Hot topic

Business Combinations
Amendments to IFRS 3

Kristiansand, 9 November 2021

Building a better working world

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Agenda

Business combination

Asset transaction

Overview

Amendments to IFRS 3

Important Accounting Distinction
Business combination vs. asset acquisition

- Business combination - IFRS 3
  - Goodwill will only arise in business combinations
  - Difference between fair value of individual assets and liabilities, and tax value, will lead to the recognition of deferred tax (despite the fact that the acquisition price is on a post tax basis)
  - Assets and liabilities are measured at fair value in a business combination, and a purchase price allocation (PPA) will normally be required
  - Transaction costs are charged to P&L
- Asset acquisition IAS - 16
  - Allocate the acquisition price to the transferred assets' based on relative fair values
  - No recognition of goodwill or deferred tax (because of IRE; IAS 12.15/24)
  - Transaction cost is capitalized as part of the acquisition cost

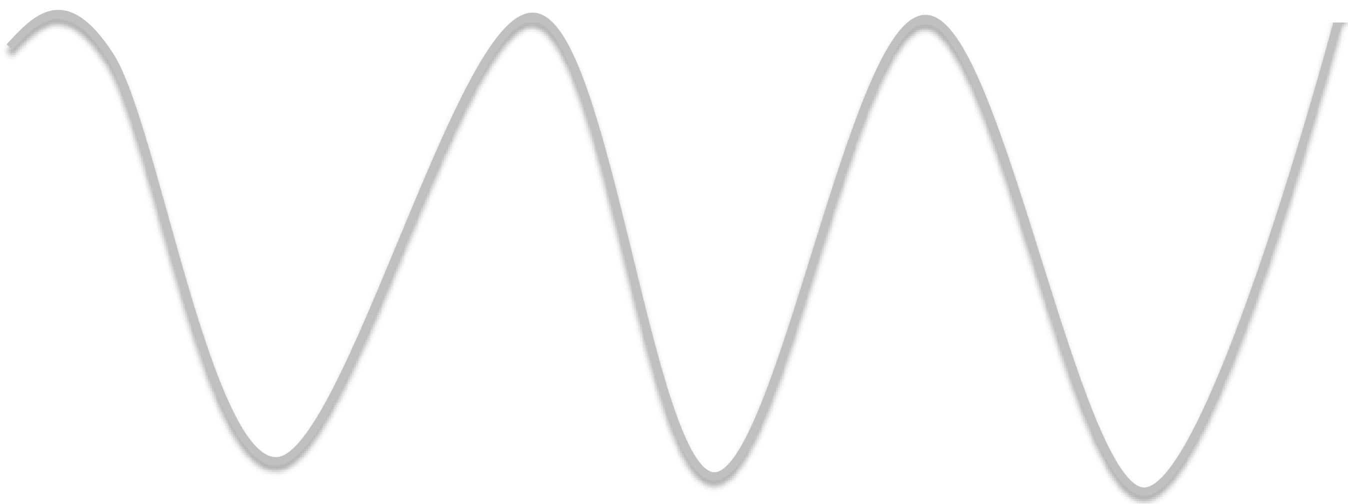
Business combination vs asset acquisition

Acquisition of asset	
Licence 100	Bank 100

Business combination	
Licence 100	Bank 100
Goodwill 78	Deferred tax 78

Focus has changed over time

More business combinations



Less business combinations

Business Combinations (old definition – replaced from 1 January 2020)

Business	Business combination
▶ An integrated set of activities and assets that is **capable** of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants	▶ A transaction or other event in which an acquirer obtains **control** of one or more businesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in this IFRS

