

IASB Agenda ref 23B

Business Combinations under Common Control

*How measurement approaches
could apply*

IASB Meeting – July 2019

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Project	Business Combinations under Common Control (BCUCC)		
Paper topic	How measurement approaches could apply		
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Purpose of this paper

- The Board's discussions to date have focussed on the information needs of various types of primary users and on when alternative measurement approaches should apply to transactions within the scope of the project.
- The purpose of this paper is to provide the Board with an overview of how alternative measurement approaches could apply, and of the questions the Board will need to consider in developing those approaches.
- This paper is designed to provide context for the Board's decision at a future meeting on when alternative measurement approaches should apply. This paper is for information only and does not ask the Board for decisions.
- The staff have also discussed how alternative measurement approaches could apply at the June 2019 joint meeting of the Capital Market Advisory Committee and the Global Preparers Forum (CMAC and GPF) and at the July 2019 meeting of the Accounting Standards Advisory Forum (ASAF). The staff will provide to the Board a verbal update on the input received at those meetings.

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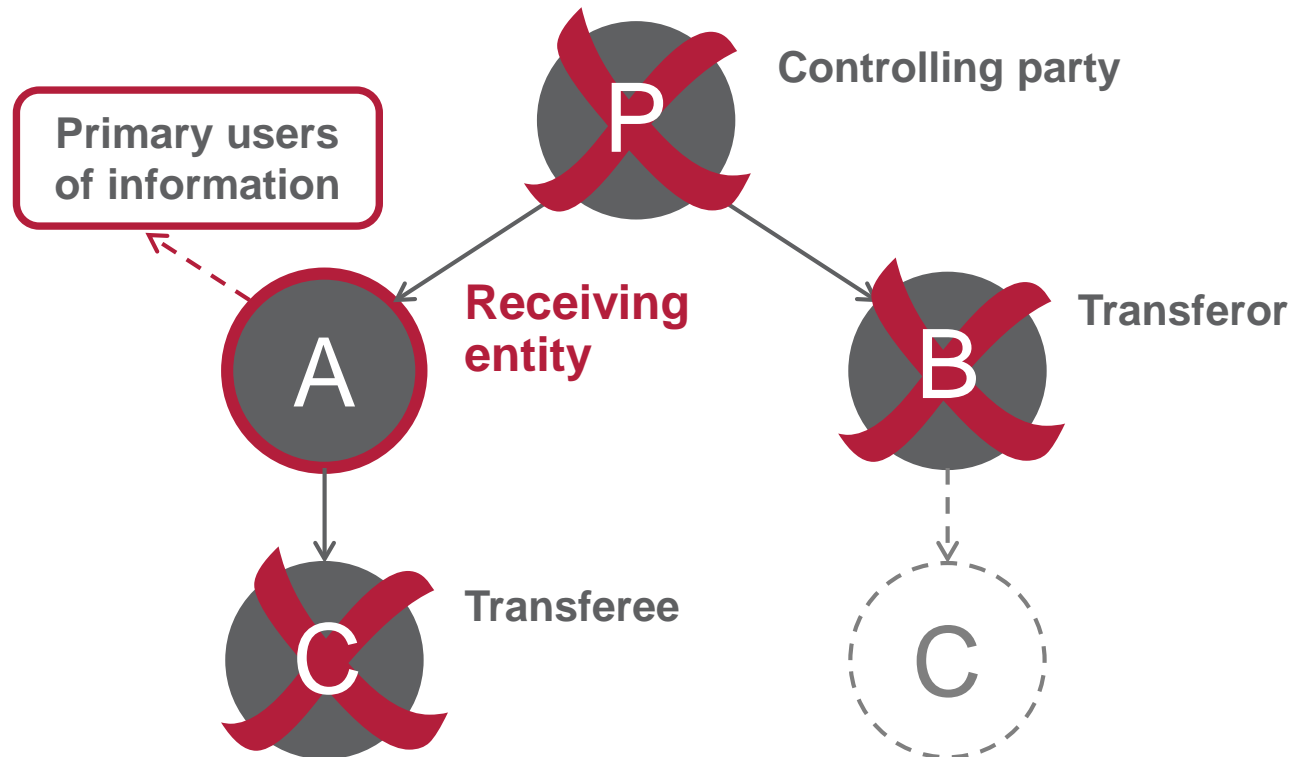
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Introduction

Focus on the receiving entity



- The project addresses reporting by the **receiving entity** in a business combination under common control. It does not consider reporting by the controlling party, the transferor or the transferee.
- The project focuses on information needs of the **primary users** of the receiving entity's financial statements.
- It is also important that costs of providing and using information are justified by the benefits of that information. The **cost-benefit** analysis can vary under different scenarios.

