Some (practical?) thoughts on Goodwill accounting

ORS – June 2019

Goodwill

- Some reflections on residual goodwill
- Some practical challenges on technical goodwill and impairment testing

Transactions in Aker BP

Marathon Oil	bp	HESS
Acquisition of Norwegian subsidiary for a cash consideration of USD 2.1 billion (2014)	Merger between Det norske and BP's Norwegian subsidiary, creating Aker BP (2016)	Acquisition of Norwegian subsidiary for a cash consideration of USD 2.0 billion (2017)
Technical GW: 1 196 MUSD Residual GW: 290 MUSD	Technical GW: 945 MUSD Residual GW: 214 MUSD	Technical GW: 182 MUSD Residual GW: 0

Svenska Petroleum Exploration	PremierOil	NORECO	centrica energy	Tullow Oil
Acquisition of Norwegian subsidiary for USD 75 million (2015)	Acquisition of Norwegian subsidiary for USD 120 million (2015)	Acquisition of license portfolio in Norway, incl. NOK 45 million (2016)	Acquisition of license portfolio in Norway (2016)	Acquisition of license portfolio in Norway (2016)

Aker BP accounting principle:

Technical GW is tested for impairment separately for each CGU which give rise to the technical goodwill

Acquisition date

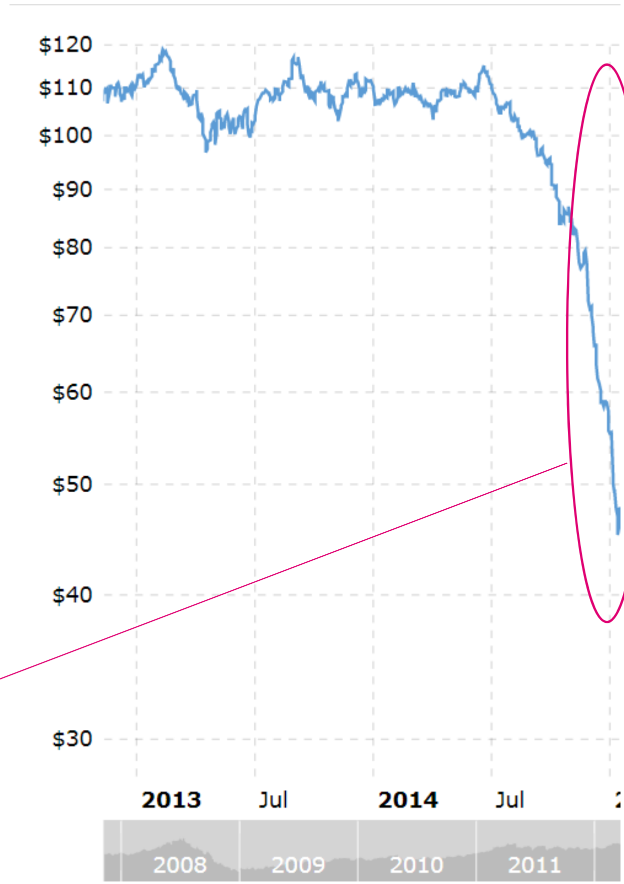
- Long period from the date of signing an agreement to the completion date
- When is the acquisition date in relation to IFRS 3.9?
- May impact the level of goodwill
- Example below from the BP deal

Acquisition date – example from Marathon acquisition

- The consideration for Marathon was cash only, so no issue with volatile share price
- The transaction was announced 2 June 2014, and completed 15 October 2014
- So the consideration was fixed, but what about the fair value measurement?
  - Brent spot price 2 June: USD 109/boe
  - Brent spot price 15 October: USD 84/boe
  - Brent spot price 31 December: USD 55/boe

Lower value on assets and fixed consideration = Goodwill increase

PPA working period



Acquisition date – example from BP acquisition

- The period between the signing of the SPA and date of fair value measurement may give rise to challenges from an accounting perspective
- Example: In the BP transaction, the consideration was mainly in shares – extract from the press release:

> Aker BP will be jointly owned by Aker ASA (40%), BP (30%) and other Det norske shareholders (30%). As part of the transaction, Det norske will issue 135.1 million shares based on NOK 80 per share to BP as compensation for all shares in BP Norge, including assets, a tax loss carry forward of USD 267 million (nominal after-tax value) and a net cash position of USD 178 million.

- The share price development from signing of the SPA to completion date:

NOK 80 x 135.1 mill = 10.8 BNOK

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NOK 127 x 135.1 mill = 17.1 BNOK

Stable value on assets, and higher consideration = Goodwill increase

Hess transaction

- The transaction was announced 24 October 2017, and completed 22 December 2017
- Consideration was fixed (2 BUSD), and the oil price relatively stable in the period
- Tax loss carried forward was a significant part of the transaction (nominal amount of 1,5 BUSD)
  - Will normally not pay the full nominal amount for Tax losses
- Negative residual goodwill offsetting positive technical goodwill
  - Resulting in lower short term expected impairment for the related CGU

Summary – Residual goodwill

- Marathon and BP
  - Increasing value of residual goodwill
- Hess
  - Negative residual goodwill
- Valuation of assets should not depend on the level of goodwill

Technical goodwill – Subsequent accounting impacts

Milliardnedskrivning for Det Norske

Det Norske Oljeselskap har kjøpt selskaper for flere milliarder kroner på norsk sokkel, nå må de ta nedskrivningene.

