Grant Thornton

Insights into IFRS 3

Business combinations where the accounting is incomplete at the reporting date

Acquisitions of businesses can take many forms and can have a fundamental impact on the acquirer's operations, resources and strategies. These acquisitions are known as mergers or business combinations which should be accounted for using the requirements in IFRS 3 'Business Combinations'.

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.

This article discusses the requirements when the business combination accounting is incomplete at the reporting date.

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Use of provisional amounts at the reporting date

The complexity of business combination accounting and the work associated with accounting for them has consequences when business combinations occur close to the reporting date. It is not always practical to finalise the accounting before the reporting entity needs to issue the financial statements that cover the period when the combination occurs. In such circumstances, IFRS 3 requires the acquirer to initially report the business combination using provisional amounts. For example, if an acquirer with a reporting date of 31 December completes a business combination during December, the acquirer may use provisional amounts for their year-end reporting. A defined period of time – referred to as the measurement period (see below) – is then available to complete the accounting. We will stress that this measurement period is not intended as a timeline to complete the accounting, and when information is available the accounting should be completed as soon as possible.

Amounts that may be reported provisionally and then potentially revised include:

- the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree
- the consideration transferred for the acquiree (or the other amount used in measuring goodwill)
- the equity interest in the acquiree previously held by the acquirer – when it relates to a business combination achieved in stages
- resulting goodwill or gain on a bargain purchase.

When provisional amounts are used, the acquirer discloses:

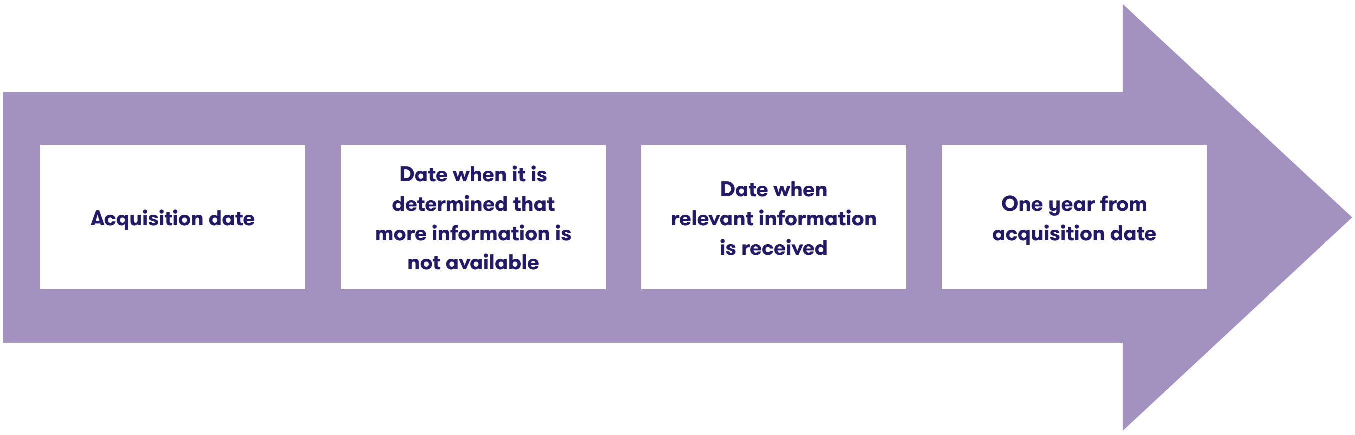
- assets, liabilities, equity interests or consideration where provisional amounts are used
- the reasons why the accounting for the business combination is incomplete
- the nature and amount of any measurement period adjustments recognised during the reporting period.

The measurement period and related adjustments

The measurement period ends at the earlier of:

- the date at which required information is obtained (or found to be unavailable)
- one year from the acquisition date.

The following diagram illustrates the timeline of the measurement period:



The measurement period cannot exceed twelve months.

Measurement period adjustments must be distinguished from normal accounting adjustments that may arise during the measurement period. Measurement period adjustments are limited to those that arise from new information obtained about facts and circumstances that existed at the acquisition date. Events after the acquisition date may also lead to changes in estimates and give rise to new assets and liabilities. However, these are not measurement period adjustments. In making this distinction the acquirer should consider:

- the timing of the receipt of the new information. For example, information received shortly after the acquisition date is more likely to indicate that the facts and circumstances existed on the acquisition date. If an intervening event cannot be identified, a significant change from the provisional fair value shortly after the acquisition date is more likely to indicate an error in the provisional amount
- the reason for the adjustment. It is key for the acquirer to identify whether the new information or events provide information about a situation that existed at the acquisition date, and not just subsequent to this date.

Type of adjustment	IFRS 3 Treatment
Measurement period adjustments	• retrospectively adjust the provisional amounts and/or recognise additional assets and liabilities to reflect new information as of the acquisition date • adjustments are recognised as if the accounting for the business combination had been completed at the acquisition date. Comparative information from prior periods is revised by: – increasing or decreasing the amount of goodwill or gain from a bargain purchase. If the adjustment affects more than one asset or liability, the adjustment to goodwill reflects the net effect of those adjustments, and – making any change in depreciation, amortisation or other income or expense effects recognised in the initial accounting for the business combination.
Other adjustments within the measurement period	• prospectively adjust the previously recognised amounts to reflect new facts and circumstances arising after the acquisition date (ie recognise adjustments in earnings in the period the adjustment is made, without adjusting goodwill) • correcting any error retrospectively in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.
Adjustments after the measurement period ends	• no adjustment to the accounting for the business combination is allowed except for correction of an error in accordance with IAS 8.

The following illustrates how measurement period adjustments are reported:

Example 1 – Changes to provisional amounts

On 1 October 20X5, Entity Q acquired 100% interest in Entity S. When Entity Q issued its 31 December 20X5 financial statements, the valuation of an acquired trademark was incomplete, as Entity Q was awaiting further information about facts and circumstances that existed as of the acquisition date. Entity Q used CU10 million as the provisional fair value of trademarks and determined a 5-year amortisation life. Entity Q appropriately disclosed in its 31 December 20X5 financial statements that the trademark was measured at a provisional amount, and the reason why a provisional amount was used. On 30 April 20X6, the valuation of the trademark was finalised. The fair value at the acquisition date amounted to CU12 million.

Analysis

Entity Q will make retrospective adjustments to the accounting for the business combination in the comparative amounts for 20X5 as follows:

- the carrying amount of trademarks as of 31 December 20X5 is increased by CU1.9 million, representing the increase in fair value of CU2 million less additional amortisation from the acquisition date to 31 December 20X5 of CU0.1 million (CU2 million x 3 months/60 months)
- amortisation expense for 20X5 is increased by CU0.1 million. The amortisation adjustments are intended to reflect that the trademark's final fair value of CU12 million has been recognised on the acquisition date
- goodwill is decreased by CU2 million.

The adjustments will need to be fully reflected in the comparative information in the 20X6 financial statements.

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 speak to your usual Grant Thornton contact or visit **www.grantthornton.global/locations** to find your local member firm.