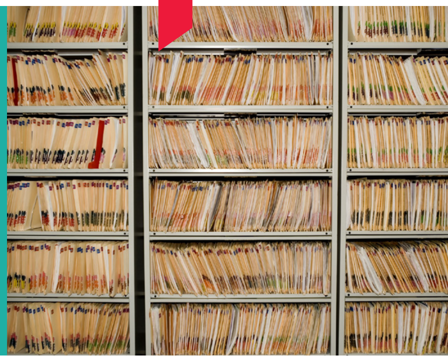
ESMA's REVIEW OF THE APPLICATION OF BUSINESS COMBINATION ACCOUNTING
INTERNATIONAL FINANCIAL REPORTING BULLETIN 2014/10



Background

The European Securities and Markets Authority (ESMA) has released a report outlining the findings of its 2012 financial statement review of the application of business combination accounting. The report evaluates the appropriateness of the application of business combination accounting from a sample of 66 business combinations of 56 European issuers (45 with significant business combinations and 11 smaller entities with material business combinations) from 11 countries with a combined market capitalisation total of approximately €1,055bn. The business combinations had fair value of consideration totalling €76bn, resulting in the recognition of €41bn of goodwill and €36bn of intangible assets.

In January 2014 the International Accounting Standards Board (IASB) issued a *Request for Information* regarding its *Post Implementation Review* (PIR) of IFRS 3 *Business Combinations*. Comments on the IASB's PIR were to be received by 30 May 2014. ESMA notes in the executive summary of its report that its findings and comments are designed to assist the IASB in its PIR in identifying areas where IFRS 3 leads to divergence in practice or lack of comparability and where there may be a need for additional clarification or guidance.

Areas addressed in ESMA's report include:

1. General observations on disclosures
2. Intangible assets and contingent liabilities
3. Disclosure of fair value measurement techniques
4. Recognition and measurement of goodwill and bargain purchase gains
5. Mandatory tender offers
6. Contingent consideration
7. Definition of a business, and
8. Adjustments to fair value amounts during the measurement period.

ESMA has indicated that it expects issuers to consider the findings of the report when preparing future IFRS financial statements, in particular those areas in which ESMA considers improvements are required; the auditors of those financial statements would also be expected to give them careful consideration. In addition, the findings and recommendations of the report will be incorporated into reviews carried out by each national authority, which will take corrective action (which may include a requirement for public restatement of financial statements) in the event that a material error is identified.

While ESMA is a European regulator, listed companies in other jurisdictions that apply IFRS (and their auditors) should be aware of, and take into account, the enforcement issues raised in the statement, as they relate to observations that are not unique to the European financial reporting environment. It is also relevant that enforcers worldwide are increasingly sharing information that they collect in the process of their activities.

STATUS
Final

EFFECTIVE DATE
n/a

ACCOUNTING IMPACT
Focus areas for European enforcers; also relevant for other jurisdictions due to global coordination among national enforcers.

Recommendations to the IASB on potential improvements to business combination accounting.

Executive summary

An overview of the key issues raised by ESMA in its report are highlighted below.

