



SOCIETY OF ACTUARIES

**International Financial Reporting for Insurers:  
IFRS and U.S. GAAP Seminar  
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**Session 22: Purchase Accounting – IFRS**

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# Session 22: Purchase Accounting-IFRS

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## Relevant IFRS Guidance

- IFRS 3-Business Combinations
- IFRS 4-Insurance Contracts
- IAS 27-Consolidated and Separate Financial Statements
- May 2009 Exposure Draft-Fair Value Measurement



## IAS 27 Relevant Topics

- Definition of control
- Accounting for non-controlling interests
- Changes in ownership interests



## IFRS 3-Purchase Accounting



## IFRS 3-Acquisition Method

- Identify acquirer
- Determine acquisition date
- Recognize/measure assets acquired and assets assumed
- Recognize/measure goodwill or gain from bargain purchase



## IFRS 3-Measurement Basis

- Identifiable assets acquired and liabilities assumed are measured at their acquisition-date fair values
- [IFRS 3(2008).18]



## Intangible Assets to Consider

- Market-related
- Customer-related
- Artistic-related
- Contract-based
- Technology-based



## Definition of Goodwill

- Consideration transferred, less
- Net identifiable assets acquired



## If Goodwill is Negative?

- Review identification and valuation of assets acquired and liabilities assumed
- If still negative, taken as a gain in the income statement



## IFRS 4-Insurance Contracts



## IFRS 4, Paragraph 31

- Permits an insurer to split the fair value of acquired insurance contracts between:
  - (a) Liability under insurer's accounting policies, and
  - (b) Intangible asset equal to the difference between the fair value of the rights/obligations assumed and (a)



## IFRS 4, Paragraph 31

- Subsequent measurement of the intangible asset shall be consistent with the measurement of the related insurance liability



## Rethinking the VOBA Equation

- Historically, VOBA calculated bottom up, consistent with liabilities held
- IFRS guidance-VOBA may be balancing item to FV net liability
- In theory, two approaches should be consistent



## What About US GAAP?

- Requires that the fair value of insurance contracts acquired in a business combination be separated into
  - (a) GAAP accounting balances using the acquirer's accounting policies and
  - (b) an intangible asset (or, at times that are expected to be rare, another liability).
- FAS 141 R, Paragraph B192



# IASB ED-Fair Value Measurement



## ED on FV Measurement

- Issued in May 2009
- Largely based on FAS 157
- Responses due by September 28, 2009
- Still time to comment!



## Definition of Fair Value

- Fair value is 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
- Same as FAS 157 under US GAAP



## Liability Valuation Approach

- If active market for corresponding asset, use observed price
- If no corresponding asset, use present value or other valuation techniques



## Non-performance Risk

- To be reflected in fair value
- Includes “own credit” risk



## Hierarchy of Inputs

- Level 1-Quoted prices in active markets
- Level 2-Other market observable inputs
- Level 3-Not based on observable market data



## Risk Margin

- Unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk



## Insurance Specific Issues



## Insurance Issues to Consider

- Presentation of reserves/VOBA
- Basis for VOBA
- Basis for risk margin
- Negative goodwill



## Reserves/VOBA Presentation

- Fair value liability and zero VOBA?
- Book value of liability and non-zero VOBA?
- Book value approach simplifies Day 2 accounting for the liability
- US GAAP requires second approach



## Basis for VOBA

- Balancing item to get net FV liability?
- Calculated value of run-off of margins?
- If balancing item, need basis for run-off over time
- Should be equivalent



## Basis for Risk Margin

- PADs on assumptions
- Cost of capital
- Calibration to consideration
- Other approaches



## Negative Goodwill

- Own credit adjustment increases the likelihood of negative goodwill
- Considerations:
  - Appropriateness of assumptions
  - Calibration of assumptions
  - Surrender value floor

