MFRS Hot Topics

Acquisition date fair value and subsequent selling price

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Welcome to MFRS Hot Topics - a publication from SJ Grant Thornton. This publication discusses the implications of a post-combination sale on the acquisition date fair value of an asset in a acquired business combination.

Issue

This Hot Topic provides guidance on the implications of a post-combination sale on the acquisition date fair value of an asset in an acquired business combination. Specifically:

- in what circumstances should an acquisition date fair value be adjusted as a result of a post-combination asset sale
- does the MFRS 3 Business Combinations concept of a 'measurement period' also apply to assets acquired in a business combination that are classified as held for sale and measured in accordance with MFRS 5 Non-current Assets Held for Sale and Discontinued Operations?

Contents

MFRS 3 and acquisition date fair values
MFRS 3 requires that most assets acquired and liabilities assumed in a business combination are recognised at their fair value by the acquirer. MFRS 13 Fair Value Measurements defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (ie an exit price).

Guidance

Adjustments to acquisition date fair values as a result of a subsequent sale

A post-acquisition sale of an asset acquired in a business combination may provide new information about the asset's acquisition date fair value. The acquisition date fair value should be adjusted to take account of this information only when:
- the selling price indicates that the original acquisition date fair value is an error or
- the asset's fair value was determined provisionally, the sale occurs within the measurement period specified by MFRS 3 and the selling price provides relevant new information about the fair value at the acquisition date.

The assessment of whether the selling price provides new information about fair value at the acquisition date depends on the facts and circumstances.

Assets classified as held for sale

We believe the concept of a measurement period adjustment applies equally to assets classified immediately upon acquisition as held for sale, and measured in accordance with MFRS 5.

Held for sale classification
MFRS 3.31 requires that the acquirer measures an acquired non-current asset (or disposal group) that is classified as held for sale at the acquisition date in accordance with MFRS 5 at fair value less costs to sell in accordance with MFRS 5.15-18. Such a classification is appropriate only if MFRS 5's criteria are met.

Discussion

MFRS 3 includes the concept of a ‘measurement period’. The relevant requirements are set out at MFRS 3.45-50. In summary, the measurement period allows an acquirer to:

- report the assets acquired, liabilities assumed, non-controlling interests and consideration transferred on a provisional basis (MFRS 3.46)
- update the provisional amounts to reflect relevant new information obtained within the MFRS 3 measurement period (as if the accounting for the business combination had been completed at the acquisition date).

The measurement period concept exists for pragmatic reasons. The International Accounting Standards Board describes its purpose as to:

> ‘provide an acquirer with a reasonable period after the acquisition date, a measurement period, during which to obtain the information necessary to identify and measure the items specified’ and ‘to resolve concerns about the quality and availability of information at the acquisition date for measuring the fair values of particular items at that date’ (MFRS 3.BC390-391).

Duration of measurement period

The MFRS 3 measurement period ends on the earlier of:

- the date the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable
- one year from the acquisition date.

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Correction of an error

In rare circumstances, a reported acquisition date amount might need to be amended because the original amount contained a material prior period error. In principle, an error could arise even if the original amount was a provisional amount. MFRS 3.47 states:

> ‘…the sale of an asset to a third party shortly after the acquisition date for an amount that differs significantly from its provisional fair value measured at that date is likely to indicate an error in the provisional amount.’

This leads to the problem of distinguishing between legitimate measurement period adjustments and errors. The concept of a measurement period does of course envisage that new information will be obtained and that this may result in an adjustment. Accordingly, we suggest that assessing whether a provisional amount is an error should take account of the provisional nature of the original estimate. In practice we expect that adjustments to provisional amounts in the measurement period will rarely be treated as errors. However, the ability to report provisional amounts should not be viewed as a permission to report amounts that are demonstrably unreasonable or without basis.

An error might arise as a result of

- clerical mistakes in determining the original amount
- inappropriate inputs and assumptions (i.e. inputs and assumptions that are inconsistent with those that market participants could be reasonably expected to make in pricing the asset or liability)
- use of a valuation method which is not generally accepted
- a failure to take reasonable account of existing information that should have been considered in making the estimate (or provisional estimate).

Measurement period adjustments

If the original acquisition date fair value is not considered to be an error, entities should consider whether the sales price should result in a measurement period adjustment. Such an adjustment is possible only if:

- the original acquisition date fair value was a provisional amount
- the sale transaction occurs within the measurement period
- the sales price provides new evidence as to facts and circumstances that existed as of the acquisition date.

This third point is the only difficult one. The acquisition date fair value should reflect circumstances at the measurement date (i.e. the acquisition date). The sale price in a post-combination sale might represent the fair value at the transaction date. This amount is unlikely to be identical to the acquisition date fair value as prices generally move over time. The entity should therefore consider both the sale price and any factors that might have caused the fair value to change between the acquisition date and the sale date. In our view, the provisional fair value should be amended only if the sale price and any 'add-backs' to reflect estimated fair value movements between the two dates are, taken together, a more reliable basis for estimating the acquisition date fair value when compared to the provisional estimate. In other words the acquirer should use the best information available (including information derived from the sale) in finalising the provisional amounts.

MFRS 3.47 provides some guidance on making the assessment. This requires the acquirer to consider 'all pertinent factors'. Such factors might include:

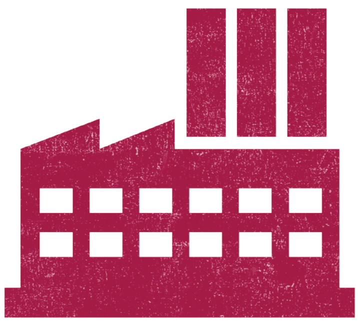
- the assumptions in the provisional estimate and the extent to which they involve significant judgment
- whether the acquirer can identify a reason for a change to provisional amounts
- the length of time between the acquisition date and the post-combination sale
- the changes in the market during that time (including inflation and time value of money)
- volatility in the market for those type of assets
- any modifications to the asset or changes in its performance
- whether the sale transaction was an unforced, arm's length sale to an unrelated party (and therefore representative of fair value at the sale date).

Assets classified as held for sale

> MFRS 3.31 states that:
> 'The acquirer shall measure an acquired non-current asset (or disposal group) that is classified as held for sale at the acquisition date in accordance with MFRS 5 Non-current Assets Held for Sale and Discontinued Operations at fair value less costs to sell in accordance with paragraphs 15-18 of that MFRS.'

This direct reference to MFRS 5 for the measurement of 'held for sale' assets has led some commentators to question whether the concept of a measurement period also applies to this category of assets. In our view the measurement period does apply. This is on the grounds that the measurement period is intended to allow acquirers some more time to identify and measure the items specified in MFRS 3.46 as of the acquisition date (MFRS 3.BC390). This permission is not restricted to items measured at fair value, but rather applies to all of the 'provisional amounts recognised at the acquisition date' (MFRS 3.45). Held for sale assets are part of the accounting for a business combination, even though MFRS 5 is applied for measurement and presentation purposes. Fair value estimates are also needed for the MFRS 5 assets (along with estimated costs to sell) and these might be incomplete at the first post-combination reporting date.

Having said that, to be classified as held for sale the assets in question must meet MFRS 5's strict criteria. These include that the asset must be ready for immediate sale, the sale must be highly probable and expected within 12 months and appropriate management commitment to sell (MFRS 5.6-8A). If those conditions are met at the acquisition date, the acquirer might be expected to have a better idea of their fair value compared to other assets such as customer-related intangibles. However, this is a matter of facts and circumstances and does not affect the general principle.



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