1. ***General observations on disclosures***
   - ESMA noted a number of areas where the disclosure requirements of IFRS 3 could be improved. These include, in particular, the reasons for undertaking the business combination, and the revenue and profit or loss that would have been reported for the period had the business combination occurred at the start of the year
   - Untailored 'boiler-plate' disclosures should be avoided, and were particularly common for disclosures about why goodwill had been recorded and the reasons for a bargain purchase gain
   - Business combination disclosures should be centralised in a single note within the financial statements of an entity's annual report, instead of being spread among numerous notes.
2. ***Intangible assets and contingent liabilities***
   - Entities need to ensure that intangible assets acquired are subsequently disaggregated and presented by class so that items that are dissimilar in nature or function are presented separately
   - Assumptions used as the basis for the subsequent accounting of acquired intangible assets (useful life and the basis for determining the amortisation pattern) should be consistent with those used in determining their initial fair value
   - The extent to which contingent liabilities were recognised was expected to be higher than the amount actually observed.
3. ***Disclosure of fair value measurement techniques***
   - Disclosure of the fair value measurement techniques and assumptions used is required where estimation uncertainty exists and there is a significant risk of a material adjustment to the carrying amount of assets in the next reporting period (IAS 1.125-129). This may apply to certain fair value measurements, regardless of whether the fair values have been finalised at the reporting date immediately following the acquisition date.
   - When an entity elects to measure non-controlling interest at fair value (rather than proportionate share of identified net assets), IFRS 3 requires disclosures to be made about how the fair value was determined and the IAS 1 disclosures referred to above may also be relevant.
4. ***Recognition and measurement of goodwill and bargain purchases***
   - Untailored 'boiler-plate' disclosures should be avoided, particularly about why goodwill had been recorded and the reasons for a bargain purchase gain (which ESMA noted seem to arise more often than the IASB had originally expected)
   - It is necessary to ensure that identifiable intangible assets are recognised separately from goodwill, in order that goodwill is not overstated.
5. ***Mandatory tender offers***
   - Entities for which mandatory tender offers are relevant need to establish, disclose, and then consistently apply an accounting policy in respect to these. A mandatory tender offer arises when an entity has acquired a sufficiently large shareholding in an investee that local laws or regulations require it to make an offer for the entire remaining share capital of the investee
   - If the accounting policy adopted is not to recognise a liability arising from the mandatory tender offer, consideration should be given to the disclosure requirements regarding contingent liabilities.
6. ***Contingent consideration***
   - Entities for which contingent consideration is relevant need to ensure adequate disclosures are made about the basis for determining contingent consideration and an estimate of a range of outcomes
   - Changes in the amount of contingent consideration are not 'measurement period' adjustments when they result from events that occur after acquisition date and are instead recorded in profit or loss
   - Contingent consideration payable to a former owner who stays on as an employee of the acquired business, but which is forfeited should the former owner's employment be terminated, is accounted for as an employee expense (unless the 'lock in' conditions are not substantive).
7. ***Definition of a business***
   - Where the determination of whether an acquisition meets the definition of a business is not straightforward, entities need to ensure that they disclose any significant management judgements that have been used in determining whether the definition of a business has (or has not) been met.
8. ***Adjustments to fair value amounts during the measurement period***
   - Entities need to ensure that when the 'measurement period' is open at reporting date that this is clearly disclosed to users of the financial statements and that the disclosures required by IFRS 3 are made. This applies when the acquisition date measurements of acquired assets and liabilities have not been finalised at the reporting date, with IFRS 3 permitting these to be adjusted within 12 months of the acquisition date
   - It is necessary to ensure that the 'measurement period' concept is only applied where it is applicable (i.e. where the initial accounting for a business combination is genuinely incomplete at the end of the reporting period).

1. General observations on disclosures

Requirements of IFRSs

The general disclosure requirement of IFRS 3.59 requires entities disclose information that enables users to evaluate the nature and financial effect of a business combinations that occur during the period, as well as those that occur after reporting date but before the financial statements are authorised for issue. IFRS 3.B64 - B66 set out the disclosure requirements to be satisfied in order for this to be achieved.

ESMA's findings

ESMA noted that overall the disclosures made by entities were comparable to the requirements of IFRS 3. Areas of concern where disclosure could be improved in the financial statements included:

- Disclosure of the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period (IFRS 3.B64(q)(ii))
- Disclosure of the reasons for the business combination (IFRS 3.B64(d))
- The use of untailored 'boiler plate' disclosures, in particular for disclosures relating to the make-up of goodwill (IFRS 3.B64(e)) and the reasons for bargain purchase gains (IFRS 3.B64(n)(ii))
- Centralising the location of disclosures relating to business combinations – ESMA noted that in some cases these disclosures were spread throughout the annual report (i.e. in the management commentary and/or other notes to the financial statements).

