as follows:

ASPE	IFRS
An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.	An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.
The result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.	The result of inputs and processes applied to those inputs that provide goods or services to customers, generate investment income (such as dividends or interest) or generate other income from ordinary activities.

The new definition of a business under IFRS has a more narrow definition of a 'business' and of 'outputs' that focusses on returns from selling goods and services to customers, rather than on cost reductions. The new definition includes the concept of substantive processes. In order to be considered a business, an acquired set of activities and assets must include, as a minimum, an input and a substantive process. IFRS also has an optional concentration test as a short-cut to concluding that certain types of acquisitions are not business combinations. Under the concentration test, if substantially all of the fair value of the gross assets acquired are concentrated in a single identifiable asset, or group of similar identifiable assets, then it is an asset acquisition.

In contrast, the definition of business under ASPE includes returns from lower costs. The concept of substantive processes does not exist under ASPE.

Once it is determined that an acquisition is a business combination, the acquisition method shall be applied.

The Acquisition Method

Under both Section 1582 and IFRS 3 a business combination is accounted for by applying the acquisition method, which includes the following steps.

Step 1: Identify the acquirer

The standards require that one of the combining entities must be identified as the acquirer. The acquirer is the entity that obtains control of another entity (i.e. the acquiree).

Under ASPE, control is defined as the continuing power to determine an entity's strategic operating, investing and financing policies without the co-operation of others. The guidance in Section 1591, *Subsidiaries*, is used to determine which entity has obtained control in a business combination and is the acquirer.

Under IFRS, an investor is considered to control an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The guidance in IFRS 10 is used to determine which entity has obtained control in a business combination and is the acquirer.

If it is not clear from Section 1591 / IFRS 10 which of the combining entities is the acquirer some additional factors to consider are:

- Which entity transferred cash, other assets or incurring liabilities to effect the business combination;
- Which entity issued its equity interests to effect the business combination;
- The relative voting rights in the combined entity after the business combination;
- The existence of a large minority voting interest in the combined entity if no other owner or organized group of owners has a significant voting interest;
- The composition of the governing body of the combined entity;
- The composition of the senior management of the combined entity;
- The terms of the exchange of equity interests;
- The relative size of the combining entities after the combination occurs; and
- Which entity initiated the combination.

Additionally, a new entity formed to effect a business combination is not necessarily the acquirer. If the new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination must be identified as the acquirer by applying the guidance in paragraphs 1582.A9-.A13 / IFRS 3.B13-B17. However, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

In some transactions, the entity that issues securities (the legal acquirer) may actually be identified as the acquiree for accounting purposes after considering the factors listed above. This is known as a reverse acquisition. The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a business combination. All the recognition and measurement principles of Section 1582 / IFRS 3 apply in this situation.

Step 2: Determine the acquisition date

The acquisition date is the date that an acquirer obtains control of the acquiree. This is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree, which is typically the closing date. However, the acquisition date could be earlier or later than the closing date depending on the specific facts and circumstances of the situation.

Step 3: Recognize and measure the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

Recognition

As of the acquisition date, the acquirer must recognize separate from goodwill all the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. To qualify for recognition, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities under ASPE / IFRS at the acquisition date and they must be part of what was exchanged in the business combination transaction and not the result of separate transactions. As a result of applying this recognition principle, the acquirer may end up recognizing some assets and liabilities that had not previously been recognized in the acquiree's financial statements. For example, some internally-generated intangible assets may not have met the criteria for recognition in the acquiree's financial statements, however, they may now meet the criteria for recognition as a result of being acquired in the business combination. An intangible asset is considered to be identifiable, and thus would be accounted for separately from goodwill, if it meets either the separability criterion or the contractual-legal criterion. The value of acquired intangible assets that are not identifiable as of the acquisition date are subsumed into goodwill (e.g. the value of an assembled workforce) along with the value attributed to items that do not qualify as assets at the acquisition date (e.g. the value of potential contracts).

