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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**20 July 2006, London**
Project:	**Business Combinations II**
Subject:	**Measurement Date for Equity Instruments Issued as Consideration (Agenda Paper 2C)**

Introduction

1. The Business Combinations Exposure Draft (BC ED) requires that consideration transferred in a business combination be measured at its fair value on the date control is achieved (the acquisition date). A consequence is that the fair value of any equity securities issued as consideration in a business combination is measured at the acquisition date—not at the agreement or closing date. This is a matter on which the current requirements under IFRSs differ from those under US GAAP and therefore an area where the Boards are seeking a converged solution.

2. Based on the redeliberation criteria established at the January 2006 Board meetings, the staff asks the Boards to discuss the proposed measurement of equity securities issued as consideration because this was an area of significant concern for respondents.

3. The staff believes that a final standard on business combinations should contain requirements identifying the date at which equity instruments issued as consideration must be measured. Without requirements it is likely that there would be divergence in practice that reduces the comparability of business combination accounting between

entities. Divergence is likely because the process of negotiating and completing a business combination occurs over a period of time that may take several months. Events that typically occur as part of this process include:

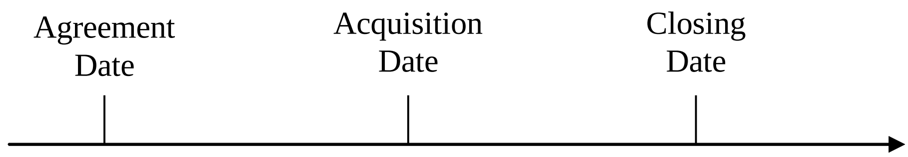
a. Initial discussions and negotiations
b. Due diligence
c. Agreement to the significant terms of the transaction
d. Shareholder approval
e. Regulatory approval
f. Closing of the transaction

4. The date at which the significant terms of the transaction are agreed upon is often referred to as the **agreement date**. Depending on the circumstances of the business combination, a letter of intent or a definitive acquisition agreement is signed at this time. At the agreement date, the amount of consideration to be transferred is, generally, established. Although the exchange price might be fixed the agreement could also foresee purchase price adjustments for specified events such as findings during a due diligence.

5. The BC ED defines the **closing date** as the date that the acquirer transfers the consideration, acquires the assets and assumes the liabilities of the acquiree. The Boards presume in the proposal that the closing date will often be the date at which the acquirer generally obtains control of the acquiree; thus will generally coincide with the **acquisition date**. However, the Boards acknowledge that depending on the pertinent facts and circumstances surrounding a business combination control could pass to the acquirer on a date other than the closing date. Therefore, the acquisition date might differ from the closing date.[1]

[1] The staff notes that the definition of the closing date implies a date at which the acquirer achieves control over the assets of the acquiree and assumes responsibility for its liabilities. This implication is unhelpful. The staff intends to clarify, in drafting the final standard, that the closing date is generally the date on which legal transfer takes place. The fact that the date of legal transfer might be later than the date on which economic control is achieved is the reason that the acquisition date might differ from the closing date.

6. The chronology of agreement date, acquisition date and closing date can be depicted as follows, note that the illustration does not purport to present scale:



7. This paper:

    a. summarises the Boards' initial deliberations;

    b. analyses the principles underlying the proposed measurement of equity securities issued as consideration;

    c. discusses respondents' concerns about the proposed measurement of equity securities issued as consideration; and

    d. asks the Boards to reaffirm that the measurement date for equity securities issued as consideration be the acquisition date, which is the date proposed in the BC ED.

8. Please note that, for simplicity, this paper focuses on situations when a 100% interest in the acquiree is acquired. The staff will bring back to the Boards the measurement of consideration for partial or step acquisitions at later Board meetings.

INITIAL DELIBERATION MATERIAL AND THE BOARDS' BASIS FOR CONCLUSIONS

9. The Boards discussed the proposed measurement for equity instruments issued as consideration at the following meetings:

    a. the IASB's December 2001 Board meeting;

    b. the FASB's 9 January 2002 Board meeting; and

    c. the 18 September 2002 joint Board meeting.