ESMA noted that although IFRS does not specify that the disclosures required by IFRS 3 are set out in a single note, they believe that doing so provides users with the most accessible and comparable information regarding an entity's business combinations.

ESMA's comments to the IASB

ESMA noted that it welcomes the IASB's work regarding its *Disclosure Initiative* project. In particular, it is noted that the proposed amendment to IAS 1 *Presentation of Financial Statements* to clarify that grouping notes in systematic order includes grouping by topic is consistent with ESMA's view that an entity's business combination disclosures should be grouped into a single note.

2. Intangible assets and contingent liabilities

Requirements of IFRSs

(i) Intangible assets

The recognition threshold for intangible assets in a business combination is lower than in IAS 38 *Intangible Assets*. Provided an intangible asset is identifiable (by meeting either the separability or contractual-legal criterion of IFRS 3.B31 – B34), it is recognised by the acquirer in a business combination.

This often results in the recognition of a number of different types of intangible assets being recognised in accordance with IFRS 3 that are not recognised in accordance with IAS 38, such as:

- Customer-related intangibles (customer relationships, lists, contracts, order backlogs)
- Marketing-related intangibles (brands, internet domains)
- Technology-based intangibles (software)
- Contract-based intangibles (licences, patents, exploration rights publishing rights, non-competition rights, concession rights)
- Other types (artistic based, management fee rights, carbon licence rights).

Subsequently, these intangible assets are measured in accordance with the requirements of IAS 38, either being amortised based on the pattern in which their future economic benefits are expected to be consumed by the entity (IAS 38.97) or, for those intangible assets with an indefinite useful life, being subject to an annual impairment test.

Classification and presentation of these intangible assets is made in accordance with the general requirements of IAS 1.29 and 59, which require assets to be disaggregated by class and that items of a dissimilar nature or function should be presented separately.

(ii) Contingent liabilities

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* prohibits the recognition of contingent liabilities (IAS 37.27).

However in a business combination, IFRS 3.23 requires that a contingent liability is recognised at acquisition date by the acquirer if:

- There is a present obligation arising from a past event, and
- Its fair value can be reliably measured.

Subsequently, contingent liabilities recognised in a business combination are accounted for in accordance with IFRS 3.56, being the higher of:

- The amount that would be recognised under IAS 37
- Initial recognition, less (if appropriate) cumulative amortisation recognised in accordance with IAS 18 *Revenue*.

ESMA's findings

ESMA noted the following areas were improvements could be made;

- More 'granular' (i.e. disaggregated) presentation of intangible assets resulting from business combinations in order to comply with the general requirements of IAS 1
- For the subsequent measurement of intangible assets, the assumptions used should be similar to those that were used to determine their fair value at acquisition date (in particular, the estimated useful life and the profile of amortisation)

  For example, ESMA noted instances where certain customer-based intangibles where subsequently measured using a straight-line amortisation rate over a relatively short useful life, and did not reflect the assumptions used (including non linear 'churn rates') that were used in determining their initial fair value
- ESMA noted that very few entities sampled (11%) recognised contingent liabilities as a result of business combination. ESMA noted that in its experience contingent liabilities are not uncommon, which would imply that the level of recognition should be higher.

ESMA's comments to the IASB

For the recognition of customer-related intangible assets in a business combination, ESMA noted that it agrees with the IFRS Interpretations Committee agenda decision in March 2009 that the way in which such a relationship is established (i.e. whether contractual or non-contractual) is not the primary basis for determining recognition. ESMA also noted that it would like to see the IASB consider this topic, and the IFRS Interpretations Committee's recommendation from its March 2009 agenda decision, during its *Post Implementation Review* of IFRS 3.

