

Consideration Transferred in Business Combination

Introduction

Business combinations are among the most significant transactions a company may enter into. They involve the acquisition of one business by another, with the acquirer assuming control over the acquiree's operations, assets, and liabilities. One of the central aspects of accounting for business combinations under **IFRS 3: Business Combinations** is the determination of the *consideration transferred*. This represents the fair value of what the acquirer has given up in exchange for obtaining control of the acquired business.

The measurement and recognition of consideration transferred are crucial because they directly affect the calculation of goodwill or, in rare cases, a gain on a bargain purchase. A precise understanding of this concept ensures transparent financial reporting, enhances comparability, and provides useful information to stakeholders.

This manual provides a detailed, step-by-step explanation of what constitutes consideration transferred, how it should be measured, the treatment of contingent and deferred considerations, the remeasurement of previously held equity interests, and related issues such as transaction costs and share-based payments.

The Concept of Consideration Transferred

In simple terms, the consideration transferred is the fair value of what the acquirer exchanges to obtain control of the acquiree. This may be in the form of cash, equity instruments, debt instruments, other assets, contingent consideration, or even the revaluation of previously held equity stakes. The standard requires that consideration be measured at the **date of acquisition**, not at the date when negotiations begin or contracts are signed.

This requirement reflects the fact that the value of financial instruments and assets may fluctuate between the signing of the agreement and the date of actual transfer of control. The fair value approach ensures that the business combination is accounted for at amounts that reflect current market conditions as of the acquisition date.

Components of Consideration

The consideration transferred can take many forms. The most common is **cash**, but it is not limited to immediate cash settlements. Companies often structure deals using a mixture of instruments.

Cash payments are the most straightforward. The acquirer pays an agreed sum to the seller on the acquisition date. This sum, being tangible and readily measurable, does not require complex accounting treatment.

Equity instruments are another common form of consideration. In such cases, the acquirer issues shares to the sellers of the acquiree in exchange for ownership. The fair value of these shares at the acquisition date must be determined and included in the total consideration. Market value is usually used, although if the shares are not publicly traded, valuation techniques must be applied.

Debt instruments may also be issued as part of the consideration. Bonds, debentures, or other debt securities may be exchanged for control of the acquiree. Again, these must be valued at fair value on the acquisition date.

Sometimes, non-cash assets are transferred. For example, the acquirer may transfer property, plant, or equipment, or even another business unit, as part of the deal. The fair value of the asset at the acquisition date forms part of the consideration.

A particularly complex form of consideration is **contingent consideration**, which is discussed separately due to its detailed treatment.

Contingent Consideration

Contingent consideration arises when the acquirer agrees to transfer additional assets or equity instruments in the future, depending on certain conditions being met. These conditions are often linked to the financial performance of the acquiree after acquisition. For example, sellers may only receive additional payments if the acquired company achieves a specified revenue target or return on capital employed.

IFRS 3 requires contingent consideration to be recognized at fair value on the acquisition date, even if payment is not considered probable. This ensures that the acquisition price reflects all aspects of the agreement between the acquirer and the seller.

The nature of contingent consideration is important. If it is settled in cash or other financial liabilities, it is classified as a **liability**. In such cases, subsequent remeasurement is required at fair value, with changes recognized in profit or loss. However, if it is settled by issuing a fixed number of the acquirer's equity instruments, it is classified as **equity**, and no remeasurement is made after the acquisition date.

For example, suppose an acquirer agrees to pay \$2 million if the acquiree achieves a profit margin above 15% in the following year. On the acquisition date, the fair value of this obligation is estimated at \$1.5 million. This amount is recognized as part of the consideration transferred. If the obligation is a liability, it will be remeasured at each reporting date until settlement, with gains or losses recorded in profit or loss.

Deferred Consideration

Deferred consideration is similar to contingent consideration, but the key difference is that payment is delayed rather than conditional. The acquirer may agree to pay a portion of the purchase price one or two years after acquisition. Such arrangements are common when acquirers face liquidity constraints or when the sellers prefer structured payouts.

