



Insights into IFRS 3

Determining what is part of a business combination transaction

Business combinations are infrequent transactions that are unique for each occurrence. IFRS 3 ‘Business Combinations’ contains the requirements and despite being fairly stable in the fifteen years since it has been released, can still be challenging when accounting for these transactions in practice.

Our ‘Insights into IFRS 3’ series summarises the key areas of the Standard, highlighting aspects that are more difficult to interpret and revisiting the most relevant features that could impact your business.

In effecting a business combination, the acquirer may also enter into transactions and arrangements with the vendor and/or acquiree. In accordance with IFRS 3, the acquirer should determine whether such a transaction is part of the exchange for the acquiree. If not, the transaction must be accounted for separately. Some transactions that should be accounted for separately (referred to here as separate transactions) are included in the purchase agreement, an example being an agreement by the vendor to reimburse the acquirer’s transaction costs. More often, identifying a separate transaction and its accounting consequences requires a careful analysis of the overall arrangement and circumstances and their substance. Many transactions that, from a commercial perspective, are consequential or integral to a business combination are not necessarily part of the accounting for the combination for IFRS 3 purposes.

As mentioned in our article [‘Insights into IFRS 3 – Consideration transferred’](#), accounting for a separate transaction often involves adjusting the contractual purchase price in order to obtain the right amount of consideration transferred. Only consideration transferred in exchange for the acquiree is considered in the calculation of goodwill (or gain on a bargain purchase). Payments that, in substance, relate to separate transactions are not included in consideration transferred for the business combination transaction and may give rise to a separate gain, loss, liability or asset. This article discusses such transactions.

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Identifying separate transactions

IFRS 3 provides a list of indicators to be considered when determining whether a transaction is part of the exchange for the acquiree or a separate transaction. The indicators are neither mutually exclusive nor individually conclusive:

Determining factor	Indicators
Reasons for the transaction	A transaction arranged primarily for the benefit of the acquirer or the combined entity (ie acquirer and acquiree) is less likely to be part of the exchange for the acquiree.
Who initiated the transaction	A transaction or other event initiated by the acquirer with the objective of providing future economic benefits to the acquirer or the combined entity is less likely to be part of the exchange for the acquiree.
Timing of the transaction	A transaction entered into between the acquirer and the acquiree during the negotiations of the terms of the business combination, with the objective of providing future economic benefits to the acquirer or the combined entity is less likely to be part of the exchange for the acquiree.

IFRS 3 provides three examples of transactions that should be accounted for separately from the business combination and provides guidance on how these transactions affect the calculation of the consideration transferred, if any:

- In effect settles pre-existing relationships between the parties
- Remunerates employees or former owners of the acquiree for future services
- Reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs.

In addition, transactions on the acquiree's share-based payment awards (replaced or not by the acquirer) may result in consequential adjustments to the contractual purchase price. This type of transactions is discussed later in our publication.

Another type of transaction that may occur at (or around) the same time as negotiating to acquire a controlling interest in the acquiree is when an acquirer enters into an arrangement with non-selling shareholders to acquire further acquiree shares at a later date. The types of arrangement that are commonly signed to reach that objective comprise:

- **purchased call options:** acquirer's right to purchase acquiree shares held by non-selling shareholders
- **written put options:** non-selling shareholders' right to sell acquiree shares to the acquirer
- **forward contracts:** binding agreement to buy or sell acquiree shares at a future date. These may be a combination of call and put options, the terms of which may be equivalent or may be different.

IFRS 3 has no specific guidance on these arrangements, which can vary considerably. Careful analysis and judgment may be required to determine the appropriate accounting treatment. Guidance set out in IFRS 10 'Consolidated Financial Statements', IAS 32 'Financial Instruments: Presentation' and IFRS 9 'Financial Instruments' should be considered. A detailed discussion of these types of arrangement and their analysis is beyond the scope of this article and is currently being debated as part of the International Accounting Standards Board (IASB's) larger on-going project on IAS 32 – Financial instruments with characteristic of equity.