Regarding recognition of contingent liabilities in a business combination, ESMA noted its concern regarding the lack of a 'probable economic outflow' criterion in IFRS 3, in contrast to the one that exists in IAS 37. ESMA also noted that there is currently no requirement for entities subsequently to present a reconciliation between the opening and closing balances of contingent liabilities in a business combination, as is required for provisions (IAS 37.84). In its report ESMA recommends to the IASB that it consider addressing these two inconsistencies between IFRS 3 and IAS 37.

3. Disclosure of fair value measurement techniques

Requirements of IFRSs

IFRS 3 does not contain any specific disclosure requirements regarding the fair value measurement techniques and assumptions used to determine the fair value of net assets acquired. IFRS 13 *Fair Value Measurement* does not contain any such specific disclosure requirements; instead, IFRS 13 requires disclosures about fair value measurements after initial recognition.

However IFRS 3.45 incorporates the 'measurement period' concept under which, if the initial accounting for a business combination is incomplete by the end of the reporting period, the acquirer has 12 months from acquisition date to finalise the accounting and retrospectively adjust the initial accounting (refer to section 8 of this *IFR Bulletin* for further details). In some cases this may result in 'estimation uncertainty' regarding the initial fair values determined for some (or all) of the net identifiable assets acquired, in which case additional disclosures are required in accordance with IAS 1.125 - 129 (which may require the disclosure of the fair value measurement techniques and assumptions used).

IFRS 3 allows non-controlling interest at acquisition date to be determined at either fair value, or at an amount based on the proportionate share of the fair values of identified net assets. Where the fair value method is adopted, an entity is required to disclose how the fair value has been determined (B64(o)(ii)).

ESMA's findings

ESMA noted that there was diversity in the fair value information disclosed by entities regarding the initial fair value measurement of the net identifiable assets acquired. Just over one third of entities disclosed how the initial fair value measurement was determined, with most of them only disclosing the technique that was used. Very few entities disclosed information about the main assumptions used in the application of those techniques.

While these disclosures are not specifically required by IFRS 3 or IFRS 13, they will most likely be required by IAS 1 when there is estimation uncertainty regarding the initial fair value measurement (which may exists where the initial accounting for a business combination is incomplete) and in consequence there is a significant risk of a change in the carrying amount(s) during the next reporting period.

ESMA also noted that just over one quarter of entities provided voluntary disclosure comparing the pre-acquisition book values of the net identifiable assets acquired with their corresponding acquisition date fair values. ESMA noted that it believes disclosure of such information us useful to users of the financial statements as it allows them to evaluate the effect of the fair value measurements.

ESMA also noted that, of the 63% of entities that used the fair value option for measuring NCI, very few provided disclosures as to how the fair value was determined (as is required by IFRS 3).

ESMA's comments to the IASB

Given ESMA's observation of a significant number of intangible assets with no active market being recognised in business combinations, ESMA recommends that the fair value disclosures of IFRS 13 be aligned with (or incorporated within) IFRS 3 so that users of the financial statements adequately understand the net assets that have been acquired. These disclosures would also enhance transparency around significant management judgements in determining the consideration paid for the acquisition.

ESMA also notes that it believes that increasing the transparency of fair value disclosures for business combinations would assist in mitigating against the occurrence over overly optimistic valuations that lead to immediate bargain purchase gains.

4. Recognition and measurement of goodwill and bargain purchase gains

Requirements of IFRSs

Goodwill

IFRS 3 requires an entity to recognise identifiable (intangible) assets separately from goodwill, with goodwill simply representing a residual excess of unidentifiable assets.

IFRS 3 requires an entity to make a qualitative disclosures about what makes up goodwill recognised in a business combination (B64(e)).

Bargain purchase

A bargain purchase exists where the value of the net identifiable assets measured in accordance with IFRS 3 exceeds the fair value of the consideration. IFRS 3.36 requires that an entity first reviews its business combination accounting when a bargain purchase occurs, to ensure that such a scenario actually does exist (IFRS 3.34 and 35 note that such instances occur 'occasionally' in specific circumstances, such as a forced sale).

