

STAFF PAPER

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Project	Business Combinations under Common Control		
Paper topic	Starting point in developing proposals		
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Introduction

1. In December 2017, the International Accounting Standards Board (Board) finalised its discussion of the scope of the Business Combinations under Common Control (BCUCC) research project. The Board tentatively decided that the project will address business combinations under common control as well as other transactions under common control that involve a transfer of control over one or more businesses. The Board's tentative decisions on the scope of the project are reported in Appendix A of Agenda Paper 23 *Cover note* for this month's meeting.
2. Also in December 2017, the staff held an educational session for the Board on potential methods of accounting for transactions within the scope of the project as well as consultations with the Accounting Standards Advisory Forum (ASAF) and the Emerging Economies Group (EEG) on that topic.
3. In this paper, the staff seek direction from the Board on the starting point in developing proposals for transactions within the scope of the project. It discusses alternative approaches, provides staff recommendation and asks the Board for a decision.

Staff recommendation

4. The staff recommend that the Board should use the acquisition method set in IFRS 3 *Business Combinations* as the starting point in developing proposals for transactions within the scope of the BCUCC project.

Structure of the paper

5. The paper is structured as follows:
 - (a) alternative approaches (paragraphs 7–25);
 - (i) Alternative 1—start from a blank sheet of paper (paragraphs 10–11);
 - (ii) Alternative 2—start from IFRS Standards (paragraphs 12–16);
 - (iii) Alternative 3—start from existing practice (paragraphs 17–25);
 - (b) staff analysis and recommendation (paragraphs 26–32); and
 - (c) question for the Board.
6. Appendix A and Appendix B report the feedback received from ASAF and EEG members respectively. ASAF and EEG members did not express a clear preference regarding the starting point the Board should use in developing proposals for transactions within the scope of the project.

Alternative approaches

7. Following the December 2017 educational session with the Board and the consultations with the ASAF and the EEG, the staff identified the following broad alternatives for developing proposals for transactions within the scope of the project:
 - (a) Alternative 1—start from a blank sheet of paper;
 - (b) Alternative 2—start from IFRS Standards; and
 - (c) Alternative 3—start from existing practice.

8. These alternatives are not discrete and they overlap. In addition, the resulting proposals under each alternative could be very similar. This is because the main focus of each alternative is to provide useful information for primary users of the reporting entity's financial statements (the reporting entity the Board is considering in this project is the entity that obtains control over the transferred business or businesses, ie the 'receiving' entity in the transaction).
9. However, each alternative identified by the staff approaches the development of proposals from a different starting point.

Alternative 1—start from a blank sheet of paper

10. Under this alternative, the Board would need to decide what accounting method would result in useful information about transactions within the scope of the project, at a cost that is justified by the benefits of that information. Specifically, the Board would need to decide:
 - (a) which items should be recognised by the receiving entity and when these items should be recognised;
 - (b) how these items should be measured both on initial recognition and at subsequent reporting dates; and
 - (c) what information about these items should be presented and disclosed in the receiving entity's financial statements.
11. In developing those proposals, the Board would primarily rely on the guidance in the *Conceptual Framework for Financial Reporting (Conceptual Framework)*. However, it is likely that the Board would also consider existing requirements in IFRS Standards for similar transactions as well as existing practice.

Alternative 2—start from IFRS Standards

12. Under this alternative, the Board would start by examining the existing requirements in IFRS Standards for transactions that are similar to transactions within the scope of the project. It would then need to assess whether, for some or all transactions within the scope, those requirements would result in useful information, at a cost that is justified by the benefits of that information. In

making that assessment, the Board would consider the guidance in the *Conceptual Framework*.

13. The Board would finally need to develop different proposals for those transactions for which the existing requirements would not result in useful information or would result in information whose benefits do not justify the cost of applying those requirements. In developing these proposals, the Board would primarily rely on the guidance in the *Conceptual Framework* but it would likely consider existing practice as well.

14. The staff considered which IFRS Standard(s) would provide the most appropriate starting point under this alternative. Existing IFRS Standards cover the following transactions from the perspective of the receiving entity:
 - (a) transfer of one or more businesses: IFRS 3 applies to business combinations between entities *not* under common control. IFRS 3 requires the acquirer to account for business combinations applying the acquisition method. Under that method, the acquirer recognises the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values and recognises any goodwill or gain from a bargain purchase.

