



A Valuation Close-up on the New Business Combinations Rule

The US GAAP

The FASB issued SFAS 141R with the objective of improving the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects.

Effective Date: 15 December 2008.

The HK GAAP

HKICPA revised HKFRS 3 ("HKFRS 3R") with the objective of maintaining international accounting standards convergence.

Effective Date: 1 July 2009.

Followings are the major amendments on business combinations (SFAS 141R & HKFRS 3R):

1. Acquiring a company in stages

- SFAS 141 & HKFRS 3 – Each transaction is treated separately by the acquirer. The cost and fair value information at the date of each acquisition is used to determine the related goodwill.
- SFAS 141R & HKFRS 3R – All identifiable assets and liabilities, as well as the non-controlling interest (the "NCI") in the target company, are recognized at their full amounts.
- Valuation insights for full acquisition, with an existing investment
 - separate valuations are required for the previously held equity interest (the "PHEI") and the 100% interest of investment;
 - SFAS 141R & HKFRS 3R – When the company obtained the control, the acquirer measures any PHEI to its fair value. A gain or loss is recorded in the income statement, as if the PHEI was disposed at the date to obtain control; and
 - the fair values of the acquirer's interest and the NCI are different on a per-share basis because of control premium or non-control discount.

Example: the acquirer (i) owned 5% minority interest where the fair value is \$500,000 as at the valuation date, and (ii) paid a total consideration of \$11 million for the remaining interest. Under the 100% acquisition interest, goodwill is calculated as follow:

Full Acquisition (Acquirer has an Existing Investment)	
Consideration transferred – 95% interest	\$11,000,000
Fair value of the PHEI – 5% interest	\$500,000
Total consideration transferred	\$11,500,000
Net assets recognized	\$9,700,000
Goodwill of the reporting unit	\$1,800,000

- Valuation insights for partial acquisition, with an existing investment
 - SFAS 141R & HKFRS 3R – Separate set of valuations are required for 1) the PHEI; 2) investment interest; and 3) the NCI of the target company;
 - SFAS 141R – The NCI, after the acquisition, is valued with non-controlling valuation methods. It is included as part of the total fair value; and
 - HKFRS 3R – The NCI, after the acquisition, is required to be measured when determining the goodwill/bargain purchase. NCI can be measured either using: i) fair value of the NCI; or ii) proportionate interest of the fair value of net identifiable assets of the entity acquired.

Example: the acquirer (i) owned 5% minority interest where the fair value is \$500,000 as at the valuation date, and (ii) paid a total consideration of \$9.5 million for 80% controlling interest. Under the 80% acquisition interest, goodwill is calculated as follow:

Partial Acquisition (Acquirer has an Existing Investment)	
Consideration transferred – 80% interest	\$9,500,000
Fair value of the PHEI – 5% interest	\$500,000
Fair value of non-controlling interest – 15% interest	\$1,500,000
Total consideration transferred	\$11,500,000
Net assets recognized	\$9,700,000
Goodwill of the reporting unit	\$1,800,000

2. Valuation of contingent consideration

- SFAS 141 & HKFRS 3: Consideration was not recognized until resolved and issued or become issuable.
- SFAS 141R & HKFRS 3R: Measure the consideration at acquisition, at its fair value.
- Valuation insights:
 - Separate set(s) of valuation is required for the consideration.