HONG KONG SOCIETY OF ACCOUNTANTS

Financial Accounting Standards Committee

Urgent Issues & Interpretations Sub-Committee

Interpretation
15
Business Combinations - "Date of Exchange" and Fair Value of Equity Instruments

Interpretations are authoritative guidance on the application of Statements of Standard Accounting Practice with which enterprises should comply if their financial statements purport to give a true and fair view. Unless indicated otherwise, Interpretations have the same status as the background material and implementation guidance contained in Statements of Standard Accounting Practice. Interpretations are not intended to apply to immaterial items.

References: SSAP 30 *Business Combinations*

ISSUES

1. An enterprise may issue its own equity instruments as purchase consideration in a business combination accounted for as an acquisition under SSAP 30. SSAP 30 paragraph 20 requires that an acquisition be accounted for at its cost, and that equity instruments issued by the acquirer be measured at their fair value at the date of exchange.

2. If equity instruments issued as purchase consideration are quoted in a market and their market price at the date of exchange is not a reliable indicator of their fair value, SSAP 30 paragraph 23 indicates that price movements for a reasonable period before and after the announcement of the terms of the acquisition need to be considered.

3. The issues are:

   (a) what is the "date of exchange" when determining the fair value of equity instruments issued as purchase consideration in an acquisition;

   (b) when is it appropriate to consider other evidence and valuation methods in addition to a published price at the date of exchange of a quoted equity instrument; and

   (c) what information should be disclosed when a published price of a quoted equity instrument has not been used as the instruments' fair value, and what information should be disclosed when an equity instrument does not have a published price.

4. SSAP 30 paragraph 62 requires the amount of an adjustment to the purchase consideration contingent on one or more future events to be included in the cost of an acquisition as at the date of acquisition if the adjustment is probable and the amount can be measured reliably. SSAP 30 paragraph 65 requires the cost of an acquisition to be adjusted when a contingency affecting the amount of the purchase consideration is resolved subsequent to the date of acquisition. Consequently, this Interpretation does not apply to equity instruments issued as adjustments to the purchase consideration contingent on one or more future events, unless the adjustments are probable and the amounts can be measured reliably as at the date of acquisition.

CONCLUSIONS

5. When an acquisition is achieved in one exchange transaction (i.e., not in stages), the "date of exchange" is the date of acquisition; that is, the date when the acquirer obtains control over the net assets and operations of the acquiree. When an acquisition is achieved in stages (e.g., successive share purchases), the fair value of the equity instruments issued as purchase consideration at each stage should be determined at the date that each individual investment is recognised in the financial statements of the acquirer.

6. The published price at the date of exchange of a quoted equity instrument provides the best evidence of the instrument's fair value and should be used, except in rare circumstances. Other evidence and valuation methods should also be considered only in the rare circumstance when it can be demonstrated that the published price at that date is an unreliable indicator, and that the other evidence and valuation methods provide a more reliable measure of the equity instrument's fair value. The published price at the date of exchange is an unreliable indicator only when it has been affected by an undue price fluctuation or a narrowness of the market.

DISCLOSURE

7. When a published price of an equity instrument issued as purchase consideration exists at the date of exchange, but has not been used as the instruments' fair value, an enterprise should disclose:

   (a) that fact;

   (b) the reasons why the published price is not the fair value of the equity instruments;

   (c) the method and significant assumptions applied in determining the fair value; and

   (d) the aggregate amount of the difference between the published price and the amount determined to be the fair value of the equity instruments.

8. When an equity instrument issued as purchase consideration does not have a published price at the date of exchange, an enterprise should disclose that fact and the method and significant assumptions applied in determining the fair value.

BASIS FOR CONCLUSIONS

9. As stated in SSAP 30 paragraph 21, when an acquisition is achieved in stages, the distinction between the date of acquisition and the date of the exchange transaction is important. When an acquisition is achieved in one exchange transaction there is no distinction between the date of exchange and the date of acquisition. Sub-paragraph 98(a) of the Framework indicates that when assets are recorded at their historical cost, the assets are recorded at the fair value of the purchase consideration given to acquire them at the time of their acquisition. Therefore, when a business is acquired in one exchange transaction (i. e., not in stages), the fair value of the purchase consideration given is determined when control, as defined in SSAP 30 paragraph 11, of the net assets and operations of the acquiree is effectively transferred to the acquirer. When a business is acquired in stages (e. g., successive share purchases), the fair value of the purchase consideration given at each stage is determined when each individual investment is recognised in the financial statements of the acquirer.

10. SSAP 30 paragraph 23 indicates that marketable securities issued by the acquirer are measured at their fair value, which is their market price as at the date of the exchange transaction, provided that undue fluctuations or the narrowness of the market do not make the market price an unreliable indicator. Estimates of premiums for large, and discounts for small, blocks of equity instruments issued in comparison to that exchanged in observable transactions are not considered.[1] When the published price of a quoted equity instrument on the date of an exchange is determined to be an unreliable indicator of its fair value, the information necessary to reliably estimate the effect of the undue fluctuation or market narrowness at that date is unlikely to be available due to the many factors that affect prices. Consequently, other evidence and valuation methods for determining fair value are considered only in the rare circumstance when it can be demonstrated that the published price is an unreliable indicator and that the other evidence and valuation methods provide a more reliable estimate of the equity instrument's fair value at the date of exchange.

Date of Issue: 25 June 2002

Effective Date: This Interpretation becomes effective for acquisitions given initial accounting recognition on or after 30 June 2002.

[1] In accordance with SSAP 1, Presentation of Financial Statements, paragraph 23, management could consider IAS 39, Financial Instruments: Recognition and Measurement, when determining the fair vale of equity instruments. Under IAS 39, an investment in an equity instrument is measured at its fair value, except in specified circumstances. Equity instruments have only one fair value in a market. IAS 39 paragraph 99 indicates that the existence of published price quotations in an active market is normally the best evidence of fair value.