 - (b) transfer of a group of items: paragraph 2(b) of IFRS 3 sets out accounting requirements for the acquisition of a group of items that does not constitute a business. The Standard requires the acquirer to allocate the cost of the group of items to the individual identifiable assets acquired and liabilities assumed on the basis of their relative fair value at the acquisition date. No goodwill or gain from a bargain purchase is recognised.

 - (c) transfer of a single item: applicable IFRS Standards require the acquirer to recognise acquired items at cost or at fair value depending on the nature of the item.

15. As stated in paragraph 1 of this paper, the Board tentatively decided that the project will address transactions that involve a transfer of control over one or more *businesses*. Therefore, in the staff's view, if the Board decides to start from existing requirements in IFRS Standards in developing proposals for transactions

within the scope of the project, the acquisition method set out in IFRS 3 would provide the most appropriate starting point.

16. The staff emphasise that starting from the acquisition method would not mean that all or most transactions within the scope of the project would be accounted for under this method. That method would only be appropriate when it would result in useful information, at a cost that is justified by the benefits of that information. For other circumstances a different method would need to be developed.

Alternative 3—start from existing practice

17. The feedback received from the outreach activities and the research performed by the staff (see Agenda Paper 23A *Method(s) of accounting for BCUCC* from April 2016) indicates that business combinations under common control are most often accounted for applying variations of the so-called ‘predecessor method’. Under that method, the assets acquired and the liabilities assumed are recognised at their carrying amounts.
18. Stakeholders also reported that, in some cases, the acquisition method set out in IFRS 3 is used. However, the staff have not observed any pattern in the application of the two accounting methods, except that in some jurisdictions the predecessor method is required.
19. If the Board decides to start from existing practice in developing proposals for transactions within the scope of the project, it could use the predecessor method as the starting point as this method is most commonly used in practice. The Board would then need to develop different proposals for transactions for which the predecessor method does not provide useful information or would result in information whose benefits do not justify the cost of applying that method.
20. However, unlike the acquisition method set out in IFRS 3, the predecessor method is not described in IFRS Standards, nor is it applied in a consistent manner, hence it does not provide a clear starting point.
21. The research and outreach the staff have performed to date show significant diversity in how the predecessor method is applied. In fact, some interested parties suggested that the main source of diversity in practice is not the fact that

both the predecessor and the acquisition method are applied. Instead, it is *how* the predecessor method is applied.

22. The main aspects of diversity relate to the following:
- (a) carrying amounts at which the assets acquired and the liabilities assumed are recognised—in some cases, carrying amounts reported by the immediate or ultimate controlling party are used; in other cases, carrying amounts reported by the transferred business are used; and
 - (b) the date from which the transaction is accounted for and comparative information provided—in many cases, the transaction is presented as if the combining parties had always been combined, including restating comparative information; in other cases, the financial statements depict the parties as combined from the date of the transaction, therefore there is no restatement of information:
 - (i) for the current period up to the date of the transaction; or
 - (ii) for the prior period(s).
23. Further differences exist in:
- (a) how to measure the consideration transferred; and
 - (b) where in equity to recognise any difference between the consideration transferred and the carrying amounts of the assets acquired and the liabilities assumed.
24. In addition, some interested parties suggested—and the staff agree with that view—that there is an interaction between *how* the predecessor method should be applied, *when* that method should be applied and *why*. In other words, if the Board decides to use the predecessor method as the starting point, it may need to answer those three questions at the same time.
25. The staff acknowledge that under Alternative 3—start from existing practice—the Board could also decide to use the acquisition method as the starting point. However, that would result in selecting the same starting point as if the Board followed Alternative 2—start from IFRS Standards (paragraphs 12–16 of this paper). Accordingly, using the acquisition method as the starting point has not been considered under Alternative 3.