    [Sentence omitted from observer notes]

10. SFAS 141 and IFRS 3 currently diverge on the measurement date for equity securities issued as consideration in a business combination. Paragraph 24 of IFRS 3 requires measuring equity instruments issued by the acquirer at the date of exchange. The current

U.S. guidance is contradictory. Paragraph 22 of SFAS 141 states that the market price for a reasonable period before and after the date the terms of the acquisition are agreed to and announced should be considered in determining the fair value of the securities issued. However, paragraph 49 of SFAS 141 states that the cost of an acquired entity could be determined as of the acquisition date.

11. BC66 of the IASB ED (see also B71-B73 of the FASB ED) states:

> The IASB and the FASB considered the agreement date and acquisition date models in their deliberations. Both Boards observed that there are valid conceptual arguments for measuring equity interests at the agreement date. However, the Boards concluded that reaching a converged answer on the measurement date was of primary importance. The FASB agreed to change, to require that equity interests issued should be measured at their fair value at the acquisition date. As a consequence all consideration transferred by an acquirer is to be measured at its acquisition date fair value.

PRINCIPLES FOR MEASURING CONSIDERATION TRANSFERRED IN A BUSINESS COMBINATION

12. In March 2006, the Boards affirmed the following recognition and measurement principles for applying the acquisition method:

> In a business combination, the acquirer <u>recognises</u> all of the assets acquired and all of the liabilities assumed.
>
> In a business combination, the acquirer <u>measures</u> each recognised asset acquired and each liability assumed at its acquisition date <u>fair value</u>.

13. Application of these principles means that the acquirer recognises the assets acquired and liabilities assumed in a business combination at their fair values at the date control is achieved (the acquisition date). The acquisition date fair value of many assets acquired and liabilities assumed can be measured directly. However, goodwill is an exception to the fair value measurement attribute because it can only be measured indirectly, as a residual. When a 100% interest is acquired goodwill will, generally, be measured as the difference between consideration paid and the fair value of assets acquired and liabilities assumed in a business combination. Thus, the importance of measuring the consideration paid is its role in the measurement of goodwill. The fair value of most

other assets acquired and liabilities assumed is measured directly without reference to consideration transferred. These observations contain two caveats. Firstly, the Board concluded that the consideration paid is presumptively the best evidence of the consideration received. Secondly, some of the assets acquired and liabilities assumed in a business combination are not measured at fair value. Thus, the amount recognized as goodwill includes (a) any differences between the consideration paid for the business and the fair value of the acquirer's interest in the acquiree (b) for assets and liabilities that are not measured at fair value, the difference between their assigned amounts and fair value, and (c) any errors in measuring the fair value of assets and liabilities measured at fair value.

14. During initial deliberations, the Boards concluded that it can be presumed in an arm's length transaction that the fair value of the consideration transferred is representative of the acquisition date fair value of the acquirer's interest in the acquiree. Furthermore, the Boards observed that measuring consideration transferred as a proxy for the acquired interest in the acquiree will help to reduce compliance costs with the final business combinations standard. Paragraphs B63 and B64 of the FASB ED's basis for conclusions state (see also BC55-BC57 of the IASB ED):

> B63 The [FASB] Board believes that emphasizing the use of the fair value of the consideration as a basis for measuring the fair value of the acquiree is appropriate for several reasons. First, the [FASB] Board observed that business combinations generally are exchange transactions in which knowledgeable, unrelated willing parties are presumed to exchange equal values. Thus, the [FASB] Board believes that in the absence of evidence to the contrary it can be presumed that the fair value of the consideration transferred is representative of the fair value of the acquirer's interest in the business. Second, the [FASB] Board believes that evidence of the fair value of discrete items of consideration transferred by the acquirer is readily available to the acquirer or obtainable at lower cost and that the fair values of those items generally will be equally if not more reliably measurable than directly measuring the fair value of the business as a whole…
>
> B64 The [FASB] Board also believes that emphasis on use of the consideration transferred as an appropriate basis for determining the fair value of the business as a whole often will avoid or minimize:

a) Unproductive disputes in practice about whether the consideration transferred or another valuation technique provides the best evidence and basis for estimating the fair value of the business in those close-call circumstances in which both measurement techniques provides sufficiently reliable estimates.

b) Incremental costs, for example, to independently verify valuations of the business that were performed by the acquirer as part of its due diligences but are not necessarily audited.

