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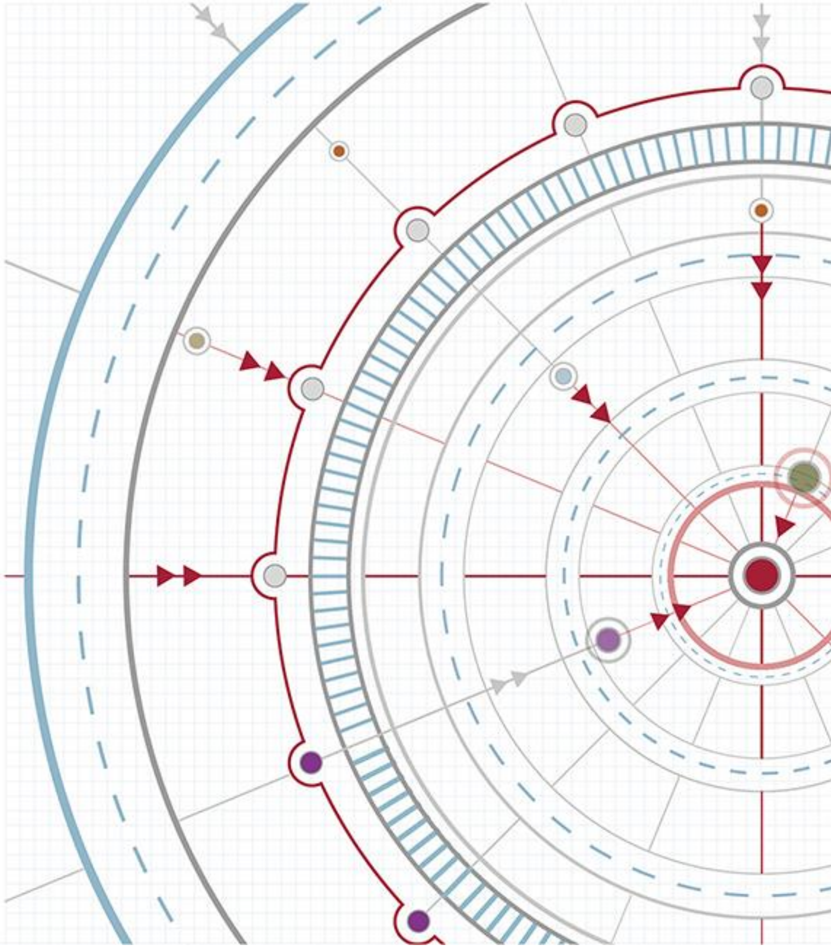

Joint CMAC-GPF meeting, 14-15 June 2018

Agenda Paper 5

Business Combinations under Common Control

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Overview

- Background
  1. The issue (slide 4)
  2. Scope of the project (slides 5-6 and Appendix 1)
  3. Business combinations vs business combinations under common control (BCUCC) (slides 7-8)
  4. Alternative approaches for BCUCC (slide 9)
  5. Primary users of information (slide 10)
- Discussion topic for the breakout session (slides 11-15)
  - Breakout groups will discuss what type of information identified in (4) would be most useful for different types of primary users of the reporting entity's financial statements identified in (5) and whether the benefits of providing that information for those primary users will outweigh the costs of providing it.