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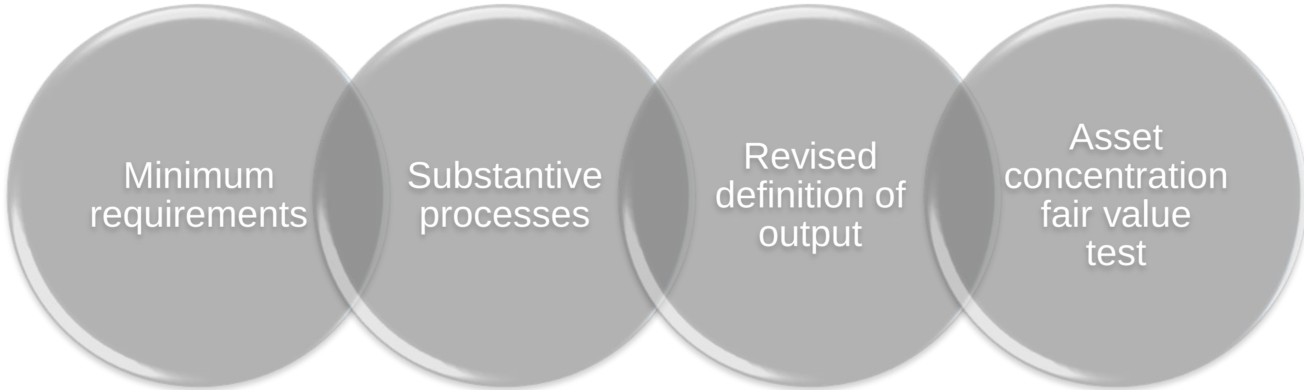
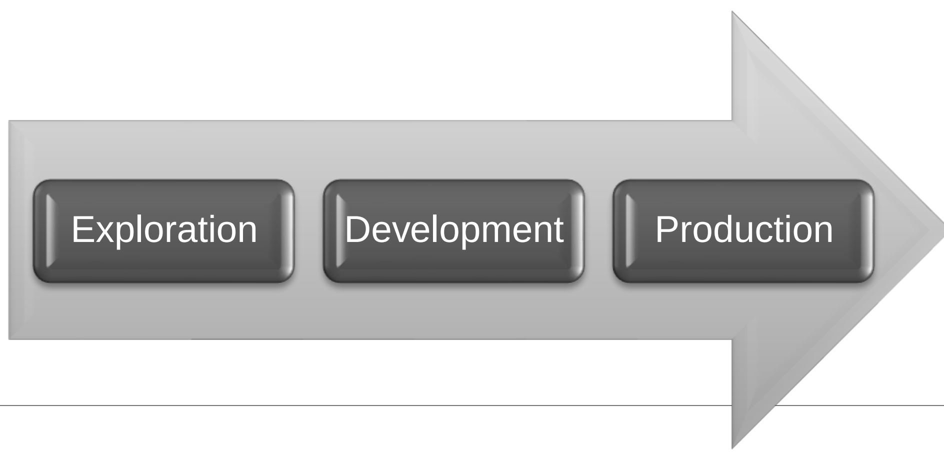
Amendments to IFRS 3 - New definition of business effective from 1 January 2020

- Additional guidance to help distinguish between the acquisition of a business and a single asset/group of assets





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Business Combinations (new definition effective 1 January 2020)

Business
▶ An integrated set of activities and assets that is capable of being conducted and managed for the **purpose of providing goods or services** to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities

Substantive process

Workforce can be accessed through contracts B12D

No output B12B	Output B12C
Process is critical to convert input to output	Critical to the ability to continue producing output, and includes workforce
and	or
Includes workforce and other inputs	Signficantly contributes to the ability to continue producing outputs, and; a) is unique or scarse b) cannot be replaced without signficant cost

Asset concentration fair value test

Optional test permitting a simplified process	
If the test is met	If the test is not met
Asset deal	*Full assessment needs to be performed*