Board's tentative decisions (1/2)

The Board directed the staff to develop measurement approaches for transactions within the scope of the project by considering:

- a) whether and how transactions within the scope of the project can be different from business combinations that are not under common control;
- b) what information would be useful to various primary users of the receiving entity's financial statements;
- c) whether the benefits of providing particular information would justify the costs of providing that information; and
- d) complexity and opportunities for accounting arbitrage that could arise under various approaches.

Board's tentative decisions (2/2)

No need to pursue a single approach for all transactions within the scope of the project

Transactions that affect non-controlling shareholders of the receiving entity

Start with the acquisition method in IFRS 3 *Business Combinations* and consider whether and how that approach should be modified, for example by requiring:

- (1) additional disclosures;
- (2) recognition of a contribution to equity instead of recognising a gain; or
- (3) recognition of any excess consideration as a distribution instead of including that excess in goodwill.

Transactions that do not affect non-controlling shareholders

The Board could pursue:

- (1) a current value approach for all or some transactions that affect non-controlling shareholders of the receiving entity; and
- (2) a different approach, such as a form of predecessor approach, for transactions that affect lenders and other creditors in the receiving entity but do not affect non-controlling shareholders.

Where we are today in the project

Transactions that affect non-controlling shareholders of the receiving entity

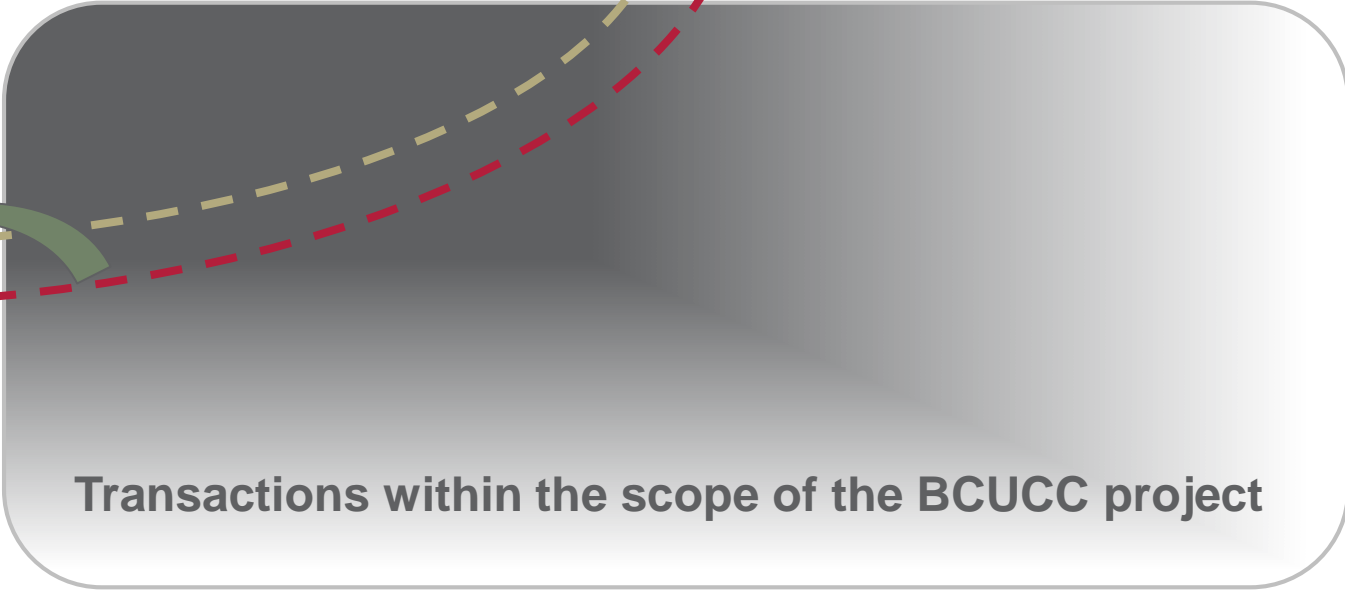
Transactions that do *not* affect non-controlling shareholders of the receiving entity