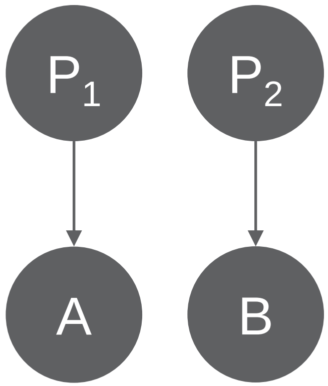
Background

The issue: diversity in practice

Before

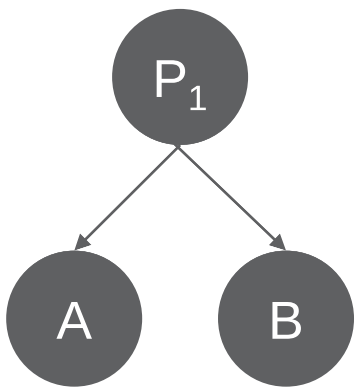
Scenario 1

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



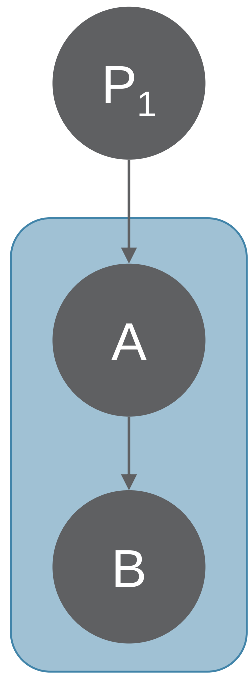
Scenario 2

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



After

Entity A acquires Entity B



Observations

Scenario 1

- The transaction is a **business combination**
- IFRS 3 *Business Combinations* requires the **acquisition method**
- Entity A reflects identifiable assets and liabilities of Entity B at **fair value**

Scenario 2

- The transaction is a **business combination under common control**
- IFRS Standards do not specify how to account for such transactions which leads to **diversity in practice**
- Entity A reflects identifiable net assets of Entity B at **fair value** or at **predecessor carrying amounts**

Scope of the project (1)—overview

focuses on transfers of **Business** (as defined in IFRS 3) under common control

includes **more** transactions than just **BCUCC**

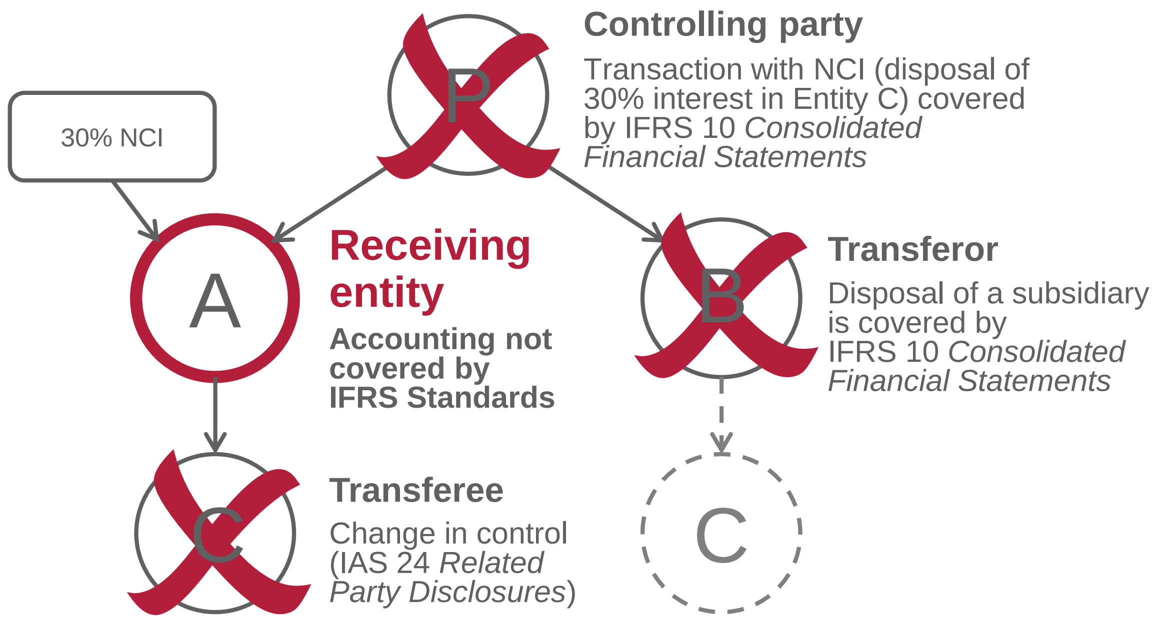
addresses financial reporting by the **receiving entity**

considers **application questions**

The Board's tentative decisions on the scope of the project are reported in **Appendix 1**.