Single identifiable asset

Group of similar assets

Substantially all

Asset concentration fair value test
Similar assets

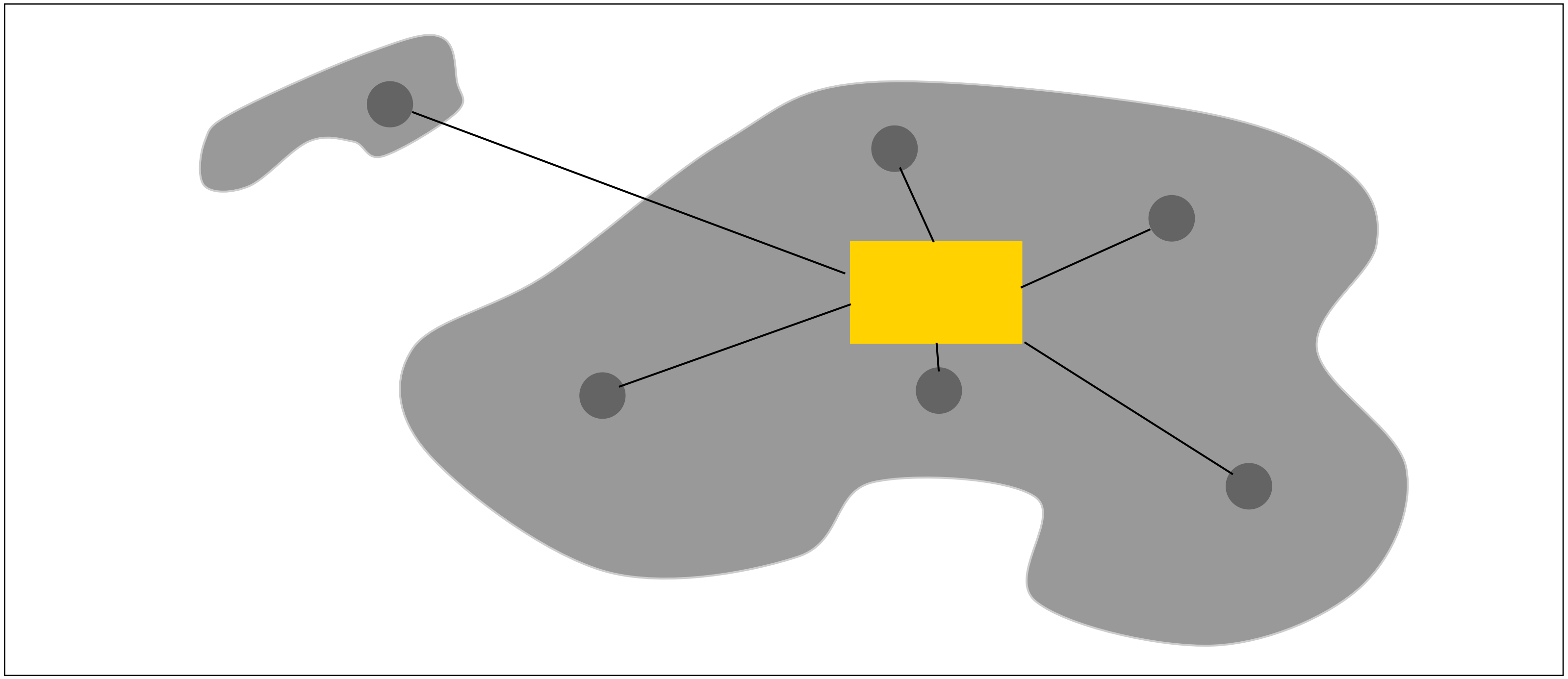
- The following shall not be considered similar assets
  - A tangible and an intangible asset
  - Tangible assets in different classes unless they are attached to, and can not be physically removed and used separately from, another tangible asset
  - Identifiable intangible assets in different classes
  - A financial asset and a non-financial asset
  - Financial assets in different classes
  - Identifiable assets that are within the same class of assets but have significantly different risk characteristics

Asset concentration fair value test
Two views….

«An option specifically given in the amendments to IFRS 3 to treat acquisitions of a single identifiable asset, or a single group of similar identifiable assets as asset deals»

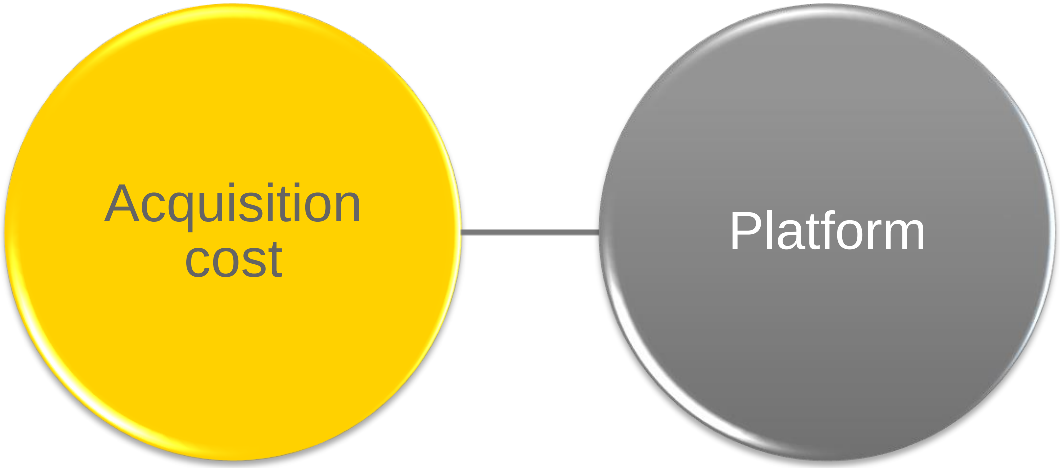
«Simplified test, should in most cases have the same outcome as the detailed assessment»