A current value approach

A predecessor approach

A current value approach for at least **some** transactions that affect non-controlling shareholders

A predecessor approach for all other transactions within the scope, including those that affect lenders and other creditors of the receiving entity and those undertaken in preparation for a sale, for example in an initial public offering.



Transactions within the scope of the BCUCC project

Further analysis of whether a current value approach is applied to **all** transactions that affect non-controlling shareholders and if not, how the distinction could be made

Applying a current value approach

Applying a current value approach

Start with the acquisition method

The Board directed the staff to develop a current value approach based on the acquisition method for transactions that affect non-controlling shareholders of the receiving entity.

To the extent those transactions are similar to business combinations, similar information should be provided and to the extent they are different, different information should be provided.

Distribution

If the consideration transferred exceeds the fair value of the acquired interest, recognise a distribution from the receiving entity's equity?

Contribution

If the fair value of the acquired net assets exceeds the fair value of the consideration transferred, recognise a contribution to the receiving entity's equity instead of recognising a gain?

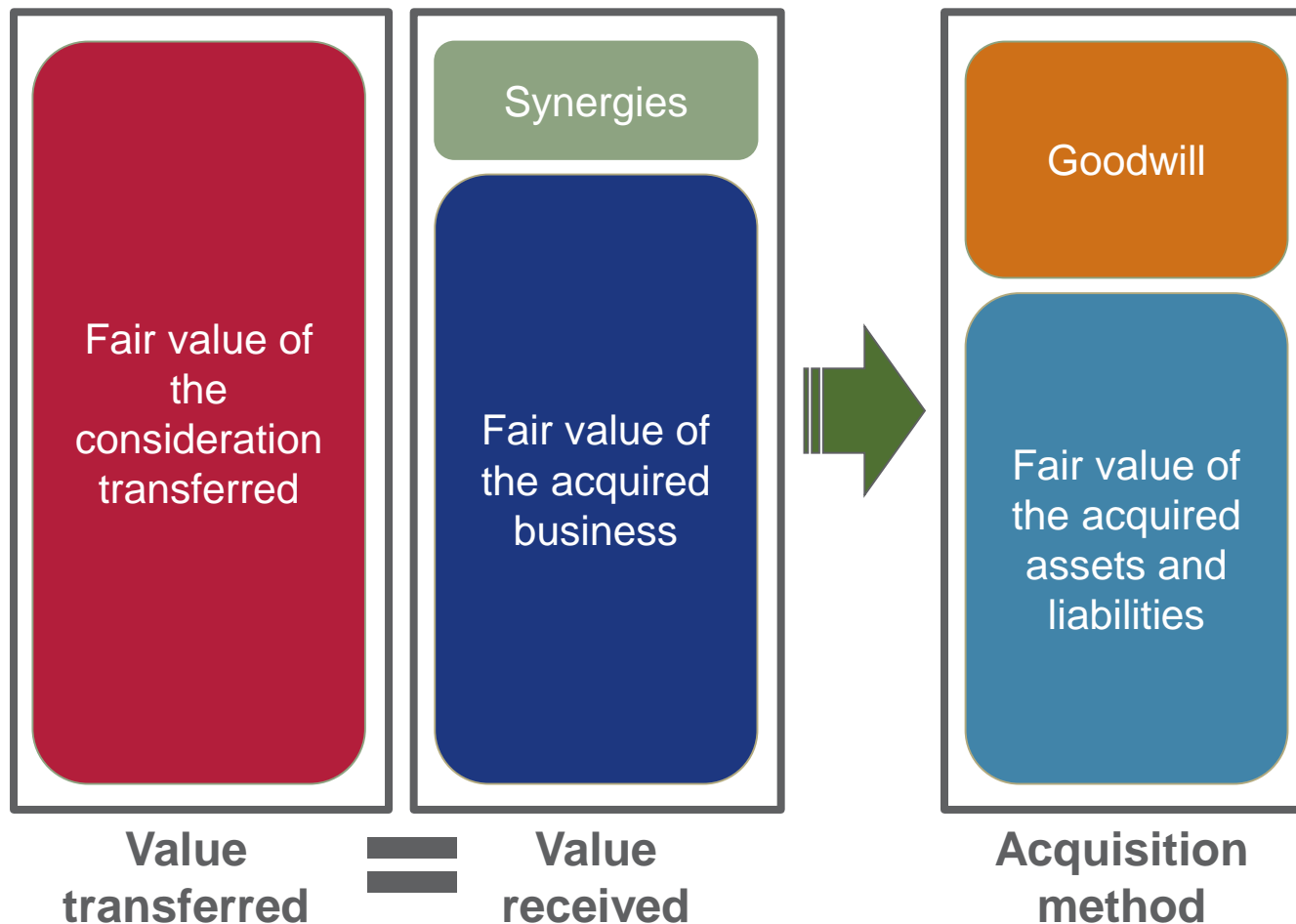
Disclosures

Provide additional disclosures to help users of the receiving entity's financial statements understand the effects of the transaction?

Requiring information about any distribution or contribution does not modify but builds on the requirements in IFRS 3. IFRS 3 already requires an entity to separately account for any part of the consideration transferred that is not part of the exchange for the acquiree (IFRS 3 Par. 51).

Applying a current value approach Illustrating a business combination

Consider a business combination from the perspective of the acquiring entity

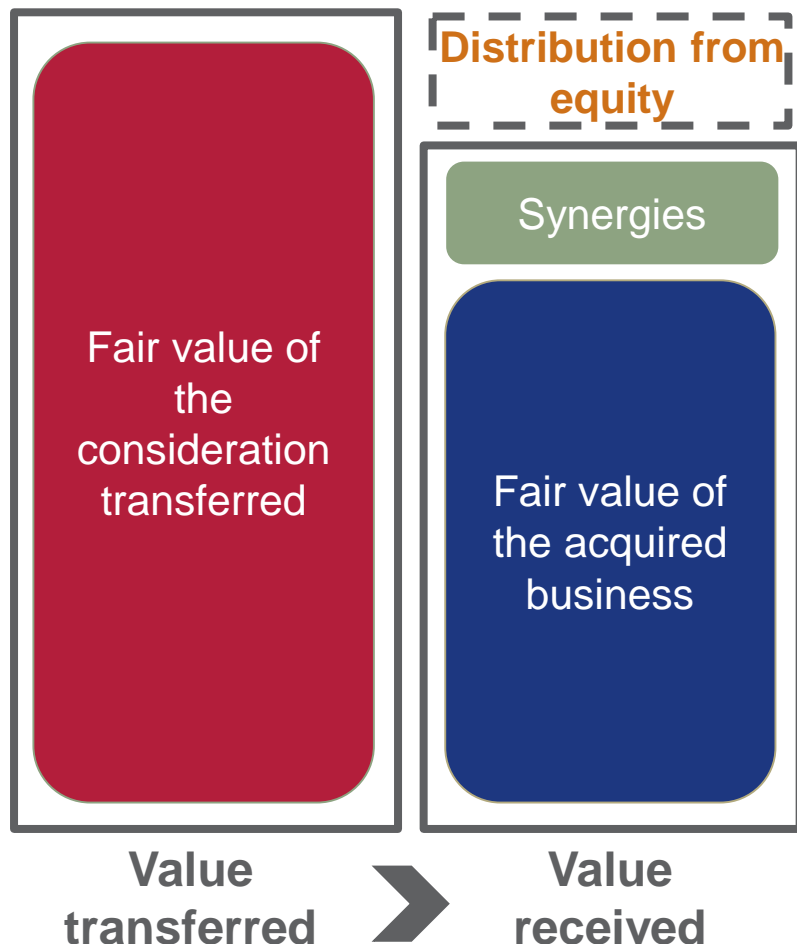


- A business combination between independent parties is the result of negotiations and is expected to benefit the acquiring entity.
- Fair value of the consideration normally reflects fair value of the acquired business and synergies expected from the combination.
- Application of the acquisition method results in recognition of goodwill that comprises any goodwill internally generated by the acquired business and expected combination synergies.