Measurement

The acquirer measures the identifiable assets acquired and liabilities assumed at their acquisition-date fair values. Even if an acquirer purchases less than 100% of an acquiree, the acquirer still recognizes the full fair value of the identifiable assets acquired and liabilities assumed. Any non-controlling interest is then measured at either its fair value or the non-controlling interest's proportionate share of the acquiree's identifiable net assets. The definition of fair value differs slightly between ASPE and IFRS. Under ASPE, fair value is defined as the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. Under IFRS 13, *Fair Value Measurement,* fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Exceptions

Both Section 1582 and IFRS 3 provide some limited exceptions to the recognition and measurement principles for the following items:

- **Contingent liabilities** – The acquirer recognizes a contingent liability assumed in a business combination at the acquisition date if it is a present obligation arising from past events and its fair value can be measured reliability. This is contrary to the recognition guidance in Section 3290, *Contingencies* / IAS 37, *Provisions, Contingent Liabilities and Contingent Assets,* since the acquirer recognizes the contingent liability acquired in a business combination even if it is not probable than an asset has been impaired or a liability has been incurred / an outflow of resources embodying economic benefits will be required to settle the obligation. IFRS 3 has been amended (applicable on or beginning after 1 January 2022, with earlier application permitted). The amendments specify that an entity applying IFRS 3 should refer to IAS 37 Provisions, Contingent Liabilities and Contingent Assets. These amendments result in a difference between IFRS and ASPE.
- **Income taxes** – Under IFRS or under ASPE if the acquirer uses the future income taxes method, a deferred / future income tax asset or liability arising from the assets acquired and liabilities assumed in the business combination as well as any potential tax effects of temporary differences and carryforwards of the acquiree that exist at the acquisition date or arise as a result of the acquisition are accounted for in accordance with Section 3465, *Income Taxes* / IAS 12, *Income Taxes*. Under ASPE if the acquirer follows the taxes payable method, paragraph 1582.A39 explains that the fair value of an item obtained in a business combination must reflect its tax base.
- **Employee benefits** – The acquirer recognizes and measures a liability (or asset) related to the acquiree's employee benefit arrangements in accordance with Section 3462, *Employee Future Benefits* / IAS 19, *Employee Benefits*. For more information on accounting for employee benefits refer to our ASPE-IFRS Comparison publication on this topic.

- **Indemnification assets** – The acquirer recognizes an indemnification asset and measures it using the same measurement basis as the related contingent liability subject to the need for a valuation allowance for uncollectible amounts. For an indemnification asset measured at fair value, the effects of uncertainty about future cash flows due to collectability considerations are already included in the fair value measure, therefore, a separate valuation allowance is not necessary.
- **Reacquired rights** – The acquirer measures the value of a reacquired right recognized as an intangible asset on the basis of the remaining contractual terms of the related contract whether or not market participants would consider potential contractual renewals in determining its fair value.
- **Share-based payment awards** – The acquirer measures a liability or equity instrument related to the replacement of an acquiree's share-based payment awards with share-based payment awards of the acquirer in accordance with Section 3870, *Stock-based Compensation and Other Stock-based Payments* / IFRS 2, *Share-based Payments*. For more information on accounting for share-based payments refer to our ASPE-IFRS Comparison publication on this topic.
- **Assets held for sale** - The acquirer measures an acquired non-current asset or disposal group that is classified as held for sale at the acquisition date at fair value less costs to sell in accordance with Section 3475, *Disposal of Long-lived Assets and Discontinued Operations* / IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*.

Additionally, under ASPE, Section 1582 includes a specific recognition and measurement exception related to asset retirement obligations which requires that they are accounted for in accordance with Section 3110, *Asset Retirement Obligations*. IFRS 3 does not include such an exception.

Under IFRS when the acquirer has adopted IFRS 16, *Leases*, the acquirer recognizes right-of-use assets and lease liabilities for leases acquired in a business combination where the acquirer is the lessee. The acquirer is not required to recognize right-of-use assets and lease liabilities for leases for which the lease term ends within 12 months of the acquisition date or leases for which the underlying asset is of low value. The lease liability is measured at the present value of the remaining lease payments as if the acquired lease were a new lease at the acquisition date. The right-of-use asset is measured at the same amount as the lease liability, adjusted to reflect any favourable or unfavourable terms of the lease. No such exception is included under ASPE.