If it is concluded that the business combination is a bargain purchase, IFRS 3 requires qualitative disclosures as to why this is the case (B64(n)(ii)).

ESMA's findings

Goodwill

ESMA noted the following in its review of goodwill that:

– Goodwill was recognised in 86% of cases (bargain purchases were recognised in 11% of cases, and neither goodwill or a bargain purchase in 3% of cases)
– When recognised, goodwill represented on average 54% of the consideration paid
– When goodwill was recognised, separate intangible assets were not recognised in 24% of cases.

Based on the above, ESMA's report encouraged entities to ensure that identifiable intangible assets are recognised separately from goodwill. Circumstances where entities should give additional consideration should be where:

– No such intangible assets have yet be recognised
– Goodwill represents a significant portion of the transaction price.

ESMA also noted that the qualitative disclosures, describing the composition of goodwill, were often missing, inadequate, or 'boiler-plate' in nature (i.e. referring simply to 'synergies' without elaborating how these synergies would be achieved).

Bargain purchases

ESMA noted the following in its review of bargain purchases:

– Bargain purchases were recognised in 11% of cases
– When recognised, bargain purchases represented 46% of the consideration paid on average (the highest noted was 130%).

From its previous experience, ESMA has noted that bargain purchases are not rare, and may result for reasons such as:

– High valuations of intangible assets that have no observable market
– Costs that do not meet the criteria of recognisable liabilities in accordance with IFRS 3, despite being considered by the parties in determining the purchase price (e.g. certain future planned structuring costs as there is no 'past event' at acquisition date).

ESMA also noted that the qualitative disclosures as to why a bargain purchase had arisen were often missing, inadequate, or 'boiler-plate' in nature. Due to the nature of bargain purchases, ESMA noted in its report that it encourages entities to provide additional specific disclosures regarding bargain purchases to assist users in their understanding of the transaction, including (for example):

- The processes undertaken to confirm that the business combination accounting was correct
- Whether the bargain purchase arose due to recognition and/or measurement restrictions/exemptions under IFRS 3.

ESMA's comments to the IASB

Goodwill

ESMA noted that in some cases (particularly in the real estate industry) goodwill results solely from the recognition of deferred tax liabilities that occur due to differences between an assets tax base and its new fair value, and recommends that the IASB should consider this area during its *Post Implementation Review* of IFRS 3.

Bargain purchase

Given the prevalence of bargain purchases in practice (when in theory they should be rare occurrences), ESMA recommends that the IASB should consider this area during its *Post Implementation Review* of IFRS 3 and its *Conceptual Framework* project, in particular:

- Improving disclosure requirements as to why a bargain purchase has arisen
- Further examination of the recognition exemptions of certain liabilities.

5. Mandatory tender offers

Requirements of IFRSs

In practice, mandatory tender offers (MTOs) occur when an acquirer, after obtaining control over (or a specified non-controlling interest in) an entity, is required (usually by law) to acquire any remaining interests held by other parties by offering to purchase the interest (often up to a defined threshold). The question which then arises is whether the existence of MTOs result in a liability for the acquirer.

Currently, IFRS 3 does not contain any specific guidance or requirements regarding MTOs.

Previously, MTOs have been discussed by the IFRS Interpretations Committee (IFRS IC) on a number of occasions:

- In November 2012 the IFRS IC tentatively decided that MTOs were executory contracts in nature and therefore no liability should be recognised (i.e. the MTO is not a linked transaction to the business combination)
- When the issue was revisited in March 2013, several members of the IFRS IC believed that a liability should be recognised at acquisition date.

Following its March 2013 meeting, the IFRS IC agreed to include this issue as part of the IASB's *Post Implementation Review* of IFRS 3.

ESMA noted in its report that due to the lack of specific guidance in IFRS, there is divergence in practice as to whether MTOs are linked to the original business combination and whether a liability to purchase the NCI should be recognised as at the date (and as part of) the original business combination.