Subsequent accounting impacts

- IAS 36.80:
  - For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer’s cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall:
  - *represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and*
  - *Not be larger than an operating segment as defined by paragraph 5 of IFRS 8 Operating Segments before aggregation*

- Unfortunately no specific guidance on technical goodwill with regard to impairment
- From Aker BP Accounting principles:
  - Technical goodwill is tested for impairment separately for each CGU which give rise to the technical goodwill. A CGU may be individual oil fields, or a group of oil fields that are connected to the same infrastructure/production facilities.
- From Aker BP impairment disclosure
  - Technical goodwill has been allocated to individual CGUs for the purpose of impairment testing. The residual goodwill is allocated to group of CGUs including all fields acquired together with all existing Aker BP's fields, as this mainly relates to tax and workforce synergies and the ability to capture synergies from managing a portfolio of both acquired and existing fields on the NCS

Subsequent accounting impacts

- Let`s visit the standard simplified example involving technical goodwill (no discounting or tax balances)

Oil field	100	100	Debt
Technical GW	78	78	Deferred tax

- Let's assume 5 years linear production;

Year	1	2	3	4	5	**Total**
EBITDA	91	91	91	91	91	**454**
Depreciation	-20	-20	-20	-20	-20	**-100**
Pretax income	71	71	71	71	71	**354**
Tax payable	-71	-71	-71	-71	-71	**-354**
Change in def tax	16	16	16	16	16	**78**
Net income	16	16	16	16	16	**78**

For now, the only income will be the «theoretical» deferred tax – does that make sense?

Subsequent accounting impacts

- The balance at end of year 1, before impairment test of technical goodwill:

Oil field	80	80	Debt
Technical GW	78	62	Deferred tax
		16	Equity

- Unlike the initial recognition, technical goodwill is now lower than the related deferred tax
- More goodwill is as such exposed for impairment
- From impairment disclosure
  - When deferred tax from the initial recognition decreases, more goodwill is as such exposed for impairment. Going forward, depreciation of values calculated in the purchase price allocation will result in decreased deferred tax liability.
- The lifetime of the technical goodwill cannot exceed the lifetime of the related CGU
  - IFRS 3 states that goodwill shall not be depreciated
  - ...so then it needs to be impaired from time to time

Techncical goodwill – «UOP impairment»

- The simplified example does typically not include tax balances, while the reality is different

At acquisition (year 0)

Discount rate	10%							
Tax rate	78%							
Tax value	30							
		1	**2**	**3**	**4**	**5**	**6**	**7**
EBITDA		50.0	44.0	37.0	35.0	30.0	22.0	1.0
Tax depreciation		-6.0	-6.0	-6.0	-6.0	-6.0		
EBIT (tax)		44.0	38.0	31.0	29.0	24.0	22.0	1.0
Tax		-34.3	-29.6	-24.2	-22.6	-18.7	-17.2	-0.8
Add-back depreciation		6.0	6.0	6.0	6.0	6.0	-	-
Free cash flow		15.7	14.4	12.8	12.4	11.3	4.8	0.2

- NPV = Recoverable amount = 54.1 at initial recognition
- Tax value of 30 = deferred tax of 18.8 (78% of difference between 54.1 and 30)
  - Technical goodwill = 18.8

Techncical goodwill – «UOP impairment»

- Income statement – year 1

Income statement	0	1
EBITDA		50.0
Depreciation		-12.3
EBIT		37.7
Cost of tax		-29.4
Net income		8.3

- Balance sheet year 1 – pre impairment

Balance sheet	0	1
Asset	54.1	41.7
Goodwill	18.8	18.8
Bank	-54.1	-38.4
Deferred tax	-18.8	-13.8
Equity		-8.3
	-	-
Tax value	30	24.0
Temporary difference	24.1	17.7

- «UOP impairment» of 78% x 12.3 = 9.6
- However:
  - New NPV is 43.8 MUSD
  - Book value 41.7 + 18.8 – 13.8 = 46.7
  - Impairment = 46.7 – 43.8 = 2.9

NPV reduction in year 1	-	10.3
Depreciation year 1		12.3
Headroom		**2.1**
Change deferred tax	**-**	**4.9**
Calculated impairment	**-**	**2.9**

Challenge #1: Evaluation of impairment triggers

Challenge #2: Split between old and new deferred tax

Challenge #3: Other functional currency than NOK

www.akerbp.com