A bit more about similar assets…

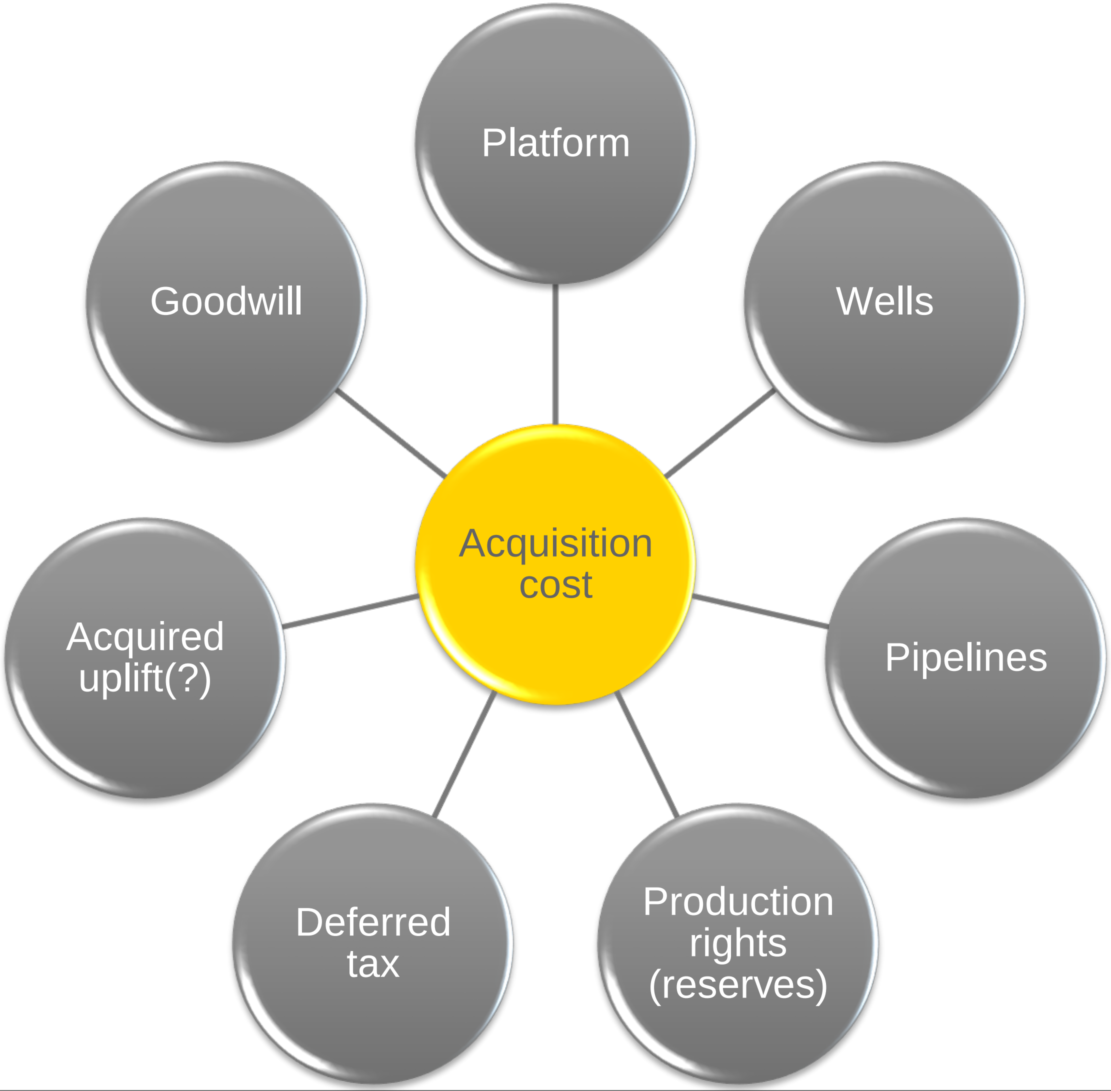


Production well   Oil & gas deposits   Platform   Pipeline

Allocation of acquisition cost
Before…



Allocation of acquisition cost



Hot topic

Business Combinations–
Disclosures, Goodwill and Impairment

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Discussion Paper

- Background of the Discussion Paper “Business Combinations—Disclosures, Goodwill and Impairment”
- The topics examined in the DP
  - Improving disclosures about acquisitions
  - Goodwill amortization and impairment
  - Simplifying the impairment test
  - Intangible assets
- Summarization