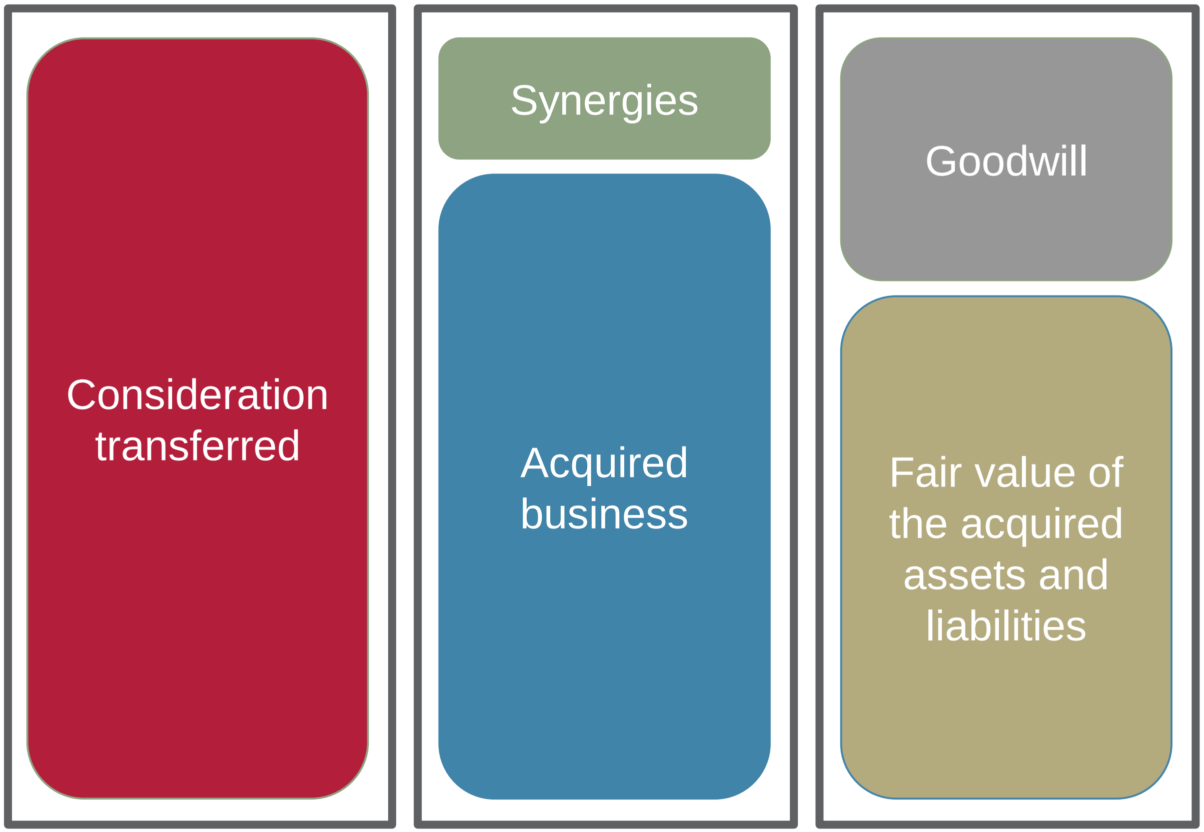
Scope of the project (2)—receiving entity

- Entity A acquires Entity C from Entity B. Entities A, B and C are all controlled by Entity P. Entity C is a business.
- The project focuses on the information needs of the **primary users** of the **receiving entity's** financial statements.



Business combinations vs BCUCC (1)