In addition, for those entities that are subject to MTOs, other IFRSs require:

- An accounting policy to be established in accordance with the criteria and guidance of IAS 8 *Accounting Policies, Estimates and Errors* paragraphs 10 - 12
- The disclosure of an accounting policy relating to MTO's (where they are material) (IAS 1.121 - 122)
- Disclosure of any contingent liability, if the entity's accounting policy is not to recognise a liability at acquisition date (i.e. details of the potential cash outflow) (IAS 37.86).

ESMA's findings

Only 6% of the business combinations sampled were step acquisitions, however most of these were affected by MTOs. However in all cases, as at the reporting date, the MTO had been finalised and so there was no potential for a liability to be recorded and/or disclosed.

Until the IASB clarifies the appropriate accounting for MTOs, ESMA encourages entities that are subject to MTOs to:

- Apply the guidance of IFRS 3.B97 to determine whether the original business combination transaction and the MTO are linked
- Establish and disclose an accounting policy regarding accounting for MTOs (in accordance with IAS 1 and IAS 8)
- Apply that accounting policy consistently to all business combinations affected by MTOs
- Where an entity's accounting policy is not to recognise a liability, ensure that the disclosure requirements for contingent liabilities (IAS 37.86) are made.

ESMA's comments to the IASB

ESMA recommends that the IASB should consider this area during its *Post Implementation Review* of IFRS 3 and its *Conceptual Framework* project, including:

- Where a MTO is required whether or not an entity controls an investee as a result of an acquisition of an interest in that investee
- When control of an entity is lost in two or more transactions, whether these transactions are linked.

6. Contingent consideration

Requirements of IFRSs

IFRS 3 requires contingent consideration in a business combination to be measured initially at fair value. Subsequently, depending on whether the contingent consideration meets the definition of equity or a financial liability, changes in fair value are:

- Not recognised (if equity)
- Recognised in profit or loss (if a financial liability), and not as an adjustment to the carrying amount of goodwill.

In addition, IFRS 3.58 states that changes in the fair value of contingent consideration as a result of events that occur after acquisition date are not measurement period adjustments, and are therefore recognised in profit or loss. Such events include:

- Earn out clauses based on future performance
- Performance targets
- Reaching a specified share price
- Reaching a specified milestone on a research and development project.

In circumstances in which a former owner of an acquired business stays on as an employee of that business, and there is an amount of contingent consideration that is forfeited should the former owners employment be terminated, IFRS 3.B55(a) requires that this amount is accounted for as an employee expense (rather than as a component of goodwill). In the January 2013 meeting of the IFRS IC, this treatment was confirmed (provided the lock in arrangements are substantive). However the IFRS IC suggested that this issue should be revisited during the IASB's *Post Implementation Review* of IFRS 3.

When a business combination contains an amount of contingent consideration, IFRS 3 requires an entity to disclose (B64(g)):

- The amount recognised at acquisition date;
- A description of the arrangement (including the basis for determining the payment amount)
- An estimate of the range of outcomes (or the reasons why a range cannot be estimated).

ESMA's findings

ESMA noted in its report that the requirements regarding contingent consideration in IFRS 3 are clear, and that entities need to ensure they comply with these requirements.

In particular ESMA noted that entities need to ensure that:

- The basis for determining contingent consideration is disclosed
- The estimate of a range of outcomes is disclosed
- Changes in the value of contingent consideration that are a result of events after acquisition date are not taken to goodwill (even if during the measurement period)
- The accounting for contingent consideration payable to a former owner who stays on as an employee of the acquired business, but which is forfeited should the former owners employment be terminated, is accounted for as an employee expense (provided the lock in arrangements are substantive).

ESMA's comments to the IASB

ESMA recommends that the IASB should consider this area during its *Post Implementation Review* of IFRS 3 and its *Conceptual Framework* project, even though this topic was not specifically included.

