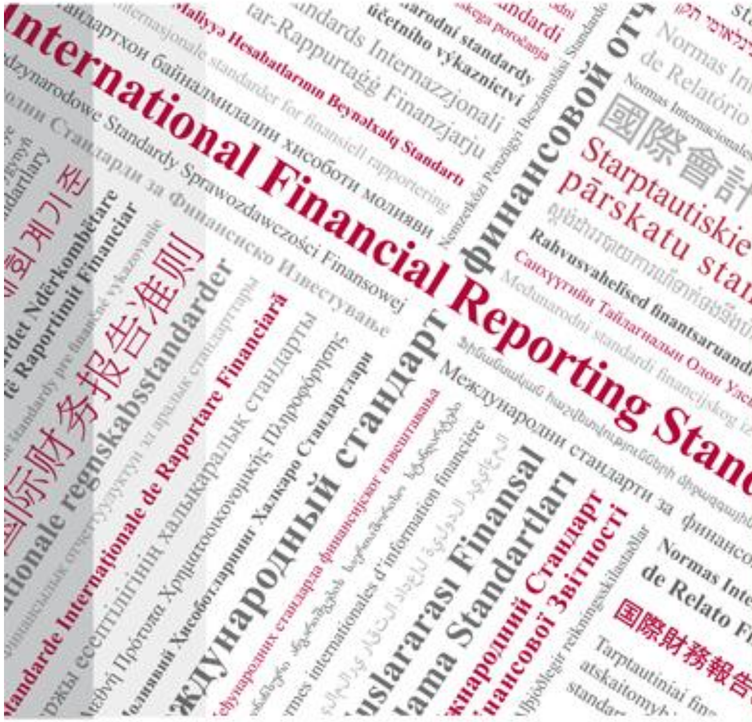
International Financial Reporting Standards



Post-implementation Review of IFRS 3 *Business Combinations*

CMAC/GPF Meeting 30 June 2014

Breakout session 2 (Agenda Paper 5B)

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

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Agenda

- Step acquisitions
- Loss of control
- Disclosures
- Measurement of contingent consideration
- Transaction costs

Step acquisitions

Main changes introduced by IFRS 3 (2008):

(a) Goodwill is measured only at the acquisition date. Previously, a portion of goodwill was calculated at each step.

(b) The assets acquired and the liabilities assumed are measured at fair value at acquisition date. The previous requirements resulted in assets measured at fair values determined at different dates (ie the dates of each step)

(c) The acquirer remeasures its previously held equity interest at its acquisition-date fair value and recognises the related gain or loss in profit or loss (because the acquirer sells its equity interest and acquires the underlying assets). Previously, the equity interest was not remeasured.

Question for CMAC members:

How useful do you find the information resulting from the step acquisition guidance in IFRS 3?

Question for GPF members

Have you encountered any practical difficulty in remeasuring any previously held equity interest at acquisition-date fair value?

Step acquisitions—Example

Entity A acquires 25% of Entity B on 1 January 20X0 for CU225. Entity A acquires a further 75% of Entity B on 1 January 20X5 for CU900.

Some data:

Entity B (target company)	1/01/20X0	1/01/20X5
Purchase consideration	225	900
Fair value of net assets	800	1,000
% acquired	25	75
Fair value of % acquired	200	750
25% interest held (equity method)		258
Fair value of 25% interest held		300

- On 01/01/20X0, 25% of Entity B's FV = CU200
- On 01/01/20X5, 25% of Entity B's FV = CU250*

Increase in value = CU50

Due to performance

Other FV increase

Investment in Entity B:

Investment in Entity B	
Investment in B on 1/01/20X0	**225**
Share in profit since acquisition	20
Share in OCI since acquisition	13
Investment in B on 1/01/20X5	**258**