Consider a business combination from the perspective of the acquirer…



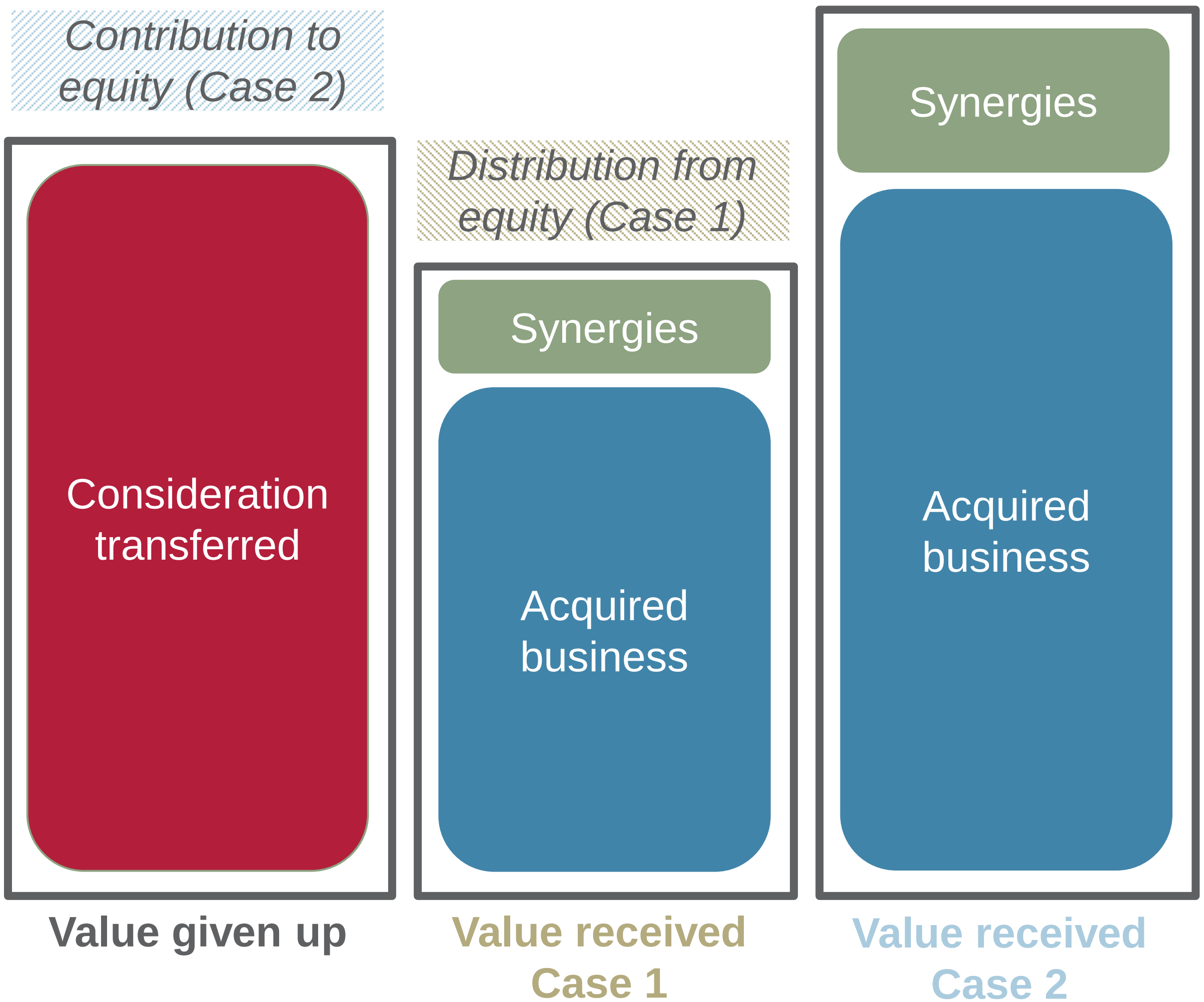
Value given up | **Value received** | **IFRS 3 model**

- 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.
- IFRS 3 acquisition method **recognises acquired assets and liabilities at fair value.** Goodwill is measured as the residual and comprises any **goodwill that was internally generated** by the acquired business and any **synergies** expected from the combination.

In a bargain purchase, consideration can be less that fair value of acquired assets and liabilities.
In such cases, a gain is recognised.

Business combinations vs BCUCC (2)

Consider a BCUCC from the perspective of the receiving entity…



- A business combination under common control **may be directed** by the controlling party and may focus on producing **benefits for other entities** within the group instead of the receiving entity.
- Fair value of the consideration in a BCUCC **may not reflect fair value of the acquired business** and **synergies** expected from the combination.
- Economically, any difference between value given up and value received **represents a contribution to or a distribution from the receiving entity's equity**.

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Alternative approaches for BCUCC

How should the receiving entity reflect acquired assets and liabilities in a BCUCC?