Applying a current value approach

Illustrating a BCUCC

Consider a business combination under common control from the perspective of the receiving entity



- A business combination under common control may be directed by the controlling party and be undertaken to produce benefits for other entities within the group instead of the receiving entity.
- Consideration may not always reflect fair value of the acquired business and synergies expected from the combination. Economically, any excess consideration over the fair value of the acquired business and expected combination synergies represents a distribution from the receiving entity's equity.
- However, regulations may be in place to require transactions that affect non-controlling shareholders in the receiving entity to be conducted at fair value. The feedback received by the staff to date indicates that transactions that involve such a distribution from the receiving entity's equity are not common in practice.
- The question arises whether and how to provide information about any such distribution in the receiving entity's financial statements if and when it occurs.

Applying a current value approach Information about a distribution in a BCUCC

- The staff have identified two broad alternatives to providing information about a distribution in a business combination under common control in the receiving entity's financial statements.

Recognition

- Recognition would require measuring the distribution. The staff have identified two broad approaches to measuring a distribution.

Measure as the excess of the consideration over the fair value of the acquired business

Measure by immediately testing goodwill for impairment applying the mechanics of IAS 36 *Impairment of Assets*

Both approaches to measuring a distribution are subject to measurement uncertainty.

or

Disclosure

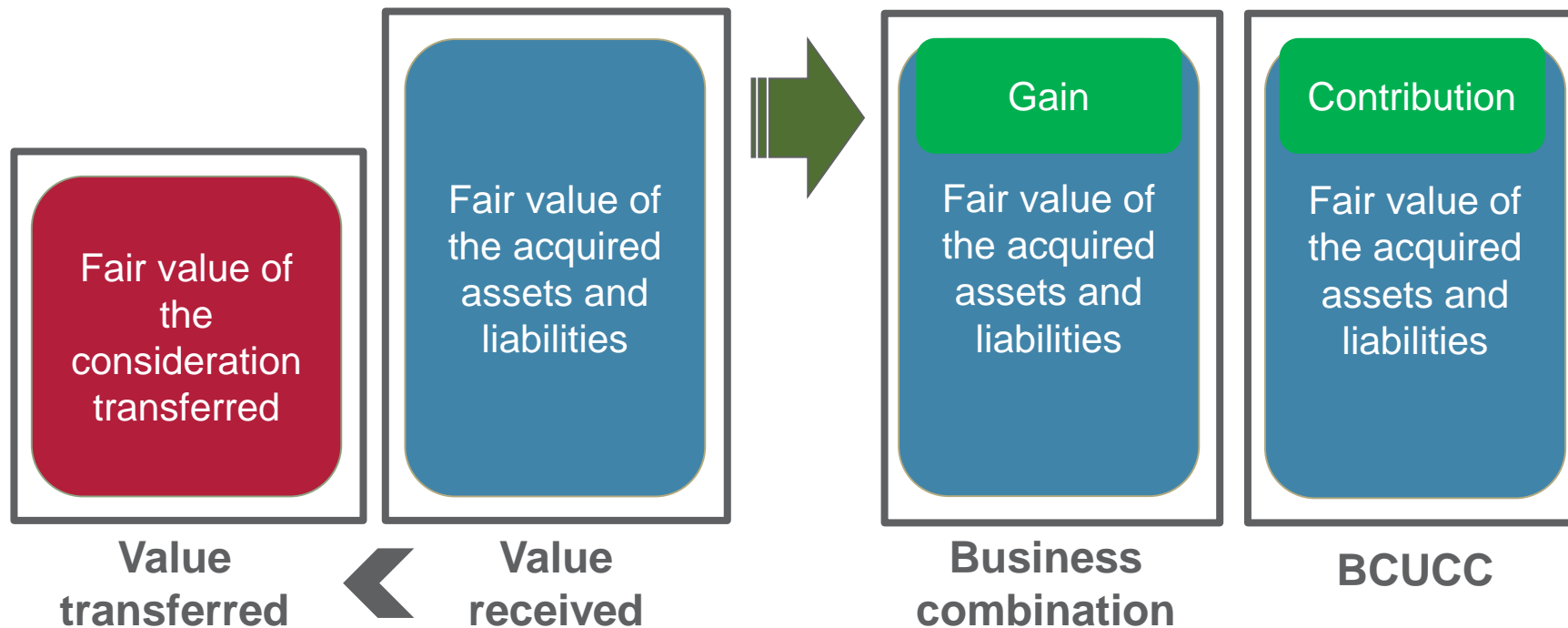
- Instead of being recognised separately, any distribution is subsumed within goodwill that is subject to subsequent annual impairment tests.
- Notes to financial statements provide information about the transaction to help users evaluate its effects on the receiving entity's financial position and performance.