Step 4: Recognize and measure goodwill or a gain from a bargain purchase

Lastly, an acquirer recognizes any goodwill that occurs as result of the business combination. Goodwill is calculated as of the acquisition date and is measured as the excess of a) over b):

a) The total of:
   - i. The consideration transferred measured in accordance with 1582 / IFRS 3 (usually measured at acquisition-date fair value);
   - ii. The amount of non-controlling interest in the acquiree measured in accordance with Section 1582 / IFRS 3; and
   - iii. For a business combination achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree.

b) The net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with Section 1582 / IFRS 3.

If the amount of b) exceeds the amount of a) then the acquirer has a bargain purchase gain instead of goodwill. Before recognizing the gain, the acquirer must reassess whether it has correctly identified and measured all the assets acquired and the liabilities assumed in the business combination. If after the reassessment a gain still remains, the acquirer recognizes it in net income on the acquisition date.

The consideration transferred in a business combination is the total of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer. The consideration transferred also includes the fair value of any contingent consideration transferred by the acquirer. An obligation to pay contingent consideration is classified by the acquirer as either equity or a liability on the basis of the definitions of an equity instrument and a financial liability per Section 3856, *Financial Instruments* / IAS 32, *Financial Instruments: Presentation*. A right to the return of previously transferred consideration if certain conditions are met is classified as an asset by the acquirer.

Additional Guidance

Section 1582 and IFRS 3 both contain specific guidance on applying the acquisition method to business combinations achieved in stages and business combinations achieved without the transfer of consideration.

Business combination achieved in stages

When an entity holds an equity interest in an acquiree immediately before the acquisition date and then obtains control of the acquiree by purchasing an additional equity interest on the acquisition date, this is referred to as a business combination achieved in stages or a step-acquisition. In this situation, the acquirer remeasures its previously held equity interest in the acquiree at its acquisition-date fair value and any resulting gain or loss is recognized in net income under both ASPE and IFRS. However, under IFRS, if the entity is following IFRS 9, the resulting gain or loss is recognized in profit or loss or other comprehensive income as appropriate.

Once control has been obtained, as long as control is not lost, all changes to ownership interest are treated as transactions among equity holder and reported within equity. Goodwill does not arise on any increase, and no gain or loss is recognized on any decrease.

Business combination achieved without the transfer of consideration

Sometimes an acquirer obtains control of an acquiree without transferring any consideration. For example, this can occur when:

- An acquiree repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control;
- Minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights; or
- The acquirer and acquiree agree to combine their businesses by contract alone and the acquirer transfers no consideration in exchange for control of the acquiree and holds no equity interests in the acquiree either on the acquisition date or previously.

In these situations, the acquisition method of accounting for a business combination still applies.

Measurement Period

Sometimes when a business combination occurs the initial accounting for the transaction is not complete by the end of the reporting period in which the transaction occurs. In this situation, the acquirer reports in its financial statements provisional amounts for the items for which the accounting is incomplete. Then during the measurement period, as new information is obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the measurement of the amounts recognized, the acquirer retrospectively adjusts the provisional amounts to reflect this new information. In addition, the acquirer also recognizes retrospectively any additional assets or liabilities if new information is obtained during the measurement period about facts and circumstances that existed as of the acquisition date that, if known, would have resulted in the recognition of those assets and liabilities as of that date. The offset to any adjustments made to the provisional amount of the assets and liabilities previously recognized is an adjustment to goodwill. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable; however, the measurement period cannot be longer than one year from the acquisition date. After the measurement period ends, any revisions to the accounting for a business combination are made only to correct an error in accordance with the requirements of Section 1506, *Accounting Changes* / IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Determining what is Part of the Business Combination

Only items that are exchanged as part of the business combination should be accounted for as part of the transaction in accordance with the requirements of Section 1582 / IFRS 3. Any pre-existing relationships or other arrangements between an acquirer and acquiree that existed before negotiations for the business combination began or other arrangements entered into during negotiations that are not part of the business combination should not be recognized as part of the business combination transaction. Instead, these arrangements must be accounted for separately in accordance with the relevant Sections of ASPE / IFRS. Some examples of such transactions are:

- A transaction that in effect settles pre-existing relationships between the acquirer and acquiree;
- A transaction that remunerates employees or former owners of the acquiree for future services; and
- A transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs.