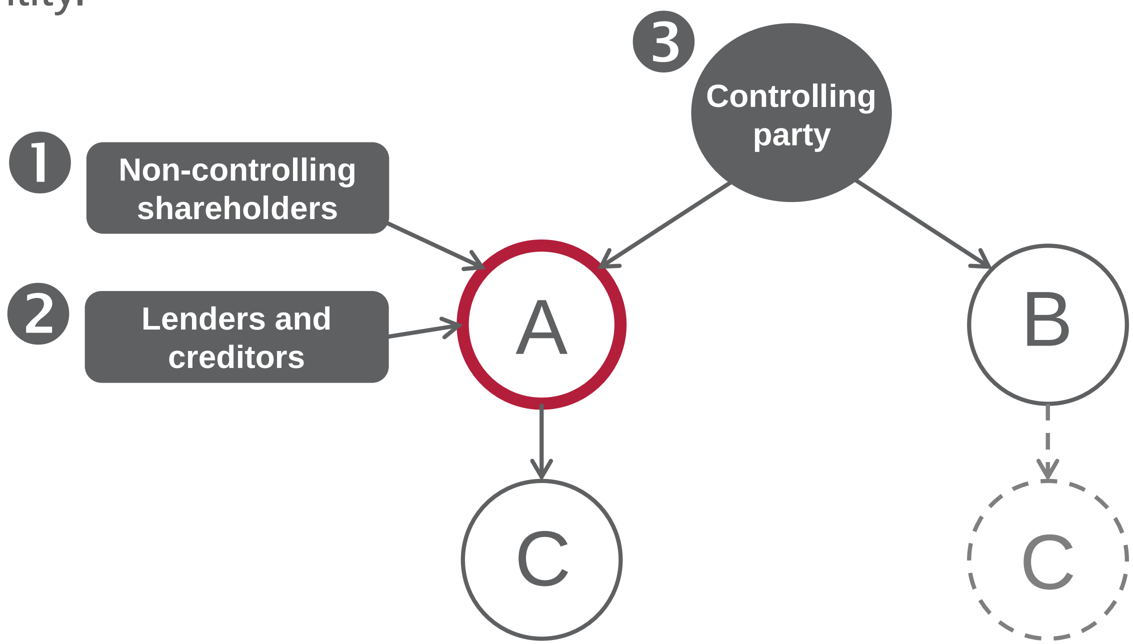
Conceptual Framework

Historical cost	Current value	Predecessor carrying amounts
	Existing practice (see slide 4)	
Receiving entity will allocate the consideration across the acquired assets and liabilities (eg based on their relative fair values).	Receiving entity will reflect acquired assets and liabilities at their current values (eg at fair values).	Receiving entity will reflect acquired assets and liabilities at their predecessor carrying amounts (eg the carrying amounts reflected in the transferee's financial statements).

Consistent with the acquisition method required by IFRS 3 for business combinations

Primary users of information

- Entity A acquires Entity C from Entity B. Entities A, B and C are all controlled by Entity P. Entity C is a business.
- The project focuses on the information needs of the **primary users** of the **receiving entity's** financial statements. In this scenario, Entity A is the receiving entity.



Discussion question for the breakout session

Breakout session

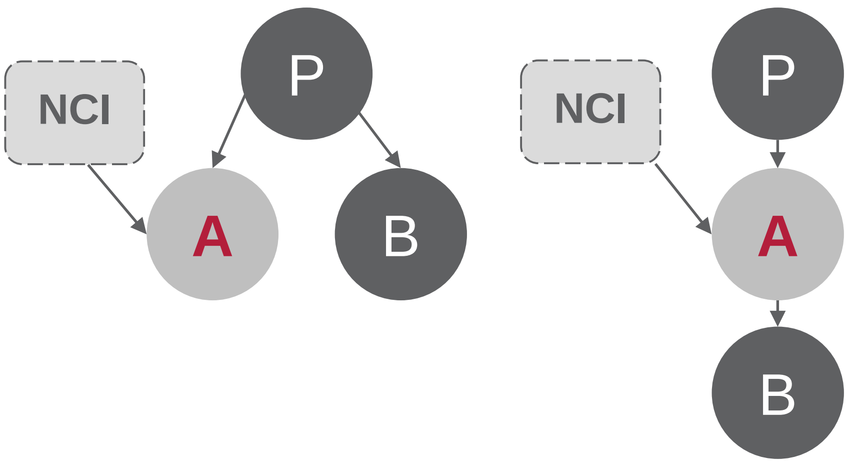
- Please discuss what type of information would be most useful for different types of primary users of the reporting entity's financial statements and whether the benefits of providing that information for those primary users will outweigh the costs of providing it.
- Staff preliminary views are set out on slides 13-15.