15. Thus, unless there is evidence that the consideration transferred is not the best basis for measuring the fair value of the acquirer's interest in the acquiree, it should make no difference if goodwill is measured based on the fair value of the acquirer's interest in the acquiree or on the fair value of the consideration transferred, whichever is more readily determinable. In most circumstances the staff believes that when measuring goodwill the fair value of consideration transferred serves as an appropriate proxy for the fair value of the acquirer's interest in the acquiree in a business combination. There might, however, be circumstances when the consideration received is a better basis for measuring the value of the exchange.

16. The measurement principle requires measuring the fair value of assets acquired and liabilities assumed in a business combination at the acquisition date. It is at this date that the acquirer obtains control over the assets and assumes responsibility for the liabilities. Given that this is the date of exchange, all consideration transferred, including equity instruments issued as consideration, should be measured at this date. The staff assumes that the acquirer derecognises any asset transferred and recognises liabilities incurred and equity issued at the date of this exchange.

COMMENT LETTER RESPONSES

17. Respondents' views on the measurement date for equity securities issued as consideration in a business combination were mixed. Those respondents who supported the proposal stated that it makes sense to measure all forms of consideration and the assets and liabilities on the same date. For example, PwC (CL #66) stated:

> We acknowledge that there are valid arguments that support measuring the fair value of the consideration given at the date that a

substantive agreement is reached and valid arguments that support the proposal made by the Boards. We believe that it is more operational to apply the model proposed by the Boards and consistent with the principle that the assets and liabilities over which control is obtained are measured at fair value on the date that they are first recognised. We therefore agree with the Boards' proposals in this regard.

18. Other respondents disagreed with the proposal. They did so for the following reasons:

   a. There is only at the agreement date a direct alignment between the fair value of consideration transferred and the fair value of the acquirer's interest in the acquiree;

   b. Subsequent changes in the fair value of the acquirer's equity instruments between the agreement date and the acquisition date could be due to factors unrelated to the business combination and should not have an impact on the fair value of the acquirer's interest in the acquiree; and

   c. Subsequent changes in the fair value of the acquirer's equity instruments between the agreement date and the acquisition date lead inappropriately to either bargain purchase or overpayment situations.

19. For example, Citigroup (CL #42) wrote:

> We disagree with the proposal to measure stock consideration paid as of the closing date and support the continued application of EITF Issue No. 99-12, Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination, as we believe that ancillary events, such as approval from shareholders and regulators, should not have an impact on fair value. An acquirer's evaluation of a target is based upon the announcement date economics and, accordingly, forms the most appropriate fair value basis of an acquired company. Changes in the market price of securities subsequent to this date bear no correlation to the value of what will be acquired and, accordingly, should not become part of the basis of what was acquired. If there were significant decreases in the acquirer's stock price prior to the acquisition-date, the resulting carrying amounts of assets and liabilities would not reflect economic reality.

20. JP Morgan (CL #106) stated:

> We do not agree that the fair value of the certain types of consideration, transferred as of the acquisition-date (i.e., the acquirer's publicly traded equity securities) is the best evidence of fair value of the acquirer's interest in the acquiree. Rather we believe that current practice (as of the announcement date) is more indicative of the fair value exchanged. The stock price at the time a commitment to purchase was made is the market reference for what was negotiated when entering into an acquisition agreement. Using the date of transfer as the acquisition-date could cause changes in stock market prices that are not indicative of the exchange agreed to between the parties. Often, these changes are the result of conditions that are outside the control of the acquirer/acquiree. Finally, the use of the transfer date as the acquisition-date may cause changes in stock market prices that inappropriately generate negative goodwill, or may in fact artificially inflate goodwill, resulting in accounting that does not reflect the economic reality of the exchange.