Δ = CU33

CU17

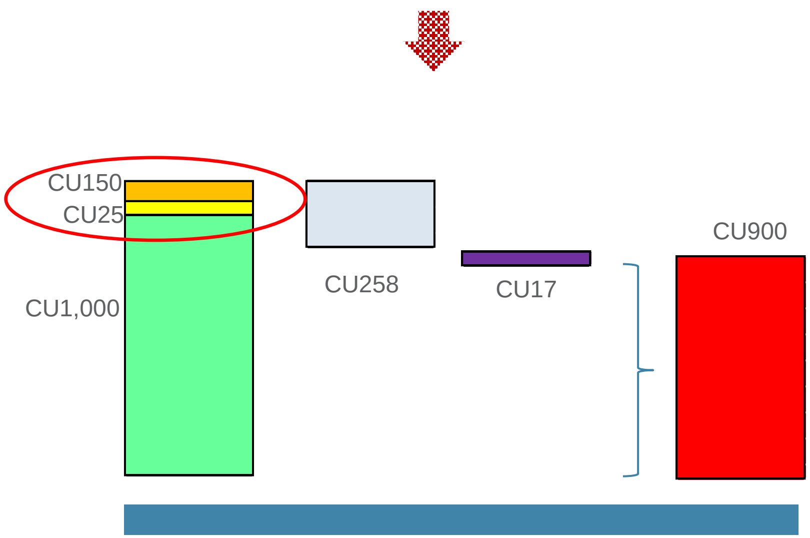
(*): Calculated based on 25% of fair value of net assets (CU1,000).

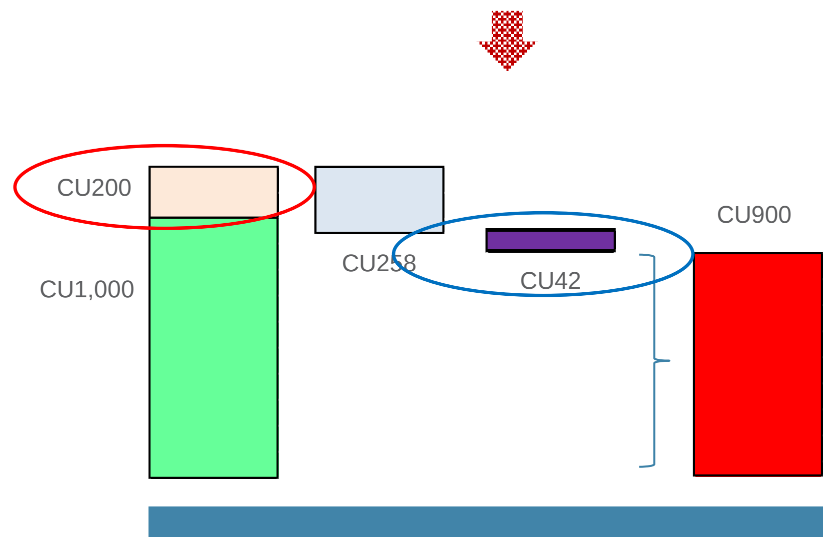
Step acquisitions—Example—*continued*

Comparison of accounting treatments (Old vs New)

Pre-IFRS 3 (2008) accounting treatment		
Fair value of net assets	1,000	
Goodwill for first tranche (25%)	25	(CU225 - CU200)
Goodwill for second tranche (75%)	150	(CU900 - CU750)
Asset revaluation reserve	17	(CU250 - CU200 - CU33)
Purchase consideration	900	
Investment in Entity B	258	

IFRS 3 (2008) accounting treatment		
Fair value of net assets	1,000	
Goodwill	200	(CU900 + CU300 - CU1,000)
Profit (remeasurement of investment in B)	42	(CU300 - CU258)
OCI (*)	13	
Purchase consideration	900	
Investment in Entity B	258	





(*): OCI has not been represented in the figure for IFRS 3 (2008) above (it would have been debited against a credit either in PL or OCI).

Loss of control

IFRS 3 (2008) amended IAS 27 (2003) to require that:

- any investment that an entity retained in a former subsidiary after control is lost is measured at fair value at the date that control is lost, because the loss of control is a significant economic event (the parent-subsidiary relationship ceases to exist and an investor-investee relationship begins). Previously the retained investment was initially measured at its carrying amount.
- any resulting gain or loss should be recognised in profit or loss. Previously there was no remeasurement.

Question for CMAC members:

How useful do you find the information resulting from the accounting for the loss of control in a former subsidiary?

