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2018

IFRS 3 BUSINESS COMBINATIONS – THEMATIC REVIEW

NOVEMBER 2018

IRISH AUDITING AND ACCOUNTING SUPERVISORY AUTHORITY

MISSION

To contribute to Ireland having a strong regulatory environment in which to do business by supervising and promoting high quality financial reporting, auditing and effective regulation of the accounting profession in the public interest

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1. INTRODUCTION & BACKGROUND

IAASA, Ireland's accounting enforcer, has responsibility for the examination and enforcement of certain listed entities' ('issuers') periodic financial reports.

IAASA has performed a desk-top review of the IFRS 3 *Business Combinations* disclosures that issuers included in their 2017/18 annual financial reports.

IFRS 3 establishes principles and requirements for how an acquirer in a business combination:

- (a) recognises and measures in its financial statements the identifiable assets and liabilities acquired, and any interest in the acquiree held by other parties;
- (b) recognises and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and
- (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

Section 3 of this Paper presents the results of this desk-top review.

Section 4 sets out the IAASA examination activity relating to issuers' IFRS 3 *Business Combinations* disclosures following our annual examination programme.

IAASA's review is based on the 2017/18 annual financial reports published by 31 equity issuers falling within IAASA's financial reporting review remit (see Appendix).

Readers should note that, in undertaking this review, additional information was not sought from the selected issuers.

2. PURPOSES OF THE REVIEW

The primary purposes of this review are to:

- (a) determine the quantum of business combinations both in terms of consideration paid and goodwill recognised by issuers during their most recent reporting periods;
- (b) determine the nature and extent of the type of information disclosed by issuers regarding their business combinations completed during their most recent reporting periods; and
- (c) provide preparers, auditors and users of financial statements with information to encourage discussion and stimulate debate on issuers' business combinations disclosures.

3. IFRS 3 BUSINESS COMBINATIONS REVIEW RESULTS

3.1 Scale of acquisition activity

IAASA's desk-top review assessed the quantum of business acquisition activity by the selected issuers and noted that:

- (a) 14 issuers (2016/17: 14 issuers) had acquisition activity during their most recent reporting periods;
- (b) the total consideration paid by the selected issuers for acquisitions amounted to €4.8bn (2016/17: €5.7bn); and
- (c) following the acquisitions, issuers recognised goodwill amounting to €1.9bn (2016/17: €4.7bn) equating to 43% (2016/17: 82%) of the total consideration paid.

3.2 Initial accounting for a business combination is incomplete

Paragraphs B67 of IFRS 3 *Business Combinations* states that:

'To meet the objective in paragraph 61, the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:

- (a) if the initial accounting for a business combination is incomplete (see paragraph 45) for particular assets, liabilities, non-controlling interests or items of consideration and the amounts recognised in the financial statements for the business combination thus have been determined only provisionally:
 - (i) the reasons why the initial accounting for the business combination is incomplete;*
 - (ii) the assets, liabilities, equity interests or items of consideration for which the initial accounting is incomplete ...'**

Certain issuers did not provide all of the information required by IFRS 3.B67(a)(i) and (a)(ii). It was noted that:

- (a) ten issuers disclosed that the amounts recognised in their financial statements for completed business combinations had been determined provisionally;
- (b) six of those ten issuers did not disclose:
 - (i) the reasons why the initial accounting for their business combinations were not finalised by the end of the reporting period; and
 - (ii) the assets, liabilities, equity interests or items of consideration for which the initial accounting was incomplete; and
- (c) four of the ten issuers did not disclose which assets, liabilities, equity interests or items of consideration for which the initial accounting is incomplete. However, these four issuers had disclosed the reasons why the initial accounting for their completed business combinations was not finalised by the end of the reporting period.

3.3 Acquired receivables

IFRS 3.B64(h) states that:

'To meet the objective in paragraph 59, the acquirer shall disclose the following information for each business combination that occurs during the reporting period:

- (a) ...*
- (h) for acquired receivables:
 - (i) the fair value of the receivables;*
 - (ii) the gross contractual amounts receivable; and*
 - (iii) the best estimate at the acquisition date of the contractual cash flows not expected to be collected ...'**

A number of issuers did not provide all of the information required by IFRS 3.B64(h). It was noted that:

- (a) four issuers did not disclose:
 - (i) the gross contractual amounts receivable; and
 - (ii) the best estimate at the acquisition date of the contractual cash flows not expected to be collected; and

- (b) two issuers did not disclose the best estimate at the acquisition date of the contractual cash flows not expected to be collected. However, these two issuers had disclosed the information required by IFRS 3.B64 (h)(i) and (h)(ii).

3.4 Contingent consideration

IFRS 3.B64(g) states that:

'To meet the objective in paragraph 59, the acquirer shall disclose the following information for each business combination that occurs during the reporting period:

- (a) ...
- (g) for contingent consideration arrangements and indemnification assets:
 - (i) the amount recognised as of the acquisition date;
 - (ii) a description of the arrangement and the basis for determining the amount of the payment; and
 - (iii) an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated ...'

Again, certain issuers did not provide all of the information required by IFRS 3.B64(g). It was noted that:

- (a) three issuers did not disclose the basis for determining the amount of the contingent consideration payment; and
- (b) two issuers did not disclose:
 - (i) the basis for determining the amount of the contingent consideration payment; and
 - (ii) the estimate of the range of outcomes with regard to contingent consideration arrangements.