STAFF ANALYSIS

21. The staff is concerned that comments from constituents suggest that there is some confusion about what the consideration measured at the agreement date represents. Therefore, the staff will analyse first the nature of consideration transferred in a business combination followed by an assessment of whether the agreement date or the acquisition date is the better measurement date for consideration transferred.

What consideration has been negotiated at the agreement date?

22. In a business combination where the acquirer pays cash the fair value of the consideration being transferred by the acquirer is readily observable. In such circumstances the Boards have tentatively decided that even if the agreement, acquisition and closing dates coincided, the acquirer would not be able to reliably identify an overpayment. The Boards have also tentatively decided that in a bargain purchase transaction the acquirer accounts for the excess of the acquirer's interest in the acquiree over the fair value of consideration transferred by reducing the amount of goodwill that would otherwise be

recognised.[2] Thus, the consideration transferred is presumed to be a more reliable basis for measuring goodwill.

23. Now consider the case where the agreement date is earlier than the acquisition date.[3] The staff believes that the consideration that the acquirer agrees to transfer on the acquisition or closing date does not purport to be the agreement date fair value of the acquiree. Rather, it is the agreement date estimate of the fair value of the acquiree at the acquisition date. That amount presumably considers the acquirer's and seller's expectations at the agreement date about any movements in the fair value of the acquiree between the agreement date and the acquisition date.

24. The staff believes that the agreement date estimate of the fair value of the acquiree at the acquisition date is susceptible to an estimation error. The amount of cash consideration fixed at the agreement date will often not *equal* the acquisition date fair value of the interest in the acquiree (that is, there will usually be a difference, perhaps not significant, between the price negotiated at the agreement date and the acquisition date fair value). The question is whether the acquirer is able to measure that estimation error with sufficient reliability to be able to account for it separately, or whether it would even be appropriate to account for it separately if the estimation error could be identified.

25. Consider the following example:

On 1 March 20X1 (the agreement date), Entity A agrees to acquire 100% of Entity B for CU 100. On this date, the fair value of Entity B is CU 90 and the fair value of Entity B's identifiable net assets is CU 80. The business combination is subject to regulatory approval. Entity A estimates at the agreement date that it will be able to obtain regulatory approval and close the transaction on 1 September 20X1 and that on this date Entity B's fair value will be CU 100.

Approval is granted and the acquisition proceeds as planned with the acquisition and closing date being 1 September 20X1. At that date the fair value of Entity B is CU 107 and the fair value of Entity B's identifiable net assets is CU 85.

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[2] If the goodwill related to that business combination is reduced to zero any remaining excess is recognised as a gain attributable to the acquirer.
[3] Assume that the acquisition and closing dates are the same.

Goodwill measured using the actual acquisition date values would be:

Fair value of Entity B on 1 September 20X1	107
Fair value of Entity B's net assets on 1 September 20X1	85
Goodwill based on the fair value of the acquiree	22
Fair value of Entity B on 1 September 20X1	107
Consideration transferred	100
Error in acquirer's estimate of the FV of the acquiree	7
Underlying Goodwill	22
Less estimation error	7
Recognised Goodwill	15

26. In the example the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest at the acquisition date. Thus, the example represents a bargain purchase business combination. The bargain purchase arose from an estimation error at the agreement date of what the fair value of the interest of the acquiree at the acquisition date would be. Notwithstanding that the bargain purchase resulted from the acquirer and the seller fixing the acquisition date price at the agreement date, the acquirer ***has*** received more than it has transferred out.

