IASB Agenda ref 23

Business Combinations under Common Control

Education session

IASB Meeting - September 2017
Disclaimer

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB® Update.

<table>
<thead>
<tr>
<th>Project</th>
<th>Business Combinations under Common Control (BCUCC)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paper topic</td>
<td>Education session</td>
</tr>
<tr>
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<td></td>
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</tr>
</tbody>
</table>
Objectives of this session

Provide the Board with an overview of:

- the status of the BCUCC project
- the issues for the Board to consider
- next steps

The staff expect that the next milestone on the project is the publication of a Discussion Paper (DP).

This paper is for information only and there are no questions for the Board.
Content

- Background
- Scope of the project
- Research and outreach
- Alternative methods
- Application of the predecessor method
- Next steps
Background
Project history

Consultations with the Board’s advisory bodies (ASAF, CMAC and GPF)

2012  BCUCC project added to the research Agenda

2014  Tentative decision on the scope of the BCUCC project

2014-16  Research and outreach

2016  BCUCC project confirmed on the research Agenda as a result of the 2015 Agenda Consultation
The issue

- Entities account for business combinations applying the acquisition method set out in IFRS 3 *Business Combinations*. Under that method the acquirer measures the net assets acquired at their fair values.

- **Business combinations under common control (BCUCC) are excluded from the scope of IFRS 3.** Therefore entities must apply IAS 8 and develop an accounting policy that results in useful information.

- In practice entities account for BCUCC using:
  - **the acquisition method as set out in IFRS 3**, by analogy; or
  - **the so-called predecessor method**, by reference to national GAAPs. Under that method the acquirer measures the net assets acquired at historical carrying amount; however, there is diversity in practice in how the method is applied.

Concerns about the diversity in practice raised by various interested parties, notably security regulators.
The issue—illustration 1

**Situation α**
- Entity A and Entity B are controlled by different parties;
- Entity B is a business.

**Situation β**
- Entity A and Entity B are controlled by the same party;
- Entity B is a business.

**Before**

**Considerations**
- Business combination
- IFRS 3
- Acquisition method
  - B’s net assets at fair value

**After**

- Entity A acquires Entity B

**Considerations**
- BCUCC
- Scoped out from IFRS 3
- Diversity in practice
  - B’s net assets at fair value vs historical carrying amounts
The issue—illustration 2

<table>
<thead>
<tr>
<th>Before</th>
<th>After</th>
<th>Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Entity A and Entity B are controlled by Entity P; • Entity A and Entity B are businesses.</td>
<td></td>
<td>Different information to public investors depending on: ✓ the accounting method applied to the pre-IPO acquisition; ✓ how P structured the pre-IPO acquisition—Entity A acquires Entity B vs Entity B acquires Entity A.</td>
</tr>
</tbody>
</table>

**1. If acquisition method applied:**

- If Entity A acquires Entity B:  
  - Historical carrying amount
  - Fair value
- If Entity B acquires Entity A:  
  - Historical carrying amount
  - Fair value

**2. If predecessor method applied:**

Both A’s and B’s net assets at historical carrying amounts (regardless of how P structures the pre-IPO acquisition).
## Transactions to consider

<table>
<thead>
<tr>
<th>NOT under common control</th>
<th>under common control</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>NOT involving transfer of a business</strong></td>
<td><strong>Covered by applicable IFRS Standards</strong> (scope exclusion do not apply)</td>
</tr>
<tr>
<td></td>
<td>For example the transfer of assets in the acquirer’s financial statements, covered by IAS 16</td>
</tr>
<tr>
<td><strong>Covered by applicable IFRS Standards</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>For example the acquisition of associates in the acquirer’s financial statements, covered by IAS 28*</td>
</tr>
<tr>
<td><strong>Covered by IFRS 3</strong></td>
<td>Not covered by IFRS Standards</td>
</tr>
</tbody>
</table>

* IC Agenda decision to be finalised.
The project focuses on the information needs of the primary users of the **acquirer’s** financial statements.
Tentative decision on scope

• In June 2014, the Board discussed the scope of the BCUCC project and tentatively decided that the project should consider:
  – business combinations under common control that are currently excluded from the scope of IFRS 3;
  – group restructurings; and
  – the need to clarify the description of business combinations under common control, including the meaning of ‘common control’.