The topic was discussed at the June 2019 joint CMAC and GPF meeting and at the July 2019 ASAF meeting.

Applying a current value approach

Information about a contribution in a BCUCC

- Occasionally, an acquirer in a business combination will make a bargain purchase in which the fair value of the acquired assets and liabilities exceeds consideration transferred. Applying the acquisition method, the acquirer recognises that excess as a gain.
- In a business combination under common control, economically any such excess represents a contribution to the receiving entity's equity rather than a gain and in the staff's view should be recognised as such.
- A contribution can be recognised using the existing mechanics in IFRS 3 for recognising a gain.



The topic was discussed at the July 2019 ASAF meeting.

Applying a current value approach

Next steps

In discussing how a current value approach should apply, the Board would need to consider:

- (a) whether and how information about any distribution or contribution should be provided; and
- (b) whether to require disclosures about a business combination under common control in addition to those already required by IFRS 3, and if so, what those disclosure requirements should be.

Applying a predecessor approach

Applying a predecessor approach

The Board tentatively decided that it could pursue a predecessor approach for transactions that do not affect non-controlling shareholders of the receiving entity.

Predecessor approach is a family of approaches. There is diversity in how a predecessor approach is applied in practice, in particular in relation to providing pre-combination information.

Pre-combination information

Entities reflect a business combination under common control from the date it occurred or as if the entities were combined from the beginning of the comparative period—or from a date when entities were first under common control, if later.

Predecessor carrying amounts

Entities recognise acquired assets and liabilities at their predecessor carrying amounts. In some cases, the carrying amounts in the transferred entities are used and in other cases the carrying amounts in the controlling party.

Presentation in equity

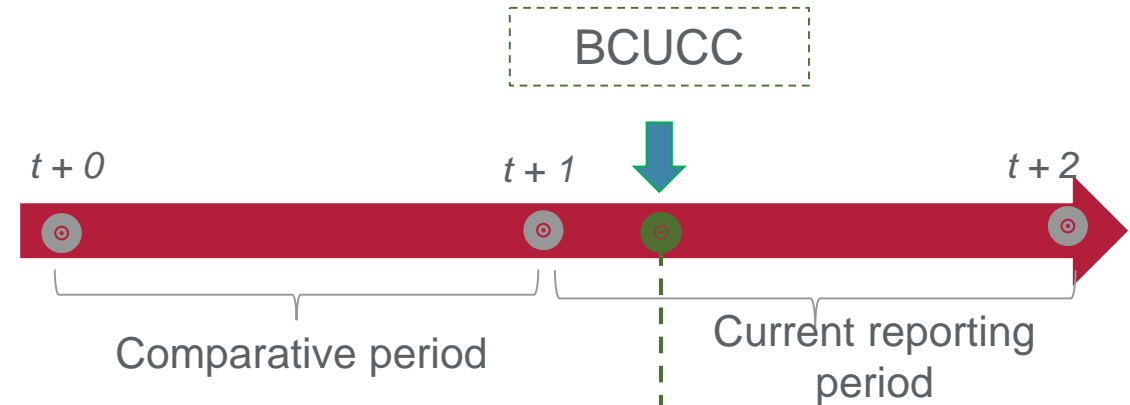
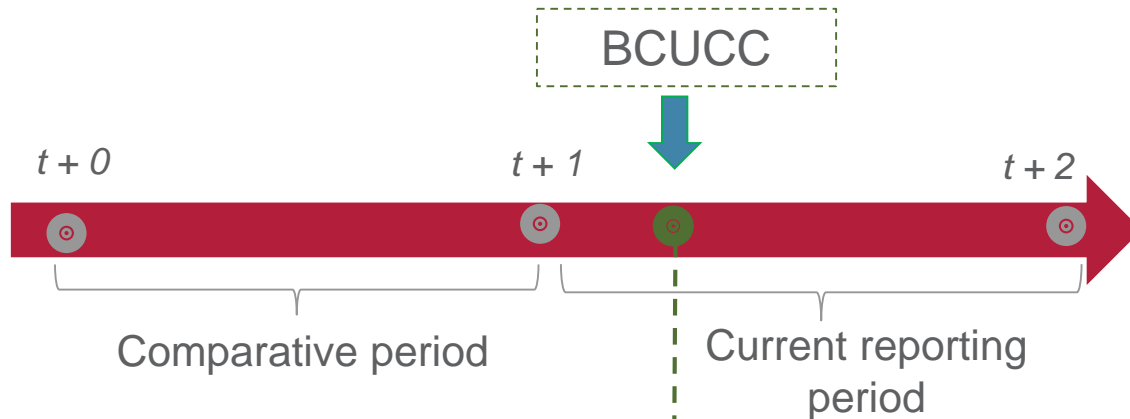
Any difference between the consideration transferred and the predecessor carrying amounts of the acquired assets and liabilities is recognised in equity. **Presentation in equity is generally not prescribed by the Board.**

