Accounting for reverse acquisition (Part1)

IFRS 3 defines a business as “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”.

A reverse acquisition is said to have occurred when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes.

The first stage in accounting for an acquisition is to determine whether a transaction or other event is a business combination. Transactions sometimes referred to as ‘true mergers’ or ‘mergers of equals’ are also business combinations as that term is used in this IFRS.”

IFRS 3 requires that all business combinations be accounted for by applying the acquisition method. IFRS 3 in addition to determine whether a transaction or other event is a business combination (IFRS 3:3), four stages in the application of the acquisition method are listed: (IFRS 3:5)

1) The formation of a joint venture;
2) The acquisition of a group of assets that does not constitute a business; and
3) A combination between entities or businesses under common control.

The first stage in accounting for an acquisition is to determine whether a transaction or other event is a business combination. This requires that we assess the assets acquired and liabilities assumed if the transactions constitute a business.

The transaction or event should be analyzed by applying the definition of a business combination, and the detailed guidance set out in paragraphs B5 to B12 of the Standard. The guidelines ensure that we consider aspects of the transaction that include assessing if the acquirer obtains control of a business (which means there must be a triggering economic event or transaction) and the possible resulting structures.

The guidance on identifying the acquirer (see IFRS 3:6, 3:7 and IFRS 3:B14 to B18) is relevant in a reverse acquisition transaction. It is suggested that the two primary factors that may lead to the conclusion that the transaction involves a reverse acquisition are:

1) The former shareholders of the entity whose shares are acquired own the majority of shares, and
2) The management of the combined entity is drawn predominantly from the entity whose shares are acquired.

Based on the limitation of IFRS 3 business combination to circumstances when the acquiree is a business, it follows for reverse acquisitions, that the accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition. While the IFRS Interpretations Committee in September 2011 noted that neither IFRS nor the Conceptual Framework for Financial Reporting require that a ‘reporting entity’ be a legal entity.

Consequently, a business that is a reporting entity, but not a legal entity, can be considered to be the acquiree in a reverse acquisition.

Accounting for the reverse acquisition

Consolidated financial statements prepared following a reverse acquisition are issued under the name of the legal parent (accounting acquiree) but described in the notes as a continuation of the financial statements of the legal subsidiary (accounting acquiree), with one adjustment, which is to adjust retroactively the accounting acquiree’s legal capital to reflect the legal capital of the accounting acquiree. That adjustment is required to reflect the capital of the legal parent (the accounting acquiree). Comparative information presented in those consolidated financial statements also is retroactively adjusted to reflect the legal capital of the legal parent (accounting acquiree).

Separate financial statements for the legal parent, if required, would be prepared on a stand-alone basis. When the entity was formed shortly before the combination, its separate financial statements should cover only its actual accounting period.

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Are you considering accounting for a business combination?

1) Identify the acquirer
2) Determine the acquisition date
3) Recognise and measure of the identifiable assets acquired (including intangible assets not recognized in the books of acquiree or considered part of goodwill), the liabilities (including contingent liabilities not in the books of the acquiree) assumed and any non-controlling interests
4) Measure the consideration transferred, if to be transferred
5) Recognise and measure goodwill or gain from a bargain purchase

For more information on accounting for business combinations, call +234 0 8053 015 363 or email to aawojulu@deloitte.com

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