Staff analysis and recommendation

26. The staff think that using the acquisition method set in IFRS 3 as the starting point in developing proposals for transactions within the scope of the project would provide the best path forward and recommend taking this approach.
27. This is because the acquisition method:
- (a) is already required for business combinations *not* under common control and hence, in the Board's view, provides primary users with useful information about such transactions, at a cost that is justified by the benefits of that information. The staff think it would be logical to consider whether this method would also provide useful information, at a cost that is justified by the benefits of that information, for at least some transactions within the scope of the project.
 - (b) provides a clear starting point as this method is described in IFRS 3, tested and well understood.
 - (c) is already used in practice in some cases to account for transactions within the scope of the project.
28. As stated in paragraph 16, using the acquisition method as the starting point does not mean that this method would be applied to all or many transactions within the scope of the project. This is just a starting point in the analysis.
29. If the Board agrees with the staff recommendation, it would need to assess *whether* and *when* a transaction within the scope of the project is similar enough to a business combination *not* under common control that the same information should be provided. In making that assessment, the Board would consider the guidance in the *Conceptual Framework*.
30. It would then need to determine which method or methods should be applied to other transactions within the scope of the project in order to provide useful information, at a cost that is justified by the benefits of that information.
31. In developing such methods, the Board could consider a variation of the predecessor method or indeed start from a blank sheet of paper and develop a new method.

32. A new accounting method could involve, for example:
- (a) measuring assets and liabilities of *all* the combining parties at fair value at the date of the transaction (sometimes referred as ‘fresh start’ or ‘new basis’ accounting); or
 - (b) measuring the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values but without recognising any goodwill or gain from a bargain purchase. Instead, the difference between the fair value of the net assets acquired and the consideration transferred could be accounted for in equity.

Question for the Board

Question 1

Does the Board agree with the staff recommendation to use the acquisition method set in IFRS 3 *Business Combinations* as the starting point in developing proposals for transactions with the scope of the BCUCC project?

If not, what approach the Board would like to adopt instead, and why?

Appendix A—feedback from ASAF members

- A1. In December 2017, the staff discussed with ASAF members (see ASAF Agenda Paper 8B *Slide deck 2—Methods of accounting*) which accounting method should be used as the starting point in developing proposals for transactions within the scope of the BCUCC project.
- A2. ASAF members did not express a clear preference regarding the starting point for the analysis. However, they made the following observations:
- (a) an ASAF member suggested that irrespective of whether the acquisition method or the predecessor method is used as the starting point in the analysis, either approach would likely lead to similar practical outcomes. That member also suggested that the so-called ‘fresh start method’ may be appropriate when an accounting acquirer cannot be easily identified (eg in a ‘merger of equals’).
 - (b) another ASAF member shared the view that different methods may be appropriate for different transactions within the scope of the project. That member also asked the Board to consider the cost constraint on applying the acquisition and the predecessor method in developing proposals for transactions within the scope of the project.
 - (c) one ASAF member encouraged the Board to consider all alternatives, including developing accounting methods directly from the guidance in the *Conceptual Framework*. Another ASAF member supported that view.

Appendix B—feedback from EEG members

- B1. In December 2017, the staff discussed with EEG members (see EEG Agenda Paper *Slide deck 3—Methods of accounting*) which accounting method should be used as the starting point in developing proposals for transactions within the scope of the BCUCC project.
- B2. EEG members did not express a clear preference regarding the starting point for the analysis. However, they made the following observations:
- (a) some EEG members said that in their jurisdictions the predecessor method is considered the appropriate method of accounting for business combinations under common control. However, they acknowledged that in some circumstances the acquisition method can provide useful information to users of financial statements.
 - (b) one EEG member argued that business combinations under common control are different from business combination *not* under common control in that there is no change in ultimate control over the transferred business(es). Therefore, in that member’s view, the acquisition method is not appropriate for such transactions even if the combining parties are not wholly owned by the controlling party.
 - (c) in contrast, another EEG member suggested to use the acquisition method as the conceptual starting point for transactions within the scope because that method is consistent with the general accounting model for transactions in which assets are acquired and liabilities are assumed or incurred (paragraph BC24 of IFRS 3). That member further noted that IAS 24 *Related Party Disclosures* requires additional disclosures but does not prescribe a different measurement basis for related party transactions.