Settlement of pre-existing relationships

The acquirer and acquiree may have an existing relationship, either through a contractual commercial arrangement (eg supplier and customer relationship) or a non-contractual relationship (eg litigation) before they entered into the business combination. In such case, the business combination is viewed as effectively settling this pre-existing relationship. It is then assumed that the contractual purchase price includes an amount relating to the settlement. Consequently:

- on the acquisition date, the acquirer recognises a settlement gain or loss in the statement of profit or loss to reflect the results of this pre-existing relationship had the transaction been settled separately from the business combination. Measurement of the gain or loss depends on whether the pre-existing relationship is contractual or non-contractual (see below)
- the contractual purchase price is adjusted for the amount deemed to relate to the effective settlement in arriving at the amount of the consideration transferred in exchange for the acquiree.

Measurement of gain or loss on the settlement of a pre-existing relationship

Non-contractual

- measured at fair value.

Contractual

- the lesser of the following:
 - the amount by which the contract is favourable or unfavourable from the acquirer's perspective when compared to market terms, and
 - the amount of any stated settlement provisions available to the counterparty by whom the contract is unfavourable
- if the latter amount is lesser than the first amount, the difference is included as part of the accounting for the business combination.

Note: any gain or loss on settlement will be affected by any related asset or liability previously recognised by the acquirer.

The following examples illustrate this guidance:

Example 1 – Settlement of pre-existing non-contractual relationship

Entity P is being sued by Entity C for an infringement of Entity C's patent. At 31 December 20X1, Entity P recognised a CU 5 million liability related to this litigation.

On 30 June 20X2, Entity P acquired 100% of the equity of Entity C for CU 120 million and obtained control of Entity C. On that date, the estimated fair value of the expected settlement of the litigation is CU 8 million.

Analysis

Because of the acquisition, the litigation between the two parties is effectively settled. Entity P accounts for this settlement separately and recognises a settlement loss of CU 3 million (difference between the fair value of the expected settlement and the previously recognised liability). In accounting for the business combination, the contractual purchase price of CU 120 million is reduced by the amount of CU 8 million attributable to the settlement resulting in a consideration transferred of CU 112 million for determining the goodwill.

Example 2 – Settlement of pre-existing supply agreement

Entity A purchases raw materials from Entity B at fixed rates through a 5-year supply agreement. Entity A is able to early terminate the agreement by paying a termination fee of CU 4 million.

Two years into the agreement, Entity A acquired 100% of the equity of Entity B for CU 40 million. On that date, the terms of the supply agreement are unfavourable to Entity A since the contractual fixed rates are higher than current market prices (ie the purchase price that could be obtained from other market suppliers at the acquisition date). The estimated fair value of the contract for Entity B (determined from a market participant perspective) is CU 5 million, with CU 2 million representing the component that is 'at market' terms (which may represent the selling effort and the existence of a customer relationship) and a CU 3 million component relating to the unfavourable pricing for Entity A (commonly referred to as the 'off-market' component).

Prior to the acquisition, Entity A concluded that the supply agreement is not an onerous contract and no liability related to the agreement has been recognised in its financial statements.

Analysis

Entity A's acquisition of Entity B effectively indirectly settles the supply agreement. Entity A accounts for this settlement as a separate transaction and recognises a settlement loss of CU 3 million* representing the 'off-market' component of the supply contract as this amount is lower than the termination fee.

In accounting for the business combination, the consideration transferred is therefore measured at CU 37 million, being the contractual price of CU 40 million reduced by CU 3 million attributable to the loss identified on settlement of the supply agreement.

The CU 2 million representing the 'at market' component of the fair value of the supply agreement is subsumed into goodwill. No separate intangible asset (ie any reacquired right) is recognised as the business combination does not represent the reacquisition of a previous right granted by Entity A to entity B to use Entity A's assets (refer to our article ['Insights into IFRS 3 – Specific recognition and measurement provisions'](#) for more details on recognition of reacquired rights).

* If Entity A had previously considered the supply agreement to be an onerous contract (in accordance with IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'), the loss on settlement would be reduced by any previously recognised liability for this onerous contract.