• The Board also tentatively decided to give priority to considering transactions that involve third parties, for example those undertaken in preparation for an IPO. This is an area of particular concern for securities regulators.
‘Group restructurings’

• ‘Group restructuring’ is not a defined term and might be used differently by different parties.

A business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory (IFRS3.B1)

• Let’s consider some examples (see next slides).
Scope—examples of transactions (1/2)

**Before**
- Entity A and Entity B are controlled by Entity P.
- Entity A controls Entity C while Entity B controls Entity D.
- There are NCI in Entity A.

**After**

**Example 1**
Entity A acquires Entity D from Entity B.

**Scope**
- BCUCC
- A’s economic position changes

**Example 2**
Entity A acquires Entity B from Entity P.

**Focus on A’s perspective**
Scope—examples of transactions (2/2)

**Before**

*Same as slide 15*

- Entity A and Entity B are controlled by Entity P.
- Entity A controls Entity C while Entity B controls Entity D.
- There are NCI in Entity A.

**After**

**Example 3**
Entity A demerges one of its business into a newly formed Entity C1 and retains control over it.

```
A -- C
   
B -- C1
   
D
```

**Scope**

- Not a BCUCC
- Does A’s economic position change?

**Example 4**
Entity P1, a newly created entity controlled by Entity A, now controls Entity C.

```
P -- A
   
P1 -- C
   
B -- D
```

**Scope**

- Not a BCUCC
- Does A’s economic position change?
Next steps

• Future Agenda papers on the scope of the project will discuss:
  – transactions that are included in the scope of the project (e.g., Example 1-2 versus 3-4);
  – the meaning of ‘common control’;
  – related projects and decisions.
Research and outreach
The staff have performed a range of research and outreach activities with different types of interested parties from various jurisdictions, including users of financial statements, regulators, standard-setters (including ASAF), preparers and accounting firms. Those activities focused on:

**Topic 1**

- **are** applied in practice to account for BCUCC;
- **should be** applied to provide useful information about BCUCC.

**Topic 2**

- **is** applied in practice;
- **should be** applied to provide useful information about BCUCC.

Refer to Agenda ref 23 Cover paper from April 2016 (referenced as Attachment 1 to Agenda ref 23 for the purpose of this meeting)
Topic 1

Alternative methods
Feedback (1/2)

**Topic 1**

- There is diversity in practice in how BCUCC are accounted for and also different views on how BCUCC should be accounted for:
  - in practice, BCUCC are typically accounted for using the predecessor method; however, in a few cases the acquisition method is also used;
  - many interested parties support using the predecessor method as a ‘default’ method of accounting for BCUCC;

*cont. …*

Refer to Agenda ref 23A *Method(s) of accounting for BCUCC* from April 2016 (referenced as **Attachment 2 to Agenda ref 23** for the purpose of this meeting)
Feedback (2/2)

Topic 1

• … cont.

– users of financial statements have different views on whether the predecessor method or the acquisition method would provide most useful information about BCUCC, and why;

– some regulators asked the Board to consider whether the acquisition method or the so-called ‘fresh start’ accounting (ie measuring all assets and liabilities of all combining entities at fair values) may be appropriate in some circumstances;

– some standard-setters suggested that different methods may be most appropriate in different circumstances (eg the ‘fresh start’ accounting in IPO scenarios); they also suggested the Board should establish a conceptual basis for determining how to report BCUCC.
Methods to consider

Topic 1

Potential alternatives

<table>
<thead>
<tr>
<th>Predecessor method</th>
<th>Acquisition method</th>
<th>‘Fresh start’ accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net assets of all combining entities at historical carrying amounts</td>
<td>Net assets of the acquired entity at fair value</td>
<td>Net assets of all combining entities at fair values</td>
</tr>
<tr>
<td>Commonly used in practice</td>
<td>Required by IFRS 3 for business combinations</td>
<td>No permitted under exist. IFRS Standards and initial outreach indicates little support</td>
</tr>
</tbody>
</table>
Which method(s) should be applied to the transactions within the scope of the BCUCC project?

- **single** method for all transactions?
- **different** methods depending on the characteristics of a transaction?