Question for GPF members

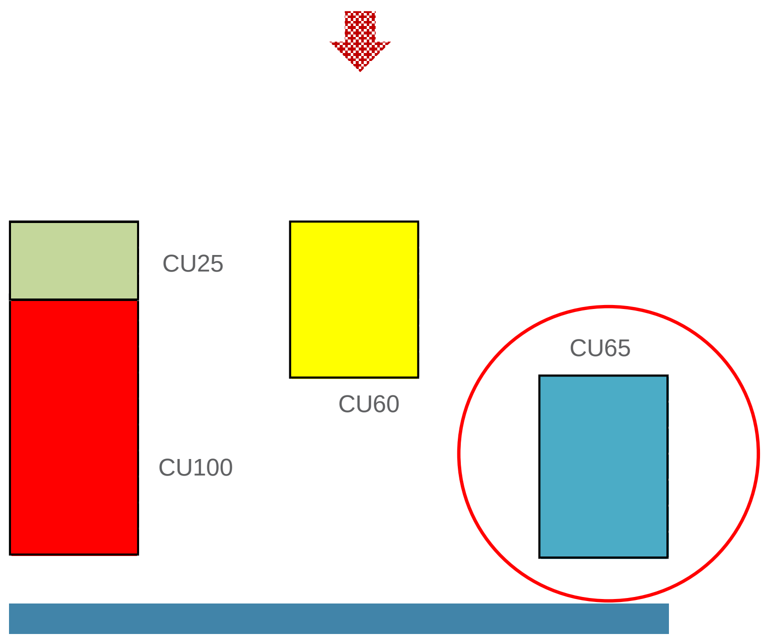
Have you encountered any practical difficulty in remeasuring any retained equity interest at fair value when control is lost?

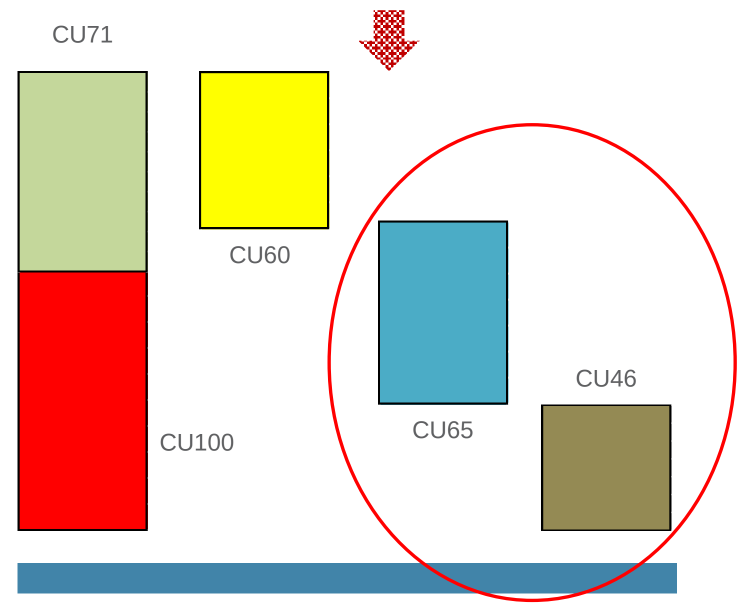
Loss of control—Example

Entity Gamma has a 60% investment in Entity Beta with carrying amount of CU60. Gamma sells 35% of Beta (carrying amount of CU35) for CU100, reducing its holding to 25% (carrying amount of 25CU).

Old accounting treatment	
Cash proceeds	100
Carrying amount of subsidiary	60
Investment in associate (25% carrying amount)	25
Profit of sale of 35%	65 (CU100 - CU35)

New accounting treatment	
Cash proceeds	100
Carrying amount of subsidiary	60
Investment in associate (25% remeasured)	71
Profit of sale of 35%	65 (CU100 - CU35)
Profit on remeasurement of the 25% retained	46 (CU71 - CU25)





Disclosures

Question for CMAC members:

- Why would information about the subsequent performance of the acquired business be useful?
- How useful do you find pro-forma information?
- Is other information need to properly understand the effect of a business combination on a group?

Question for GPF members

- What are the main challenges to preparing the disclosures required by IFRS 3 or by the related amendments, and why?
- How straight-forward would it be to provide disclosures on the subsequent performance of the acquired business?

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Measurement of contingent consideration

According to IFRS 3:

- the consideration transferred in a business combination (including any contingent consideration) is measured at fair value.
- changes in the fair value of contingent consideration resulting from future events (eg meeting an earning target) are generally recognised in P&L.

Question for CMAC members:

- How useful do you find the information resulting from the measurement of contingent consideration?

Question for GPF members

- What are the main implementation challenges in measuring the fair value of contingent consideration?

Transaction costs

According to IFRS 3 transaction costs are recognised in profit or loss.

Question for CMAC and GPF members:
Do you think that transaction costs should be included in the total consideration paid (ie included as part of value of goodwill)? If so, why?

Thank you


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