Example 3 – Settlement of pre-existing license agreement (including a reacquired right)

Entity Q granted a 5-year license to Entity S to use Entity Q's technology at a fixed annual rate. Entity Q and Entity S can both obtain an early exit from the license agreement by paying a termination fee of CU 2 million. Two years into the agreement, Entity Q acquires Entity S for CU 100 million. On that date, the fair value of the license agreement is CU 6 million (fair value measured on the basis of its remaining contractual life). The terms of the license agreement are unfavourable to Entity Q when compared to market terms by CU 1.5 million.

Analysis

The business combination leads to the effective indirect settlement of the licensor-licensee relationship. Entity Q accounts for this settlement as a separate transaction and recognises a settlement loss of CU 1.5 million (the lower of the value of the unfavourable pricing and the contractual termination fee).

In accounting for the business combination, the consideration transferred is measured at CU 98.5 million being the contractual price of CU 100 million reduced by the CU 1.5 million loss on settlement of the license agreement considering that a portion of the consideration transferred is attributable to the settlement of the pre-existing license agreement.

In this situation, the business combination includes a reacquired right (ie reacquisition of the right to use the technology previously granted by Entity Q to Entity S). The reacquired right is recognised separately from goodwill and measured at CU 4.5 million in accordance with IFRS 3, being measured as the difference between the above fair value measurement and the off-market value of the license and representing the license's fair value at current market rates (refer to our article ['Insights into IFRS 3 – Specific recognition and measurement provisions'](#) for more details).

Employee compensation arrangements

In many business combinations, some or all of the selling shareholders may also be key employees in the acquired business (eg owner-managers). These individuals may remain employed with the acquired business after the business combination. In addition, the purchase agreement may include contingent payments that depend both on meeting a specified target and on these employee-shareholders' continued employment for a specified period. (Refer to our article ['Insights into IFRS 3 – Consideration transferred'](#) for more details on the concept of contingent consideration).

Such contingent payment arrangements must be analysed to determine whether some or all of the payments are, in substance, compensation for future employee services rather than payment for the acquired business. This determination will depend on the specific terms and conditions of the purchase and other related agreements and may require judgement.

IFRS 3 provides indicators (in addition to the general indicators discussed on page 2) to assist in this analysis. All of these indicators should be considered. However, IFRS 3 states that if a contingent payment is automatically forfeited upon termination of employment, the payment is always considered remuneration for post-combination services, without having to proceed with the analysis of the other indicators (ie the indicator is conclusive by itself, unless the service condition is not substantive). This was confirmed by an IFRIC agenda decision issued by the IFRS Interpretations Committee (IFRIC) in January 2013 and reconfirmed in a more recent IFRIC agenda decision in April 2024. This conclusion does not however mean that when the contingent consideration is not automatically forfeited upon termination, that is it automatically part of the consideration transferred. In this context, all the other indicators should be analysed to conclude whether it is consideration transferred or post-combination remuneration. In addition, contingent consideration clauses that are remuneration expenses (because they are forfeited if the selling employees resign) are often referred to as 'good leaver' or 'bad leaver' clauses and are part of complex agreements which may include put and call options. Such agreements need to be carefully assessed to determine whether the terms of the arrangement creates a service condition and results in a payment that is forfeited in case of termination of the employment under certain circumstances.

Indicators	Analysis and possible conclusions
Continuing employment	• if the contingent payment is automatically forfeited upon termination of employment, it is considered remuneration for post-combination services • if the payment does not require continued employment and is not affected by termination, the payment should nevertheless be assessed to determine whether it should be considered as part of the consideration transferred or as a post-combination remuneration expense based on the following additional indicators
Duration of employment	• if the period of required employment coincides with or is longer than the contingent payment period, it is likely to be considered remuneration
Level of remuneration of the selling shareholder employee	• if the remuneration (excluding the contingent payment) of the employee is reasonable compared to other key employees, the contingent payment is likely to be considered part of consideration transferred
Incremental payments to selling shareholder employees	• if the amount of contingent payment is the same for all selling shareholders regardless of their continued employment, the payments are likely to be part of consideration transferred • if the selling shareholder employee is paid a higher amount than those who did not become employees, any incremental amount paid to the selling shareholder employee is likely to be considered remuneration
Number of shares previously owned by a selling shareholder employee	• the contingent payment is likely to be a profit-sharing remuneration arrangement if the selling shareholder employee previously owned a substantial interest in the acquiree • alternatively, if the selling shareholder employee only owned a minimal amount of interest and all other selling shareholders receive the same contingent payment, the contingent payment is likely to be part of consideration transferred • when making this analysis, the ownership interests of parties related to the selling shareholder employee are also considered
Linkage of the formula for determining contingent payment to the valuation	• if the contractual purchase price is based on the low end of a range established in the valuation of an acquiree and the formula for determining contingent payment relates to that valuation, it suggests that the contingent payment is additional consideration • alternatively, if the formula for determining the contingent payment is consistent with prior profit-sharing arrangements, it suggests that the payment is intended as remuneration