27. Identifying or measuring the estimation error would require the preparation of a business valuation at the acquisition date. However, the staff believes that the estimation error will, normally, not be identifiable at the acquisition date. Recall that the Boards have already agreed that it is not likely that a bargain purchase, or overpayment, can be measured reliably even if the agreement and acquisition dates are the same. It seems incongruous to believe that the acquirer will be able to separate any bargain purchase or overpayment element that results from this estimation error from other causes of a bargain or overpayment. It is also not clear what the incremental information content of these separated components would be.

28. In the example presented above the actual agreement and acquisition date fair values of the acquiree and its assets and liabilities were known. The Boards' tentative decisions on how to account for bargain purchases and overpayments are consistent with goodwill, or the portion of any bargain purchase taken to income, being measured as the difference between the fair value of consideration transferred and the fair value of the identifiable

assets acquired and liabilities assumed in a business combination. Or said differently, the Boards decided that a direct measure of the fair value of an acquiree cannot be measured with sufficient reliability to recognise an overpayment as an expense or to recognise goodwill and a gain.

29. This means for the example introduced in paragraph 25 that goodwill could also be measured as follows:

Consideration transferred	100
Fair value of Entity B's net assets on 1 September 20X1	85
Goodwill	15

30. The amount of goodwill acquired in the business combination is the same as in paragraph 25.

Fair value of the equity instruments issued as consideration

31. The staff has analysed in the preceding section business combinations in which the consideration transferred is cash. In these situations no estimation uncertainty existed with respect to the fair value of consideration transferred in the business combination. As a consequence, it does not matter whether the fair value of consideration transferred is fixed at the agreement or the acquisition date. In contrast, where the consideration transferred by the acquirer is equity instruments (or any other non-cash asset or liability) the fair value of those instruments issued is likely to change between the agreement date and the closing date. This means that the transaction price negotiated at the agreement date reflects assumptions by the acquirer and seller about the acquisition date fair value of the acquiree and the acquisition date fair value of equity instruments to be issued as consideration in the transaction.

32. Any estimation error will affect the measurement of goodwill on acquisition. In the analysis of transactions involving cash consideration the staff concluded that an acquirer is unlikely to be able to measure an estimation error related to the acquiree with sufficient reliability to separate it from goodwill. In the case of equity securities being issued as consideration, the acquisition date fair value of consideration transferred will not usually *equal* the acquisition date fair value of the acquired business because the value of the equity securities has changed unexpectedly. An unexpected change in the value of the securities affects the measurement of goodwill on acquisition.

33. Consider the following example:

On 1 March 20X1 (the agreement date), Entity A agrees to acquire 100% of Entity B for 100 shares of Entity A. On this date, the fair value of Entity B is CU 90 and the fair value of Entity B's identifiable net assets is CU 80. The stock market price for one share of Entity A is CU 0.95.

Entity A estimates at the agreement date that it will be able to close the transaction on 1 September 20X1 and that on this date Entity B's fair value will be CU 100 and that the stock market price for one share of Entity A will be CU 1.

1 September 20X1 is the closing date and the acquisition date of the business combination. At this date, the fair value of Entity B is CU 107 and the fair value of Entity B's identifiable net assets is CU 85. The stock market price for one share of Entity A is CU 0.90.

Goodwill could be measured at the acquisition date as follows:

Fair value of Entity B on 1 September 20X1	107
Fair value of Entity B's net assets on 1 September 20X1	85
Goodwill based on the fair value of the acquiree	22

Fair value of Entity B on 1 September 20X1	107
Agreement date estimate of fair value of the acquiree	100
Error in acquirer's estimate of the FV of the acquiree	7

Fair value of consideration transferred on 1 September 20X1	(90)
Agreement date estimate of fair value of consideration transferred	(100)
Error in acquirer'sestimate of the FV of consideration transferred	10

Total estimation error	17

Underlying Goodwill	22
Less estimation error	17
Recognised Goodwill	5

or simply:

Fair value of consideration transferred on 1 September 20X1	90
Fair value of Entity B's net assets on 1 September 20X1	85
Goodwill	5

34. In the example the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest at the acquisition date. Thus, the example represents a bargain purchase business combination. The bargain purchase arises from two estimation errors:

    a. an error of CU 12 in estimating the acquisition date fair value of the acquirer's interest in the acquiree; and

    b. an error of CU 5 in estimating the closing date fair value of the consideration transferred.