	Non-controlling shareholders	Controlling party	Lenders and creditors
Historical cost			
Current value	?	?	?
Predecessor carrying amounts			

❶ Non-controlling shareholders

Transaction

Before **After**



The staff think that information about **fair values exchanged** would be most useful to non-controlling shareholders (NCI). Such an approach would:

- result in information comparable with information provided about business combinations between third parties;
- reflect the effect of the transaction on the receiving entity's financial position;
- reflect distribution from or contribution to the receiving entity's equity.

Staff preliminary view

Require recognition of acquired assets and liabilities at fair value

Consider disclosure requirements

The staff think that such information should be provided by **recognising** acquired assets and liabilities at fair value with supporting **disclosure** and that the **benefits** of providing that information **outweigh the costs**.

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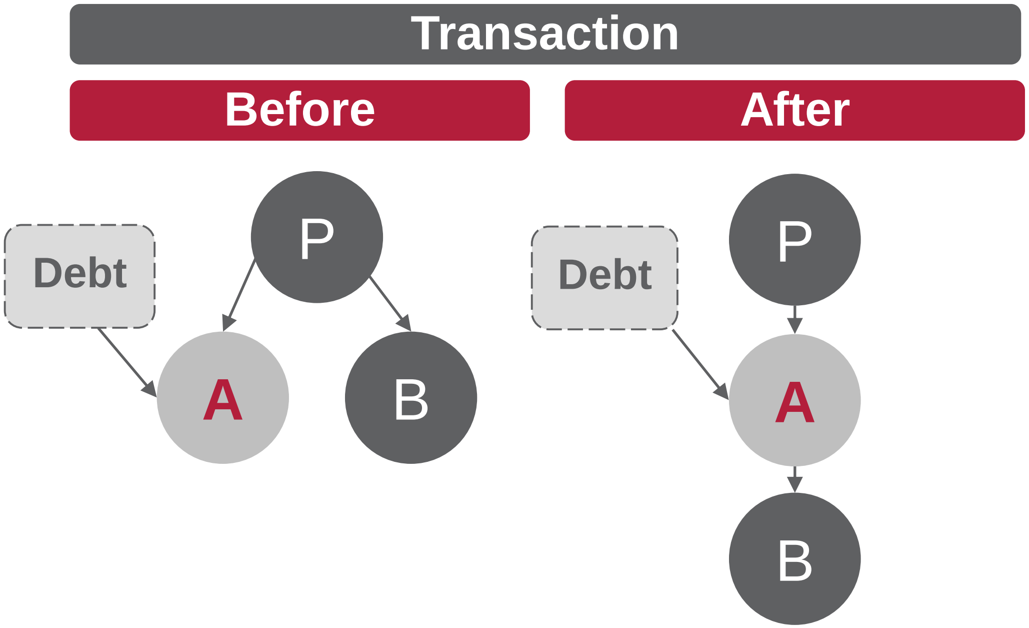
❷ Lenders and creditors



Staff preliminary view

Do NOT require recognition of acquired assets and liabilities at fair value

Require recognition at predecessor carrying amounts

Consider disclosure requirements

The staff think that **information needs** of lenders and creditors **are different** from those of NCI. This is because lenders and creditors:

- are exposed to credit risk rather than residual equity risk;
- have a finite interest in the reporting entity whereas equity interest is indefinite.

The staff also note that lenders may have access to information other than solely through the entity's financial statements.