Indicators	Analysis and possible conclusions
Formula for determining contingent payment	- if the formula is based on a multiple of earnings, it suggests that the formula is intended to establish or verify the fair value of the acquiree. In this case, the payment is likely to be part of consideration transferred - alternatively, if the formula is based on a specified percentage of earnings, it suggests that it is intended as a profit-sharing arrangement
Other agreements and issues	- the terms of other arrangements with the selling shareholders (eg not to compete agreements, executory contracts, consulting contracts and lease agreements) and the income tax treatment of contingent payments may indicate that the contingent payment could be a payment that is not consideration for the acquired business - for example, in conjunction with the acquisition, the acquirer may enter into a lease agreement with a selling shareholder (the lessor). If the payment terms of the lease are significantly below market, it is possible that part of the contingent payment is for payment of the lease and should be recognised as lease expense. Alternatively, if the lease payment terms are at market terms, the contingent payment is likely to be part of consideration transferred

Other employment compensation arrangements, such as key staff retention bonuses, are also post-combination expense items and not therefore part of consideration transferred (see Example 5 below). Replacement of an acquiree's share-based payment awards can also affect the amount of the consideration transferred as discussed on page 8.

The following examples illustrate IFRS 3's guidance on employee compensation arrangements:

Example 4 – Payments to selling shareholder who remains as an employee

Entity X acquires a 100% interest in Entity Z, a company owned by a single shareholder, for a cash payment of CU 5 million and a contingent payment of CU 1 million. The terms of the agreement provide for the contingent payment two years after the acquisition, if the following conditions are met:

- the accumulated net earnings of Entity Z for the two-year period following the acquisition date exceed a certain amount.
- the former shareholder continues to be employed by Entity Z for at least two years after the acquisition, ie no part of the contingent payment will be paid if the former shareholder does not complete the two years employment period.

Analysis

In this situation, the former shareholder is required to be continuously employed in order to be eligible for the contingent payment. This is because the contingent payment will be forfeited upon termination of employment within the contingent payment period. The CU 1 million contingent payment is deemed to be payment for future services and is recognised in the post-combination statement of profit or loss as compensation expense.

In accounting for the business combination, only the cash payment of CU 5 million is treated as consideration transferred in accordance with IFRS 3.

Example 5 – Compensation arrangements with employees

Entity A acquired Entity B for a cash payment of CU 30 million. In conjunction with the business combination, Entity A entered into an arrangement with certain key employees (who are not shareholders) of Entity B to provide for incentive payments to employees if they remain employed for at least two years after the acquisition date. The employees will continue to receive performance bonuses under their existing employment contracts.

Analysis

In this situation, Entity A will make the incentive payments to the key employees for performing additional services post acquisition. Although the transaction is associated with the business combination, it is accounted for separately from the business combination as:

- the incentive payments are in contemplation of post-acquisition services to be performed by key employees. While not linked to performance, they are designed to encourage the employees to stay for a specified period. Accordingly, the payment is recognised as remuneration in the post-combination statement of profit or loss.
- Even if the agreement is entered into as at the acquisition date and is a condition to the business combination, the incentive payment does not form part of the consideration transferred because such payment is made in contemplation of future services expected to be received after the acquisition date. It is not possible to argue that the incentive payments represent an identifiable assumed liability (contingent) of the acquired business, because it is not an obligation of the acquiree at the acquisition date.

The treatment would however be different if the incentive payments were already part of the employment contracts of the employees. In this situation, the contractual obligation to make the payments would represent a possible obligation of the acquiree until the business acquisition became probable, being the time at which the contractual obligation satisfies the definition of a liability. This is on the basis that the incentives were contractually agreed by the acquiree and the employees a long time before the acquisition (refer to Example 6) and before the acquirer and the seller entered into negotiations to effect the business combination.