35. Some staff emphasise that in this example measuring consideration transferred at the agreement date would effectively reduce the overall estimation error from CU 17 to CU 12.[4] The staff believes that there is merit in analysing first the nature of the estimation errors identified in the example and to assess subsequently whether the agreement date or the acquisition date is the better measurement date for consideration transferred.

36. The first estimation error has already been analysed in paragraphs 22 to 30 of this paper. The staff will now focus on the error in estimating the closing date fair value of consideration transferred. The BC ED proposes measuring consideration transferred in a business combination at the acquisition date. The staff will, therefore, analyse separately an error in estimating the acquisition date fair value of consideration transferred.

[4] A calculation of goodwill is attached as Appendix A

Error in estimating the acquisition date fair value of consideration transferred

37. The estimation error occurs because of unexpected changes in the fair value of consideration transferred between the agreement date and the acquisition date. Unexpected changes in the fair value of equity instruments could be a consequence of:

    a. a different market reaction to the business combination than was anticipated by the acquirer;

    b. events that affect the fair value of the target and, therefore, have an impact on the fair value of the acquirer were not anticipated by the acquirer;[5] or

    c. the acquirer did not foresee events unrelated to the business combination, that affect the value of the acquirer but not, or have a proportionally different impact to the impact on, the acquiree.

38. Some argue that changes in the fair value of equity instruments issued due to the **market reaction on the business combination** are an indicator of the market perception of that transaction; thereby providing a better estimate of the acquisition date fair value of the acquirer's interest in the acquiree. For example, the market might perceive the potential synergies achievable by the acquirer to be lower, or higher, than reflected by the acquisition price. As a consequence, a market perception that the overall goodwill associated with the acquisition will not be realised (through synergies) should be accounted for when measuring consideration transferred. That is to say, goodwill would be recorded at a lower or higher amount based on the post-acquisition reaction price of the issued securities. This is analogous to impairing or revaluing goodwill, albeit before the acquisition date.

39. The fair value of equity securities to be issued as consideration in a business combination could also be affected by unexpected **changes in the fair value of the acquiree**. If the exchange ratio between the acquirer and acquiree is fixed at the agreement date an increase in the acquiree's fair value will also affect the fair value of the acquirer. In such circumstances the unexpected change in the fair value of the consideration is

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[5] This would occur because the exchange ratio between the acquirer and target is fixed; therefore an increase in the value of the target could have an impact on the value of the acquirer.

representative of a change in the fair value of the acquirer's interest in the acquiree. Thus, both, the agreement date estimate of the acquisition date fair value of the consideration transferred and the agreement date estimate of the acquirer's interest in the acquiree are affected equally. It would make no sense separating the estimation error associated with the consideration from the initial estimate of the acquisition date fair value of the consideration, as both relate to the acquisition date fair value of the acquirer's interest in the acquiree.

40. The fair value of the acquirer's stock might also change due to **events unrelated to the business combination** such as changes in the fair value of other subsidiaries of the acquirer or the economic effects of new government regulation on the acquirer. The staff believes that unexpected changes in the fair value of equity instruments should not be included in the measurement of the consideration transferred in a business combination because they do not relate to the acquisition date fair value of the acquirer's interest in the acquiree and were not negotiated between the contract parties. However, the staff believes that, generally, it will not be possible to isolate specific reasons for estimation errors with sufficient reliability.

41. Or put simply, whether equity instruments issued as consideration are measured at the agreement date or at the acquisition date there is always a potential for a difference between the fair value of the consideration transferred and the fair value of the acquirer's interest in the acquiree. However, this difference cannot be measured reliably. Hence, it will be necessary to account either for all or for none of the estimation errors associated with the acquisition date fair value of consideration transferred.