3.5 Other IFRS 3 disclosures

IFRS 3.B64(b), (d), (m) and (k) states that:

'To meet the objective in paragraph 59, the acquirer shall disclose the following information for each business combination that occurs during the reporting period:

- (a) ...
- (b) the acquisition date ...;
- (d) the primary reasons for the business combination ...;
- (k) the total amount of goodwill that is expected to be deductible for tax purposes ...;
- (m) the disclosure of separately recognised transactions required by (l) shall include the amount of acquisition-related costs and, separately, the amount of those costs recognised as an expense and the line item or items in the statement of comprehensive income in which those expenses are recognised ...'

A number of issuers did not provide all of the information required by IFRS 3.B64(b), (d), (k) and (m). It was noted that:

- (a) four issuers did not disclose the date that their business combinations were completed;
- (b) two issuers did not disclose the primary reasons for their business combinations;

- (c) three issuers did not disclose the amount of goodwill that is expected to be deductible for tax purposes; and
- (d) six issuers did not disclose the amount of acquisition-related costs following the completion of their business combinations.

3.6 Contingent consideration – valuation techniques

IFRS 3.B67(b) states that:

'... the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:

- (a) ...
- (b) *for each reporting period after the acquisition date until the entity collects, sells or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires:*
 - (i) ...;
 - (ii) ...;
 - (iii) *the valuation techniques and the key model inputs used to measure contingent consideration ...'*

It was noted that four issuers did not disclose the valuation techniques and the key model inputs used to measure the contingent consideration in their annual financial reports.

3.7 Business combinations completed after the reporting period end but before the financial statements are authorised for issue

IFRS 3.B66 states that:

'If the acquisition date of a business combination is after the end of the reporting period but before the financial statements are authorised for issue, the acquirer shall disclose the information required by paragraph B64 unless the initial accounting for the business combination is incomplete at the time the financial statements are authorised for issue. In that situation, the acquirer shall describe which disclosures could not be made and the reasons why they cannot be made....'

It was noted that three issuers had business combinations that completed after the end of the reporting period but before the financial statements were authorised for issue. However, one of these issuers did not provide the information required by IFRS 3.B66.

4. ENFORCEMENT ACTIVITY RELATING TO IFRS 3 *BUSINESS COMBINATIONS*

As part of its programme of examining the financial statements of issuers, IAASA has engaged with a number of issuers regarding their IFRS 3 *Business Combinations* disclosures.

The table below summarises the outcome of such engagement with some issuers.

TABLE – IAASA ACTIVITY RELATING TO ISSUERS’ IFRS 3 *BUSINESS COMBINATIONS* DISCLOSURES

Matter raised	Outcome
1. Directors’ explanation as to why the initial accounting for particular acquisitions had not been finalised by the end of the reporting period [IFRS 3.B67(a)(i) and (a)(ii) refer].	The directors provided an undertaking to disclose the information required by IFRS 3.B67(a)(i) and (a)(ii) where the initial accounting for future acquisitions is not finalised by the end of future reporting periods.
2. Directors’ view as to whether or not the requirements of IFRS 3.B67(b) were complied with in full regarding contingent consideration.	The directors provided an undertaking to disclose the information required by IFRS 3.B67(b) for all material movements in contingent consideration together with the valuation techniques and the key model inputs used to measure contingent consideration in future periodic financial statements.
3. Directors’ explanation as to why the information required by IFRS 3.B66 in respect of business combinations completed after the year-end but before the financial statements were authorised for issue was not disclosed in the annual financial statements.	The directors provided the information to IAASA and provided an undertaking that the information required by IFRS 3.B66 will be disclosed in future periodic financial statements where future business combinations are completed after the reporting date but before the financial statements are authorised for issue.
4. Directors’ explanation as to why the information required by IFRS 3.B64(d), (k), (m) and (q)(ii) in respect of business combinations completed during the reporting period was not provided in the annual financial statements	The directors provided the information to IAASA and provided an undertaking that the information required by IFRS 3.B64 (d), (k), (m) and (q)(ii) will be disclosed in future periodic financial statements.

5. CONCLUSIONS

In its financial statement examination process, IAASA continues to focus on and engage with issuers in relation to IFRS 3 *Business Combinations* disclosures.

It is IAASA’s expectation that Boards and Audit Committees will continue to carefully assess and consider the disclosure requirements of IFRS 3 *Business Combinations* and ensure that all relevant information is disclosed in the financial statements.

APPENDIX

ISSUERS INCLUDED IN THIS REVIEW

	Issuer	Report
1	AIB Group plc	31 December 2017
2	Aminex plc	31 December 2017
3	Aryzta AG	31 July 2017
4	Bank of Cyprus Holdings plc	31 December 2017
5	Bank of Ireland Group plc	31 December 2017
6	C&C Group plc	28 February 2018
7	Cairn Homes plc	31 December 2017
8	CRH plc	31 December 2017
9	Dalata Hotel Group plc	31 December 2017
10	Datalex plc	31 December 2017
11	DCC plc	31 March 2018
12	FBD Holdings plc	31 December 2017
13	Glanbia plc	31 December 2017
14	Glenveagh Properties plc	31 December 2017
15	Grafton Group plc	31 December 2017
16	Green REIT plc	30 June 2017
17	Greencore Group plc	30 September 2017
18	Hibernia REIT plc	31 March 2018
19	IFG Group plc	31 December 2017
20	Independent News & Media plc	31 December 2017
21	Irish Continental Group plc	31 December 2017
22	Irish Residential Properties REIT plc	31 December 2017
23	Kenmare Resources plc	31 December 2017
24	Kerry Group plc	31 December 2017
25	Kingspan Group plc	31 December 2017
26	Mainstay Medical International plc	31 December 2017
27	Paddy Power Betfair plc	31 December 2017
28	Permanent TSB Group Holdings plc	31 December 2017
29	Ryanair Holdings plc	31 March 2018
30	Smurfit Kappa Group plc	31 December 2017
31	UDG Healthcare plc	30 September 2017