Alternatively, Entity B may also have entered into similar agreements with its key employees at the request of Entity A during negotiations to conclude the business combination. In this latter situation, the incentive payments would be considered Entity B's post-combination remuneration as Entity A and Entity B entered into these agreements in order to retain Entity B's key employees (ie the agreement was entered into by the parties in order to benefit the combined entity).

Example 6 – Compensation arrangements with employees

Entity A acquired Entity B for a cash payment of CU 30 million. Prior to Entity A entering into discussions with Entity B's shareholders to acquire Entity B and in anticipation of a possible change of control, Entity B amended the employment contracts it had previously signed with its CEO and CFO, to include a clause stipulating that in the event of a change of control of Entity B, the CEO and the CFO would each be eligible for a cash payment of CU 1 million (change of control bonuses) if they remain employed until the date of acquisition. The CEO and CFO are not however required to remain employed after the transaction is completed to be eligible for these change of control bonuses.

Change of control bonuses must be paid 30 days after the closing of the transaction.

Analysis

In this example, Entity A must determine whether the incentive payments to be made by Entity B upon closing of the transaction represent a present obligation satisfying the definition of a liability of Entity B assumed by Entity A at the acquisition date or if they represent a post-combination remuneration expense.

This results from this fact pattern that the obligation to make the incentive payments is part of the identified liabilities of Entity B assumed by Entity A at the acquisition date. This is because it:

- was included in the employment contracts of the CEO and CFO before Entity A entered into negotiations to acquire Entity B.
- was arranged by entity B with the CEO and CFO with the objective to create incentives to remain employed by Entity B only until the closing of the business combination and therefore to primarily benefit the acquiree or its former owners before the combination.

Acquisition costs

In most situations, the acquirer pays its own acquisition-related costs. IFRS 3 provides that such acquisitions costs are recognised as an expense when incurred in the statement of profit or loss. The only exception is the treatment of costs to issue debt or equity, which are treated as a reduction of proceeds of the related instruments. This treatment also applies to acquisition costs paid by the acquiree or its former owners that are reimbursed by the acquirer.

A purchase agreement may specify that acquisition costs are paid by the vendor and may be separately reimbursed by the acquirer or included in the amount of the purchase price specified in the purchase agreement. For instance, the vendor may pay these expenses as a way of facilitating the negotiations and moving forward the sale if the total amount of the consideration of the business combination will cover the vendor for these expenses paid on the acquirer's behalf. In both cases the acquirer recognises these costs as an expense. If costs are not reimbursed directly, the applicable portion of the contractual price should be treated as an in-substance reimbursement and excluded from the consideration transferred.

Example 7 – Acquisition costs paid by the vendor

Entity Q acquired Entity S for CU 20 million from Vendor V. The purchase agreement provides that Vendor V pays all costs related to the transaction such as legal, due diligence and other professional fees. Entity Q is not explicitly required to reimburse these costs (ie the Share Purchase Agreement does not refer to such costs and to the fact that they should be assumed by the acquirer).

The acquisition related costs paid by Vendor V on behalf of Entity Q amounted to CU 0.5 million. Vendor V incurred an additional CU 0.1 million for its own legal fees related to the transaction.

Analysis

In this situation, the CU 20 million paid by Entity Q effectively includes the reimbursement for the acquisition related costs. Entity Q should account for such costs separately from the business combination as an immediate expense.

In accounting for the business combination, the consideration transferred is measured at CU 19.5 million (contractual purchase price reduced only by the acquisition costs paid on behalf of Entity Q) which represents the amount paid in exchange for the acquired business.

Replacement of acquiree share-based payment awards

In business combinations where an acquiree's existing share-based payment awards are replaced by the acquirer, special considerations apply when determining both consideration transferred and post-combination expenses. Acquiree awards are often replaced in order to, for example:

- avoid future dilution of the acquirer's ownership of the acquiree
- create a more effective employee incentive when the acquirer's shares will be more liquid than the acquiree's after the combination
- rationalise compensation arrangements within the expanded group, or
- harmonise the acquiree's and the acquirer's management packages and how these plans are granted.