42. Measuring consideration based on share price at, or around, the agreement date excludes both the expected and unexpected portions of changes in the fair value of the consideration between the agreement and acquisition dates. On the other hand, measuring consideration transferred at the acquisition date will include both expected and unexpected changes. The latter approach is the one taken by the BC ED.

Should consideration transferred be measured at the agreement date or at the acquisition date?

43. Some staff agrees with those constituents who argue that the conceptual basis for measuring equity instruments issued in a business combination at the acquisition date is not very strong. However, that staff also observes that neither is there a strong conceptual basis for measuring consideration transferred at the agreement date.

44. As explained in the preceding section of this paper, measuring shares to be issued as consideration based on their value at the acquisition date would include estimation errors which might stem from events unrelated to the business combination and, therefore, should not be included in the measurement of goodwill. On the other hand, measuring shares to be issued as consideration based on their value at the agreement date would exclude estimation errors arising from expected changes in the fair value of those shares and changes related to changes in the fair value of the acquiree.

45. During initial deliberation the Boards have compared the measurement of consideration transferred in a business combination to:

    a. share-based payment transactions; and

    b. equity forward contracts.

46. Measuring the fair value of consideration transferred at the acquisition date would be consistent with the measurement guidance given in IFRS 2 *Share-based Payment*. If in an equity-settled share-based payment transaction the fair value of goods or services received cannot be estimated reliably, paragraph 10 of IFRS 2 requires measuring their fair value indirectly by reference to the fair value of the equity instruments granted. For transactions with parties other than employees the fair value of the equity instruments granted is measured at the date the entity obtains the goods or the counterparty renders the service.

47. Paragraph BC126 of IFRS 2 states[6]:

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[6] SFAS 123R does not specify a measurement date for share-based payment transactions with parties other than employees. EITF Issue No. 96-18 states:

> [The measurement date] is the earlier of the following:

BC126 The [IASB] Board considered whether the delivery (service) date fair value of the equity instruments granted provided a better surrogate measure of the fair value of the goods or services received from parties other than employees than the grant date fair value of those instruments. For example, some argue that if the counterparty is not firmly committed to delivering the goods or services, the counterparty would consider whether the fair value of the equity instruments at the delivery date is sufficient payment for the goods or services when deciding whether to deliver the goods or services. This suggests that there is a high correlation between the fair value of the equity instruments at the date the goods or services are received and the fair value of those goods or services…

BC128 The [IASB] Board therefore concluded that for transactions with parties other than employees in which the entity cannot measure reliably the fair value of the goods or services received at the date of receipt, the fair value of those goods or services should be measured indirectly, based on the fair value of the equity instruments granted, measured at the date the goods or services are received.

48. On the other hand, those who believe that consideration transferred should be measured at the agreement date compare the purchase agreement to an equity forward contract. They argue that at the agreement date the parties are essentially committed to the transaction such that they normally cannot unilaterally terminate the transaction without the payment of a break-up fee or a high likelihood of litigation. Therefore, the acquirer's obligation to issue equity securities in exchange for the target's business has characteristics of a forward contract. As a consequence the value of the transaction should not be revalued after the agreement date.

49. The staff believes that there are valid reasons for and against either analogy.[7] However, the acquisition date model would effectively align the measurement of consideration

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(a) The date at which a commitment for performance by the counterparty to earn the equity instruments is reached (a "performance commitment"), or

(b) The date at which the counterparties performance is complete.

Therefore, in the context of share-based payment transactions with parties other than employees the measurement date could be the vesting date or some other date between grant date and vesting date.

[7] For an extensive discussion of both analogies see Agenda Paper 4A of the joint meeting of FASB and IASB in September 2002.

transferred with the measurement date of assets acquired and liabilities assumed in a business combination which are measured at the acquisition date. Measuring equity securities issued as consideration at the agreement date would misalign the measurement of consideration transferred with the measurement date of assets acquired and liabilities assumed in the business combination.