- How to choose which method to apply to a transaction?
- Which combination of methods to consider?
Different approaches (2/2)

Topic 1

Which method(s)

single

- simplicity;
- provides consistent information for all transactions included in the scope; but
- all transactions are accounted for in the same way regardless of their characteristics.

different

- might provide information that is most useful for a particular type of transaction;
- achieves better comparability between transactions with similar characteristics; but
- difficult to define the subsets of transactions to which the different methods are applied.
Next steps

- Future Agenda papers on the alternative methods will discuss:
  - which method(s) should be explored in the DP (single method or different methods, and which method(s)?);
  - how to define the subsets of transactions to which different methods are applied.
Topic 2
Application of the predecessor method
Feedback (1/2)

Topic 2

- In practice, the difference between the consideration and the acquired net assets is accounted for in equity.
- However, there is diversity in practice and different views with respect to:
  - carrying amounts of the acquired net assets (those recognised by the controlling party or those recognised by the transferred entity?);
  - from which date to combine the combining entities and how to present comparative information;
  - measurement of the consideration; and

Refer to Agenda ref 23B Application of the predecessor method from April 2016 (referenced as Attachment 3 to Agenda ref 23 for the purpose of this meeting)
Feedback (2/2)

Topic 2

• … cont.

  – where in equity to recognise the difference between the consideration and the acquired net assets. Most suggested that this is a matter commonly addressed by local legislation and should not be prescribed by the Board.
Application questions

How the predecessor method should be applied?

- **Carrying amounts**: Different alternatives to explore
- **Comparatives**: Different alternatives to explore
- **Consideration**: Different alternatives to explore
- **Difference**: Presentation in equity generally not prescribed by the Board
Application questions—carrying amounts

Topic 2

Which predecessor carrying amounts should be used?

<table>
<thead>
<tr>
<th>Before</th>
<th>C’s net assets</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td>P</td>
<td>100CU in P’s cons. F/S</td>
<td>Entity A acquires Entity C</td>
</tr>
<tr>
<td>A</td>
<td>70CU in B’s cons. F/S</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>60CU in C’s sep. F/S</td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>?? CU in A’s cons. F/S</td>
<td></td>
</tr>
</tbody>
</table>
Topic 2

Which predecessor carrying amounts should be used?

... those recognised by the transferred entity or business

The predecessor carrying amounts recognised by the controlling party, including any goodwill that might have arisen on past acquisition of the transferred entity by that controlling party, might be irrelevant from the perspective of the combining entities.

... those recognised by a controlling party

BCUCC could be directed by a controlling party. The predecessor carrying amounts recognised by the controlling party reflect the perspective of that party.

An illustrative example is provided in the Appendix (slides 41-42 and 43-44)
Application questions—comparatives

Topic 2

From which date should the combining entities be combined and how should comparative information be presented?

... prospective approach

The new combined entity created by a BCUCC had not existed before the date on which the BCUCC took place. Financial information about such an entity before that date would be pro-forma information. However, the structure of the transaction could affect which comparative information is provided (see next slide).

... retrospective approach

Presenting the new combined entity as if it had always been combined reflects the perspective of the controlling party.
Before

- Entity A and Entity B are controlled by entity P.
- Entity A controls Entity C while Entity B controls entity D.
- No NCI.
- Entity P wants to sell A, B, C and D in an IPO.

After

Example 1
In preparation of the IPO, Entity A acquires Entity B.

Example 2
In preparation of the IPO, Entity B acquires Entity A.

Comparatives

If comparative information is NOT restated:

- in Example 1: users of financial statements of A-B-C-D will have comparative information for A-C, but not for B-D;
- in Example 2: users of financial statements of A-B-C-D will have comparative information for B-D, but not for A-C.

Depending on how Entity P organises the transaction, users of financial statements of A-B-C-D will receive different comparative information.
Topic 2

The consideration transferred might consist of cash, shares, assets transferred by the acquirer, liabilities incurred or a combination of the above.

How to measure the consideration transferred?

... fair value

... carrying amount

The staff note that the measurement basis adopted to measure the consideration in the form of issued shares would not affect the net amount recognised in equity nor recognised assets, liabilities, income and expenses.

However, the measurement basis adopted for other form of consideration could.