In determining whether a transaction is part of or separate from the business combination the acquirer should consider the reasons for the transaction, who initiated the transaction and the timing of the transaction.

Acquisition-related Costs

Costs that an acquirer incurs in order to effect a business combination are acquisition-related costs. These costs are expensed as incurred, except for costs to issue debt or equity securities which are recognized under ASPE in accordance with Section 3856 and Section 3610, *Capital Transactions,* and under IFRS in accordance with IAS 32 and IFRS 9, *Financial Instruments* if applicable.

Subsequent Measurement and Accounting

Subsequent to a business combination an acquirer measures and accounts for the assets acquired, liabilities assumed or incurred and equity instruments issued in the business combination in accordance with other applicable Sections of the respective Handbook. However, Section 1582 and IFRS 3 provide specific guidance on subsequent measurement and accounting for the following items:

- **Reacquired rights** – A reacquired right recognized as an intangible assets is amortized over the remaining contractual period of the contract in which the right was granted. If an acquirer subsequently sells the reacquired right to a third party it includes the carrying amount of the intangible asset in determining the gain or loss on sale.
- **Contingent liabilities recognized as of the acquisition date**[1] – Subsequent to initial recognition and until the point when the liability is settled, cancelled or expires, the acquirer measures it at the higher of: a) the amount that would be recognized in accordance with Section 3290 / IAS 37; and b) the amount initially recognized less any cumulative amount of income recognized in accordance with Section 3400, *Revenue* /IFRS 15, *Revenue from Contracts with Customers*. However, this requirement does not apply to contracts accounted for in accordance with Section 3856 / IFRS 9.
- **Indemnification assets** – At the end of each subsequent reporting period, the acquirer measures an indemnification asset on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount and if the indemnification asset is not subsequently measured at its fair value, management must assess its collectability. An indemnification asset is only derecognized when the acquirer collects the asset, sells it or otherwise loses the right to it.
- **Contingent consideration** – Changes in the fair value of contingent consideration that are not measurement period adjustments are accounted for as follows:
  - Under both ASPE and IFRS contingent consideration classified as equity is not remeasured and its subsequent settlement is accounted for within equity.
  - Under ASPE, contingent consideration accounted for as an asset or liability is remeasured at fair value when the contingency is resolved and any resulting gain or loss is recognized in net income.
  - Under IFRS, contingent consideration that is not equity and is within the scope of IFRS 9 is remeasured at fair value at each reporting date and changes in fair value are recognized in profit or loss in accordance with the requirements of IFRS 9. Contingent consideration that is not equity and that is not within the scope of IFRS 9 is remeasured at fair value at each reporting date and changes in fair value are recognized in profit or loss.

Disclosure

Under both ASPE and IFRS an acquirer is required to disclose information in its financial statements that enables users to evaluate the nature and financial effects of business combinations that occur during the reporting period or after the end of the reporting period, but before the financial statements are complete. In general, many of the disclosure

[1] Refer to Measurement section in Section 3 above on contingent liabilities for amendments to IFRS 3 not yet applicable

requirements under Section 1582 and IFRS 3 are the same. However, IFRS 3 requires much more extensive disclosures than Section 1582.

Conclusion

In general the principles related to business combinations under ASPE and IFRS are the same. However, minor differences do exist between the two standards including the subsequent measurement of contingent consideration and the extent of disclosure requirements. If you require further guidance on accounting for business combinations under ASPE or IFRS please contact your local BDO Canada LLP office. If you are considering the adoption of a new standard, learn how our BDO Accounting Advisory Services Team can help you with the transition.

To learn more about the differences between standards, view our ASPE-IFRS: A Comparison Series.