In accordance with IFRS 3, exchanges of share-based payment awards in conjunction with a business combination are accounted for as modifications of share-based payment awards in accordance with IFRS 2 'Share-based Payment'.

When the acquirer is obliged to replace the acquiree's share-based payment awards (the original awards) with its own awards (the replacement awards), either all or a portion of the value of the replacement awards forms part of the consideration transferred. Sometimes the acquirer is 'obliged' to replace the acquiree awards if the acquiree or its employees can enforce replacement, eg if replacement is required by:

- the terms of the acquisition agreement
- the terms of the acquiree's awards, or
- applicable laws or regulations.

The same guidance applies in situations where the acquirer replaces the original awards voluntarily. See below for guidance on situations where the acquirer chooses not to replace the original awards.

IFRS 3's objective in accounting for replacement awards is to allocate their value between the amounts attributable to:

- pre-combination service (treated as part of consideration transferred), and
- post-combination service (accounted for as compensation expense in the post-combination financial statements).

IFRS 3 provides specific guidance on how the allocation is determined. This requires the acquirer to measure both the replacement and original awards using a market-based measure (in accordance with IFRS 2) on the acquisition date. This is one of IFRS 3's measurement exceptions discussed in our article ['Insights into IFRS 3 – Specific Recognition and Measurement Provisions'](#) because IFRS 2's market-based measure is not fully equivalent to fair value.

When an unexpired award is replaced by the acquirer, part of the market-based value of the replacement award reflects the acquiree's obligation that remains outstanding at the date of the business combination (corresponds to the services rendered by the employees until that date and for which awards were issued but not yet exercised) and is accounted for as part of the consideration transferred in the business combination. The remaining balance of the market-based value of the replacement award is accounted for as a post-combination expense for the services to be received over the period to when the replacement award vests, in accordance with IFRS 2.

IFRS 3's guidance on the allocation of the value of the replacement awards is as follows:

Element	IFRS 3 guidance
Pre-combination service	• it is measured using the acquisition date market-based measure of the original awards multiplied by the ratio of the vesting period completed at acquisition date to the greater of: – the original vesting period of the acquiree awards, or – total vesting period resulting from the business combination (in case changes were made due to the business combination). • it is included in consideration transferred • the amount allocated to the pre-combination service cannot exceed the value of the original awards on the acquisition date
Post-combination service	• it is the difference between the acquisition date market-based measure of the replacement award and the amount allocated to pre-combination service • in effect, any excess of the value of the replacement awards over the value of the original awards is accounted for as employee compensation expense in post-combination earnings • post-combination compensation expense is recognised over the vesting period if it requires post-combination service (even if the original awards are already vested on the acquisition date). If no further service is required, it is recognised as an immediate expense.

Other situations:

Element	IFRS 3 guidance
Estimate of replacement awards expected to vest	- the allocation between the pre-combination and post-combination portion of the replacement awards should reflect the best available estimate of the number of replacement awards expected to vest - any changes in the estimate of vesting are recognised in post-combination earnings and not as an adjustment to consideration transferred - similarly, the effects of other events (ie modifications or revised estimates of the outcome of any performance conditions) occurring after the business combination are recognised in post-combination earnings in accordance with IFRS 2
Share-based payment awards that will expire as a consequence of a business combination	if the acquirer voluntarily replaces awards that are due to expire because of the business combination, all of the value of the replacement awards is treated as post-combination expense. No value is allocated to consideration transferred
Effect of the classification of share-based payment awards	- the same requirements apply regardless of whether a replacement award is classified as cash-settled or equity-settled in accordance with IFRS 2 - if classified as cash-settled (ie as liabilities), all subsequent changes in the value of the replacement awards and related income tax effects are recognised in post-combination earnings
Income tax effects	income tax effects of the replacement awards are recognised in accordance with IAS 12 'Income Taxes'

The following example illustrates the accounting for replacement of share-based payment awards:

Example 8 – Replacement of acquiree share-based payment awards

Entity P purchases Entity S. Entity S has existing equity-settled share-based payment awards (original awards), which include a clause requiring replacement with an award of at least equivalent value by any future acquirer. The original awards specify a vesting period of four years. At the acquisition date, Entity S's employees have already rendered two years of service.