STAFF RECOMMENDATION AND QUESTION FOR THE BOARDS

50. The BC ED proposes measuring equity instruments issued as consideration in a business combination at their acquisition date fair value. In the staff's view, the proposed accounting is consistent with the recognition and measurement principles adopted by the Boards.

51. The preceding analysis has shown that the selection of either measurement date model could lead to different bargain purchases or overpayments being recognised in a business combination.

52. Some constituents believe that there is only at the agreement date a direct alignment between the fair value of consideration transferred and the fair value of the acquirer's interest in the acquiree. However, in the staff's view, the number of equity instruments issued as consideration is intended to reflect the fair value of the acquirer's interest in the acquiree at the acquisition date and not the agreement date. It could, therefore, also be argued that a direct alignment between the fair value of consideration transferred and the fair value of the acquirer's interest in the acquiree exists only at the acquisition date and not at the agreement date. Measuring equity securities issued as consideration at the agreement date would effectively misalign the measurement of consideration transferred with the measurement date of assets acquired and liabilities assumed in the business combination.

53. Some staff, therefore, believe that a departure from the recognition and measurement principles adopted by both Boards is not conceptually justified and recommend the Boards affirm that the fair value of equity instruments issued as consideration in a business combination is measured at the acquisition date.

54. However, some staff believe that the Boards should adopt a more practical approach regarding the measurement date for equity instruments. They emphasise that, both, measuring equity instruments at the agreement date as well as measuring equity

instruments at the acquisition date are indirect measures and may not achieve the objective of measuring the acquisition date fair value of the acquirer's interest in the acquiree. Therefore, the measurement should be adopted which results in a better representation of the acquisition date fair value of the acquirer's interest in the acquiree. They believe that adoption of the agreement date will more often lead to a better measurement of the fair value of the acquirer's interest in the acquiree than adoption of the acquisition date as the measurement date for consideration transferred.

55. Those staff concede that measuring consideration transferred at the agreement date will often not meet the objective of measuring the fair value of the acquirer's interest in the acquiree. However, for a variety of cost-benefit, operationality and consistency reasons they would accept measuring the fair value of consideration transferred at the agreement date as a practical expedient to measuring the fair value of the acquirer's interest in the acquiree. Thus, they recommend that equity instruments issued in a business combination should be measured at the agreement date.

56. Alternatively, those staff propose to investigate further the adoption of a principle according to which consideration transferred should be measured either at the agreement date or at the acquisition date whichever value better achieves the objective of measuring the acquisition date fair value of the acquirer's interest in the acquiree.

57. Those staff who support measuring equity instruments issued at the acquisition date agree with the latter principle. However, they do not believe that measuring equity instruments at the acquisition date conflicts with this principle. They emphasise that the acquisition date fair value of consideration transferred should not be used to measure the acquisition date fair value of the acquired interest in the acquiree if there is evidence that indicates that the acquisition date fair value of consideration transferred is not the best measurement basis.

Do the Boards believe that the fair value of equity instruments issued as consideration in a business combination should be measured at the agreement date or at the acquisition date?

APPENDIX A

Goodwill could be measured in the example in paragraph 34 at the agreement date as follows:

Fair value of Entity B on 1 September 20X1	107
Fair value of Entity B's net assets on 1 September 20X1	85
Goodwill based on the fair value of the acquiree	22
Fair value of Entity B on 1 September 20X1	107
Agreement date estimate of fair value of the acquiree	100
Error in acquirer's estimate of the FV of the acquiree	7
Fair value of consideration transferred on 1 March 20X1	(95)
Agreement date estimate of the FV of consideration transferred	(100)
Error in acquirer's estimate of the FV of consideration transferred	5
Total estimation error	12
Underlying Goodwill	22
Less estimation error	12
Recognised Goodwill	10

or simply:

Fair value of consideration transferred on 1 September 20X1	95
Fair value of Entity B's net assets on 1 September 20X1	85
Goodwill	10