An illustrative example is provided in the Appendix (slides 41-42 and 45-46)
Next steps

- Future Agenda papers on the application of the predecessor method will discuss:
  - which predecessor carrying amounts should be used;
  - from which date the combining entities should be combined and how comparative information should be presented;
  - how to measure the consideration transferred.
Next steps
Next steps

- *Education session*
- Clarify the scope of the project
- Consider which method(s) should be applied
- Consider how the predecessor method should be applied
- Publish the DP
Thank you
Appendix
Illustrative example of application of the predecessor method
Illustrative example—fact pattern (1/2)

Fact pattern

- Entities A and B are controlled by Entity P.
- Entity A is a listed entity. 30% of Entity A is owned by public shareholders.
- Entity A acquires 100% of Entity B by issuing shares to Entity P.
- Fair value of issued shares is CU120, nominal value is CU20.
Entity P acquired Entity B from a third party a few years ago and reflected assets and liabilities of Entity B at their fair value at the time of that acquisition in accordance with IFRS 3 (fair value ‘step up’ of CU5).

The following information is available immediately before the BCUCC presented in slide 41:

<table>
<thead>
<tr>
<th></th>
<th>Entity P</th>
<th>Entity A</th>
<th>Entity B</th>
<th>Cons A</th>
<th>Cons B</th>
<th>P Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub A</td>
<td>130</td>
<td></td>
<td></td>
<td>(130)</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Sub B</td>
<td>100</td>
<td></td>
<td></td>
<td></td>
<td>(100)</td>
<td>0</td>
</tr>
<tr>
<td>Other net assets</td>
<td>200</td>
<td>150</td>
<td>110</td>
<td></td>
<td>5</td>
<td>465</td>
</tr>
<tr>
<td><strong>Total net assets</strong></td>
<td><strong>430</strong></td>
<td><strong>150</strong></td>
<td><strong>110</strong></td>
<td><strong>(130)</strong></td>
<td><strong>(95)</strong></td>
<td><strong>465</strong></td>
</tr>
<tr>
<td>Share capital</td>
<td>100</td>
<td>50</td>
<td>20</td>
<td>(50)</td>
<td>(20)</td>
<td>100</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>330</td>
<td>100</td>
<td>90</td>
<td>(80)</td>
<td>(75)</td>
<td>365</td>
</tr>
<tr>
<td><strong>Total equity</strong></td>
<td><strong>430</strong></td>
<td><strong>150</strong></td>
<td><strong>110</strong></td>
<td><strong>(130)</strong></td>
<td><strong>(95)</strong></td>
<td><strong>465</strong></td>
</tr>
</tbody>
</table>
Illustrative example—carrying amounts (1/2)

Which predecessor carrying amounts should be used by Entity A?

- Carrying amounts recognised by the transferred entity [Entity B]:

<table>
<thead>
<tr>
<th></th>
<th>Entity A</th>
<th>Entity B</th>
<th>Cons B</th>
<th>A Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub B</td>
<td>120</td>
<td></td>
<td>(120)</td>
<td>0</td>
</tr>
<tr>
<td>Other net assets</td>
<td>150</td>
<td>110</td>
<td></td>
<td>260</td>
</tr>
<tr>
<td><strong>Total net assets</strong></td>
<td><strong>270</strong></td>
<td><strong>110</strong></td>
<td>(120)</td>
<td><strong>260</strong></td>
</tr>
<tr>
<td>Share capital</td>
<td>170</td>
<td>20</td>
<td>(20)</td>
<td>170</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>100</td>
<td>90</td>
<td>(90)</td>
<td>100</td>
</tr>
<tr>
<td>Other reserve</td>
<td></td>
<td>(10)</td>
<td>(10)</td>
<td></td>
</tr>
<tr>
<td><strong>Total equity</strong></td>
<td><strong>270</strong></td>
<td><strong>110</strong></td>
<td>(120)</td>
<td><strong>260</strong></td>
</tr>
</tbody>
</table>

Assumptions:
- issued shares measured at fair value; and
- difference recognised in other reserve.

CU120 is the fair value of issued shares.

CU170 is an aggregate of:
- CU50, share capital of Entity A before the acquisition; and
- CU120, the fair value of issued shares.
Which predecessor carrying amounts should be used by Entity A? (cont.)