As required, Entity P replaced the original awards with its own share-based payment awards (replacement awards). With the replacement awards, the vesting period is reduced to one year (from the acquisition date).

The value (market-based measure) of the awards at the acquisition date are as follows:

- original awards: CU 100
- replacement awards: CU 110

As at the acquisition date, all awards are expected to vest (ie the acquirer estimates that all the employees will meet the new service conditions at the acquisition date).

Analysis

The value of the replacement awards is allocated between consideration transferred and post-combination compensation expense.

The portion attributable to pre-combination service is CU 50 (CU 100 × 2/4 years) and is included as part of consideration transferred. That portion is calculated as the value determined at the acquisition date of the original award (CU 100) multiplied by the ratio of the pre-combination service period (two years) to the greater of the total vesting period (three* years) or the original vesting period (four years). The CU 50 is accounted for as a credit to the parent's equity on the basis that:

- it is Entity P's own shares that are to be issued, and
- the award satisfies the definition of an equity-settled share-based payment award.

The remaining CU 60 (CU 110 - CU 50) is attributable to compensation for the employees' future services. This will be recognised as compensation expense in post-combination earnings over the remaining service period of one year (vesting period of the replacement award).

* two years rendered by employees as at the acquisition date plus one year vesting period of the replacement award.

Non-replaced share-based payment awards

In some business combinations, the acquiree's share-based payment scheme continues to exist post-acquisition. Under IFRS 3, the accounting of such situation will depend on whether the awards are vested or unvested at the acquisition date (see below). In both situations, the awards are measured at their market-based measure (in accordance with IFRS 2) at the acquisition date.

Element	IFRS 3 guidance
Vested awards	• recognised as part of non-controlling interest (NCI) (see note below)
Unvested awards	• allocated between amounts attributable to: – pre-combination service – forms part of NCI – post-combination service – accounted for as compensation expense in the post-combination financial statements (credits are also presented as part of NCI) • pre-combination service – calculated using the value of the award measured at the acquisition date and multiplied by the ratio of the vesting period completed at acquisition date to the greater of: – the original vesting period of the existing awards, or – total vesting period (in case changes were made due to the business combination) • post-combination service – remaining balance of the value of the award recognised over the remaining vesting period

Note – the measurement option set out in IFRS 3 that allows the acquirer to measure the NCI either at fair value or their proportionate share in the recognised amounts of the acquiree's identifiable net assets, is not available for this type of NCI as the instruments do not entitle their holders to a proportionate share of the entity's net assets in the event of liquidation.

The following example illustrates the accounting for non-replaced share-based payment awards:

Example 9 – Continuation of acquiree share-based payment awards

Entity Q purchases Entity S. Entity S has an existing equity-settled share-based payment scheme. The awards vest after four years of employee services. At the acquisition date, Entity S's employees have rendered two years of services. None of the awards are vested at the acquisition date.

Entity Q did not replace the existing share-based payment scheme but reduced the remaining vesting period from two years to one year. Entity Q determines that the market-based measure of the award at the acquisition date is CU 100 (based on IFRS 2's measurement principles and conditions at the acquisition date).

Analysis

The market-based measure of CU 100 is allocated between non-controlling interest and post-combination compensation expense.

The portion attributable to pre-combination service is CU 50 ($\text{CU } 100 \times 2/4 \text{ years}$) and is included as part of NCI. That portion is calculated as the value determined at the acquisition date of the award (CU 100) multiplied by the ratio of the pre-combination service period (two years) to the original vesting period (four years) as this later period is greater than the total vesting period (three* years).

The remaining CU 50 ($\text{CU } 100 - \text{CU } 50$) is attributed to the employees' future services. This amount will be recognised as an expense in post-combination earnings over the remaining service period of one year, with the credit recorded in NCI.

* two years rendered by employees as of the acquisition date plus one year vesting period after the acquisition date.

How we can help

We hope you find the information in this article helpful in giving you some insight into IFRS 3. If you would like to discuss any of the points raised, please visit www.grantthornton.com.kh/en/Contact



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