Providing pre-combination information

Diversity in practice in providing pre-combination information

Pre-combination information is provided for all combining entities

Pre-combination information is provided only for the receiving entity



Combined or carveout pre-combination information for all entities

Consolidated information

Pre-combination information for receiving entity only

Consolidated information

Acquired assets, liabilities and results of operations are recognised from **the beginning of the comparative period.**

Acquired assets, liabilities and results of operations are recognised **from the date of the transaction.**

Recognising predecessor carrying amounts

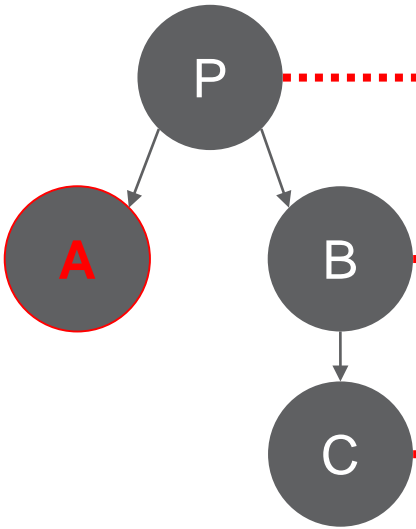
Diversity in practice in recognising predecessor carrying amounts

Carrying amounts recognised by the transferred entity or business

or

Carrying amounts recognised by the intermediary parent or controlling party

Before

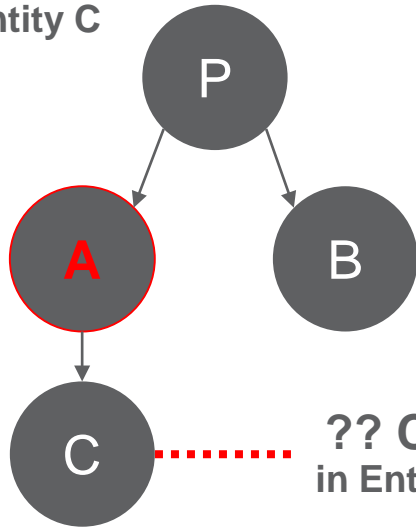


Entity C's net assets

- CU100 in Parent P's cons. F/S
- CU70 in Entity B's cons. F/S
- CU60 in Entity C's sep. F/S

After

Entity A acquires Entity C



?? CU in Entity A's cons. F/S

Applying a predecessor approach

Next steps

In discussing how a form of predecessor approach should apply, the Board would need to consider:

- (a) which predecessor carrying amounts should be recognised by the receiving entity;
- (b) what pre-combination information, including comparative information should be required; and
- (c) what disclosures about a business combination under common control should be provided.



Feedback and discussion

Does the Board have any questions or comments on the staff's analysis presented?

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