While information about fair values may be useful for lenders and creditors, the staff think that their information needs can be met via **disclosures** and that any **benefits of recognition at fair value will not outweigh the costs**.

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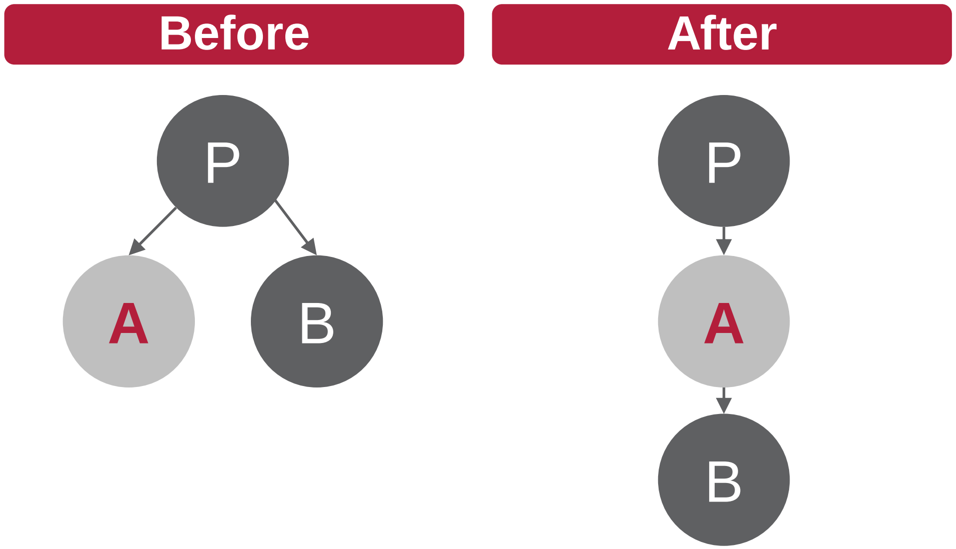
❸ Controlling party

Transaction



Unlike NCI and lenders and creditors, the controlling party **can satisfy its information needs without relying on the receiving entity's financial statements**.

Besides, the transaction itself is different from the point of view of the controlling party. For the controlling party, there is no 'acquisition'; instead, there is a **continuation of control**.

Staff preliminary view

- **Do NOT require recognition of acquired assets and liabilities at fair value**
- **Require recognition at predecessor carrying amounts**
- **Consider disclosure requirements**

Accordingly, the staff do not think that there are information benefits for the controlling party in recognising acquired assets and liabilities at fair value. Instead, they should continue to be reflected at **predecessor carrying amounts** with supporting disclosure.

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Appendix 1
Board’s tentative decisions to date

Appendix 1
Board's tentative decisions to date

Jun 2014
Setting the scope

The Board tentatively decided that the BCUCC project should consider:

- business combinations under common control that are currently excluded from the scope of IFRS 3 *Business Combinations*;
- group restructurings; and
- the need to clarify the description of business combinations under common control, including the meaning of 'common control'.

Appendix 1

Board's tentative decisions to date

Oct 2017

Clarifying the scope

Group restructuring

The Board clarified that the scope of the BCUCC project includes transactions under common control in which a reporting entity obtains control of one or more businesses, regardless of whether IFRS 3 *Business Combinations* would identify the reporting entity as the acquirer if IFRS 3 were applied to the transaction.

Appendix 1
Board's tentative decisions to date

Dec 2017

Clarifying the scope

Application questions

The Board tentatively decided that the scope of the project also includes transactions involving transfers of one or more businesses where all of the combining parties are ultimately controlled by the same controlling party or parties, and the transactions are:

- preceded by an external acquisition and/or followed by an external sale of one or more of the combining parties; or
- conditional on a future sale such as in an IPO.

Appendix 1
Scope finalised

Transactions under common control in which a reporting entity obtains control of one or more businesses, regardless of whether:

– the reporting entity can be identified as the ‘acquirer’, if IFRS 3 were applied to the transaction;

– the transaction is conditional on a future sale of the combining parties, such as in an IPO;

– the transaction is either preceded by an external acquisition of one or more combining parties, or followed by an external sale of the combining parties, or both.