Background

- IFRS 3 *Business Combinations* (issued 2004, revised 2008) introduced
  - Removal of amortization of Goodwill and all intangible assets
  - Broadened the range of intangible assets recognized separately from Goodwill in an acquisition
- Post-implementation review (“PIR”) in 2013 and 2014 assessed whether IFRS 3 worked as intended
- IASB started a research project on goodwill and impairment, which is the subject of the Discussion Paper. The project considers the following topics identified in the PIR:
  - disclosing information about acquisitions;
  - testing goodwill for impairment – effectiveness and cost;
  - whether to reintroduce amortization of goodwill; and
  - recognizing intangible assets separately from goodwill [not covered in this presentation]

Improving disclosures about acquisitions

Investors want to understand how an acquisition is performing relative to management expectations

A company should be required to provide investors with the information that the company's management uses to monitor acquisitions

Investors could use this information to assess management's decisions to acquire businesses

Note

Management is "Chief Operating Decision Maker" as defined in IFRS 8 *Operating Segments*

What information should be provided?

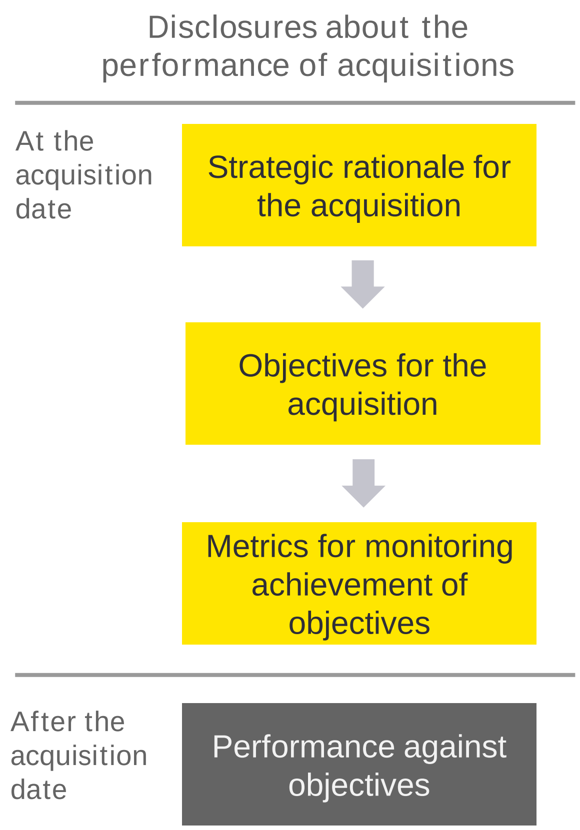
Strategic rationale for a business that links the acquisition to the company's overall business strategy

Management's objectives for the acquisition at the acquisition date

- Both financial and non-financial

Information management uses to monitor the performance of an acquisition

- Unlikely one single metric
- Same metrics as management uses
- In the year of the acquisition, the metrics used to monitor objectives should be disclosed



What information should be provided? (continued)

If a company does not monitor whether its objectives are being met, it should disclose that fact and the reasons

If the company stops monitoring before the end of the second full year, it should disclose that fact and the reasons

If the company changes the metrics, it should disclose the new metrics and the reasons for the change

The information is required for all acquisitions monitored by management

Reporting performance of an acquisition

At acquisition date	
If monitored by management **Disclose objectives**	If not monitored **Disclose reasons for not monitoring**

Within 2 years	
If monitoring continues **Disclose performance against objectives**	If monitoring ceases **Disclose reason for ceasing to monitor**