Deferred payments are measured at their present value at the acquisition date, using an appropriate discount rate. The unwinding of the discount over time is recognized as finance cost in subsequent periods.

Bargain Purchase and Goodwill

The total consideration transferred, together with the fair value of non-controlling interests and the fair value of previously held interests, is compared with the fair value of the acquiree's

identifiable net assets. If the consideration exceeds the net assets, the difference is recorded as **goodwill**.

In rare cases, the net assets exceed the consideration. This results in a **bargain purchase**, which IFRS 3 requires to be recognized immediately in profit or loss as a gain. Such situations may arise in distressed sales, for example, where the acquiree is facing financial difficulties and the acquirer negotiates a lower price.

Transaction Costs

A common misunderstanding is that transaction costs form part of the consideration transferred. IFRS 3 is explicit that **transaction costs are expensed as incurred**. These costs, such as legal fees, due diligence expenses, and advisory fees, do not represent consideration for the acquiree but rather costs of executing the transaction.

However, costs directly related to the issue of debt or equity instruments are accounted for under the respective standards, such as IAS 32 or IFRS 9.

Share-Based Payments

Another area addressed by IFRS 3 is share-based payment awards. Sometimes the acquirer agrees to exchange its share-based payment awards for those of the acquiree. The standard distinguishes between awards that are part of the consideration transferred and those that are compensation for future services.

If the awards relate to past services, their fair value is included in the consideration transferred. If they relate to future services, they are treated as post-combination expenses, recognized in profit or loss over the vesting period.

This distinction is critical because it affects both the measurement of consideration and the future expense profile of the acquirer.

Presentation in the Financial Statements

In the consolidated financial statements, the consideration transferred is presented as part of the acquisition accounting. The notes to the financial statements must disclose the components of consideration, the methods used for fair value determination, and the accounting treatment of contingent and deferred consideration.

Transparency in disclosure helps users understand how the transaction was structured, the risks associated with contingent arrangements, and the assumptions underlying valuation techniques.

Example

Suppose Company A acquires 100% of Company B on 1 January 2025. The deal includes the following:

- An immediate cash payment of \$10 million.
- Deferred payment of \$2 million payable after two years, with a discount rate of 8%.

- Contingent consideration of up to \$3 million if revenue exceeds a specified threshold in the following year. The fair value of this contingent consideration at the acquisition date is estimated at \$2.2 million.
- A previously held interest of 20% in Company B, which had a carrying amount of \$1.5 million but a fair value of \$2.5 million at the acquisition date.

The calculation of consideration transferred would be:

- Immediate cash: \$10 million
- Deferred payment: $\$2\text{m} \div (1.08^2) = \1.72 million
- Contingent consideration: \$2.2 million
- Remeasured previously held interest: \$2.5 million

Total consideration transferred = \$16.42 million.

This figure is then compared with the fair value of Company B's net assets to calculate goodwill or a bargain purchase gain.

Practical Considerations

In practice, determining consideration transferred involves significant judgment, especially when estimating the fair value of contingent and deferred consideration. Valuation techniques such as discounted cash flow models, option pricing models, or Monte Carlo simulations may be applied, depending on the complexity of the arrangement.

Furthermore, management must carefully assess the classification of contingent consideration as equity or liability, as this affects future reporting. The choice of discount rate for deferred payments and the assumptions underlying performance targets can have material impacts on reported figures.

Conclusion

Consideration transferred is at the heart of accounting for business combinations. It represents the economic sacrifice made by the acquirer to obtain control of another business. By requiring measurement at fair value and by addressing complex elements such as contingent consideration, deferred payments, and previously held interests, IFRS 3 ensures that business combinations are accounted for consistently and transparently.

For finance professionals, a solid understanding of consideration transferred is essential. It affects not only the calculation of goodwill but also the recognition of subsequent expenses and liabilities. Inaccurate measurement can mislead stakeholders, distort reported performance, and undermine trust in financial reporting.

In summary, proper treatment of consideration transferred provides a reliable foundation for the consolidation process, ensures compliance with IFRS standards, and supports informed decision-making by investors, regulators, and other users of financial statements.