7. Definition of a business

Requirements of IFRSs

Only where the net identifiable assets acquired meet the definition of a 'business' as defined by IFRS 3 can business combination accounting set out in IFRS 3 be applied.

Appendix A of 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'*

In most cases, meeting this definition is straightforward. However at the extremes management judgement is required, particularly regarding whether the elements of a business (inputs, processes, and outputs) as noted in IFRS 3.B7 are:

- Present, and
- Capable of being managed as a business.

Significant management judgements are required to be disclosed in accordance with IAS 1.122.

Correctly determining whether the definition of a business has been met is critical as there are number of significant differences between business combination accounting and asset acquisitions, such as:

- Differences in the recognition and measurement requirements of certain items under IFRS 3 compared to other IFRSs (e.g. intangible assets, contingent liabilities)
- Requirement to recognise goodwill under IFRS 3
- Deferred tax consequences under IFRS 3
- Expensing acquisition costs under IFRS 3.

ESMA's findings

ESMA noted that there were instances where entities had used significant management judgement in determining whether the definition of a business had been met, but had not disclosed how these judgements had been made (as required by IAS 1.122).

ESMA noted in its report that it commonly sees these areas of significant management judgement in transactions in the real estate, extractive, and pharmaceutical industries.

ESMA's comments to the IASB

Given that significant management judgement is currently required in determining whether the definition of a business has been met, ESMA recommends that the IASB continue to develop the definition of business and improve guidance in this area.

8. Adjustments to fair value amounts during the measurement period

Requirements of IFRSs

IFRS 3 incorporates the 'measurement period' concept, which is only applicable where the initial accounting for a business combination is incomplete by the end of the reporting period. In such cases, the acquirer has 12 months from acquisition date to finalise the accounting and retrospectively adjust the initial accounting. Adjustments relate only to conditions that existed at the acquisition date, and do not take into account changes arising as a result of transactions or events that took place after the acquisition date.

In circumstances where adjustments may be needed, an entity is required to disclose (IFRS 3.B67(a)):

- The fact that the initial accounting is incomplete
- Reasons why the initial accounting is incomplete
- For which items the initial accounting is incomplete
- The nature and amount of any 'measurement period' adjustments made in the reporting period.

These disclosures are required for each material business combination, or in aggregate for individually immaterial business combinations.

As noted above, IFRS 3 only allows 'measurement period' adjustments to be made based on new information regarding facts and circumstances that existed at acquisition date. In practice, 'measurement period' adjustments usually involve determining the final value of:

- The identifiable net assets acquired
- Non-controlling interests
- Consideration transferred (except some contingent consideration – refer to section 6)
- Previously held interests of the acquirer
- Goodwill or bargain purchase.

Where the initial accounting for a business combination is incomplete by the end of the reporting period, an entity that is applying the 'measurement period' requirements of IFRS 3 would usually be required to disclose a related accounting policy (IAS 1.121 - 122).

ESMA's findings

In general, ESMA noted that most entities included a statement in their business combination accounting policy regarding adjustments to the identifiable net assets acquired before the business combination accounting is complete.

However, there were a number of omissions or inadequate disclosures noted by ESMA in respect of all the disclosure requirements of IFRS 3.B67(a). In some cases, it was not clear from an entity's financial statements whether the 'measurement period' was still open at the reporting date.

ESMA also noted in its report that entities need to remember that the 'measurement period' concept is not a default position to be applied to all business combinations, and that it is only to be applied when the initial accounting for a business combination is genuinely incomplete at the end of the reporting period (i.e. entities do not have a default 12 month period after an acquisition date to finalise the accounting for their business combinations).

ESMA's comments to the IASB

Given the overall poor compliance with the disclosure requirements of IFRS 3.B67(a) (in particular, why the initial accounting is incomplete and for which items it is incomplete), ESMA recommended that the IASB may wish to revisit the disclosure requirements in this area.

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