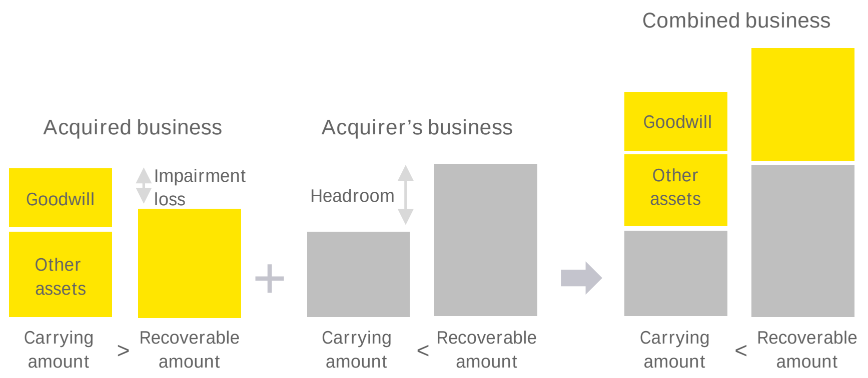
After 2 years	
If monitoring continues **Disclose performance against objectives**	If monitoring ceases **No further disclosures needed**

Concerns with the proposals

- Impossible to provide because the acquired business is being integrated:
  - It may be difficult to isolate an acquiree's separate financial information
  - Monitoring of the combined business
- Commercially sensitive information
- Forward-looking information
  - IASB's view is that information provided is not forward-looking but historical performance of the acquiree

Goodwill impairment and amortisation

- Can the impairment test be made more effective?
  - Impairment tests provide useful information
  - Goodwill impairment losses are sometimes recognized too late
    - May be due to management optimism or shielding
- The Board's preliminary view: not feasible to design a different impairment approach that is significantly more effective



Management optimism

- Result of judgment in determining CGU's recoverable amount
- Difficult to avoid management optimism
- Board considers this best handled by auditors and regulators

Shielding

- Headroom can protect goodwill against impairment
- Reduction in headroom and goodwill are allocated first to the unrecognized headroom
- Building headroom into the impairment test will increase subjectivity

Should amortisation of goodwill be reintroduced?

- Amortization of goodwill could
  - Take some pressure of the impairment test
  - Provide a mechanism that targets goodwill directly
- Both models have limitations
  - No impairment test has been identified that can test goodwill directly
  - Difficult to estimate the useful life of goodwill and the pattern in which it diminishes
- Board's preliminary view is that the impairment-only approach should remain
  - Small majority by the board (8 /14)

Pro amortisation	Against amortisation
▸ PIR suggested that the impairment test is not working as the Board intended ▸ Carrying amounts of goodwill are overstated ▸ Goodwill is a wasting asset with a finite useful life ▸ Amortisation would reduce the cost of accounting for goodwill	▸ The impairment-only model provides more useful information than amortisation ▸ If applied well, the impairment test achieves its purposes ▸ Acquired goodwill is not a wasting asset, nor is it separable from internal goodwill ▸ Reintroducing amortisation would not save significant cost

Simplifying the impairment test

- The board's preliminary review suggest the development of three proposals
  - Relief from the annual impairment test
  - Removing the restriction on including cash flows from future restructurings, improvements or enhancements
  - Allowing the use of post-tax cash flows and discount rates

Annual impairment test

- The impairment test is complex, time-consuming, costly and requires judgment
- Limited benefits and may not always justify its cost
- Preliminary view is that the proposal should remove the requirement for an annual impairment test for CGU's containing goodwill if there is no indication of impairment

Current condition requirement

- Currently required to exclude cash flows from a future enhancement
  - Not typically how a company prepares its internal cash forecasts
  - Requires adjustments to financial forecasts
- Removing the restrictions will make the impairment test
  - less prone to error;
  - easier to understand;
  - easier to perform; and
  - reduce the cost and complexity

Post-tax cash flows and discount rates

- Determining pre-tax discount rates is costly and complex
- Pre-tax discount rate is hard to understand, is not observable and does not provide useful information
- Valuations are generally performed on a post-tax basis

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IKKE NOE SPESIELT. VILLE BARE STIKKE HODET INNOM OG KLAGE LITT.
MEN IKKE PÅ NOE SPESIELT?
NIX. BARE SÅNN GENERELT, LIKSOM. JEVNT FORDELT.
INGENTING DU VIL TREKKE FRAM SOM KRITISK PÅ NOEN MÅTE, ALTSÅ?
NEI, IKKE I DAG.
POSITIV TILBAKEMELDING...
DET ER SÅNNE ØYEBLIKK MAN LEVER FOR.