- Carrying amounts recognised by the **parent entity** [Entity P]:

<table>
<thead>
<tr>
<th></th>
<th>Entity A</th>
<th>Entity B</th>
<th>Cons B</th>
<th>A Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub B</td>
<td>120</td>
<td>(120)</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Other net assets</td>
<td>150</td>
<td>110</td>
<td>5</td>
<td>265</td>
</tr>
<tr>
<td><strong>Total net assets</strong></td>
<td>270</td>
<td>110</td>
<td>(115)</td>
<td>265</td>
</tr>
<tr>
<td>Share capital</td>
<td>170</td>
<td>20</td>
<td>(20)</td>
<td>170</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>100</td>
<td>90</td>
<td>(90)</td>
<td>100</td>
</tr>
<tr>
<td>Other reserve</td>
<td></td>
<td>(5)</td>
<td>(5)</td>
<td></td>
</tr>
<tr>
<td><strong>Total equity</strong></td>
<td>270</td>
<td>110</td>
<td>(115)</td>
<td>265</td>
</tr>
</tbody>
</table>

- **CU5** is the ‘fair value step-up’ recognised in entity P when it acquired Entity B.

**Assumptions:**
- Issued shares measured at fair value;
- Difference recognised in other reserve; and
- Fair value ‘step-up’ unchanged since Entity P acquired Entity B from a third party.
Illustrative example—consideration (1/2)

How to measure consideration?

- Measured at the **fair value** of transferred shares:

<table>
<thead>
<tr>
<th></th>
<th>Entity A</th>
<th>Entity B</th>
<th>Cons B</th>
<th>A Group</th>
</tr>
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<tbody>
<tr>
<td>Sub B</td>
<td>120</td>
<td>(120)</td>
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<td></td>
</tr>
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<td>110</td>
<td>(120)</td>
<td>260</td>
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<tr>
<td>Share capital</td>
<td>170</td>
<td>20</td>
<td>(20)</td>
<td>170</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>100</td>
<td>90</td>
<td>(90)</td>
<td>100</td>
</tr>
<tr>
<td>Other reserve</td>
<td></td>
<td>(10)</td>
<td>(10)</td>
<td></td>
</tr>
<tr>
<td><strong>Total equity</strong></td>
<td>270</td>
<td>110</td>
<td>(120)</td>
<td>260</td>
</tr>
</tbody>
</table>

**CU120** is the fair value of issued shares.

**CU170** is an aggregate of:
- CU50, share capital of Entity A before the acquisition; and
- CU120, the fair value of issued shares.

**Assumption:**
- difference recognised in other reserve.

(CU10) is the difference between consideration transferred (CU120) and the carrying amount of the acquired net assets (CU110).
**Illustrative example—consideration (2/2)**

**How to measure consideration? (cont.)**

- **Measured at the nominal value of transferred shares:**

<table>
<thead>
<tr>
<th></th>
<th>Entity A</th>
<th>Entity B</th>
<th>Cons B</th>
<th>A Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub B</td>
<td>20</td>
<td></td>
<td>(20)</td>
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<td>150</td>
<td>110</td>
<td></td>
<td>260</td>
</tr>
<tr>
<td><strong>Total net assets</strong></td>
<td>170</td>
<td>110</td>
<td>(20)</td>
<td>260</td>
</tr>
<tr>
<td>Share capital</td>
<td>70</td>
<td>20</td>
<td>(20)</td>
<td>70</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>100</td>
<td>90</td>
<td>(90)</td>
<td>100</td>
</tr>
<tr>
<td>Other reserve</td>
<td></td>
<td></td>
<td>90</td>
<td>90</td>
</tr>
<tr>
<td><strong>Total equity</strong></td>
<td>170</td>
<td>110</td>
<td>(20)</td>
<td>260</td>
</tr>
</tbody>
</table>

**CU20** is the nominal value of issued shares.

**CU70** is an aggregate of:
- **CU50**, share capital of Entity A before the acquisition; and
- **CU20**, the nominal value of issued shares.

**Assumption:**
- difference recognised in other reserve.

**CU90** is the difference between consideration transferred (CU20) and the carrying amounts of the acquired net assets (CU110).