IASB Agenda ref 23

Business Combinations under Common Control

Follow up on the approaches being developed by the staff

IASB Meeting – May 2018
Disclaimer

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<table>
<thead>
<tr>
<th>Project</th>
<th>Business Combinations under Common Control (BCUCC)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paper topic</td>
<td>Follow up on the approaches being developed by the staff</td>
</tr>
<tr>
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</tr>
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<td></td>
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</tr>
</tbody>
</table>
Purpose of the session

Background

In April 2018, the Board discussed two approaches being developed by the staff for a specific subset of transactions within the scope of the BCUCC project.

Follow up

The purpose of this session is to provide an update on the approaches being developed by the staff and to give Board members an opportunity to provide further feedback and to ask questions.

This session is educational and the staff do not ask the Board to make any decisions.
Content

• Recap of the *Full Fair Value* and *Ceiling* approaches
• Further development
  – Building on existing IFRS Standards
  – Illustrating the *Revised Ceiling* approach
• Summarising the approaches
• To be continued
• Appendix 1—Illustration of the *Full Fair Value* and *Ceiling* approaches (Extract from April 2018 Agenda Paper 23)
• Appendix 2—Board’s tentative decisions to date
Recap of the *Full Fair Value* and *Ceiling* approaches
Subset of transactions considered

The analysis presented by the staff in April 2018:

- was based on a **simple scenario** where Entity A acquires Entity B and the two entities are under common control;
- considered information needs of the **existing non-controlling shareholders** (NCI) in Entity A; and
- focused on the usefulness of information **before applying the cost constraint** on useful financial information.
The Board discussed two approaches being developed by the staff for the specific subset of transactions within the scope of the project.

- **Full Fair Value or Ceiling approach**
- **Transactions within the scope of the BCUCC project**

eg acquisition with NCI in the receiving entity
Underlying principles

For the specific subset of transactions considered:

- **fair values exchanged** is useful information for NCI
- **identifying and accounting for any equity transaction**

Building on the requirements in:
- IFRS 3 *Business Combinations*
- IAS 1 *Presentation of Financial Statements*
Recap of the approaches

**Full Fair Value** approach

- Considers the transaction from the market participant perspective and reflects *fair values exchanged*.
- **Goodwill** is the difference between FV acquired business and FV acquired identifiable net assets (ie internally generated goodwill in the acquired business). A *gain* is never recognised.
- An *equity transaction* is recognised if:
  - FV Consideration > FV Business (a distribution from equity); or
  - FV Consideration < FV Business (a contribution to equity).

**Ceiling** approach

- Considers fair values exchanged with the aim to avoid recognising any *inflated goodwill*.
- **Goodwill** is the excess of FV consideration over FV acquired identifiable net assets but is capped at FV acquired business (ie capped purchased goodwill). A *gain* is never recognised.
- An *equity transaction* is recognised if:
  - FV Consideration > FV Business (a distribution from equity); or
  - FV Consideration < FV Identifiable Net Assets (a contribution to equity).

**Both approaches produce the same result as IFRS 3 if equal fair values are exchanged.**

An illustration of the two approaches from April 2018 Agenda Paper 23 is reported in Appendix 1.
Both approaches would involve costs and complexity related to determining fair values, in particular the need to determine the fair value of the acquired business in some or all scenarios.

Both approaches involve significant measurement uncertainty as they require recognition of amounts that depend on a single estimate of the fair value of the acquired business in some or all scenarios.

Neither approach focusses on reflecting synergies between the combining parties as goodwill is always capped at the internally generated goodwill in the acquired business.

The challenges relate to using the fair value of the acquired business.
Further development
### Way forward

<table>
<thead>
<tr>
<th></th>
<th><strong>Full Fair Value</strong></th>
<th><strong>Ceiling</strong></th>
<th><strong>Existing Standards</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Is determining the fair value of the acquired business required?</td>
<td>Determine in <strong>ALL scenarios</strong></td>
<td>Determine <strong>ONLY WHEN</strong> FV Consideration &gt; FV Identifiable Net Assets</td>
<td><strong>NEVER</strong> required</td>
</tr>
<tr>
<td>Does the fair value of the acquired business affect recognition?</td>
<td>Affects recognition of goodwill and of equity transaction in <strong>ALL scenarios</strong></td>
<td>Affects recognition of goodwill and of equity distribution <strong>ONLY WHEN</strong> FV Consideration &gt; FV Business</td>
<td><strong>NEVER</strong> affects recognition</td>
</tr>
<tr>
<td>Are synergies between the combining parties reflected?</td>
<td><strong>NOT reflected</strong> as goodwill is calculated by reference to the fair value of the acquired business</td>
<td><strong>NOT reflected</strong> as purchased goodwill is capped at the fair value of the acquired business</td>
<td><strong>CAPTURED</strong> as purchased goodwill is allocated to all acquirer’s CGUs that are expected to benefit</td>
</tr>
</tbody>
</table>
Building on existing Standards (1/2)

Step 1 – Initial accounting for the transaction

**Business combination NOT under common control**

- IFRS 3 *Business Combinations* does not require determining the fair value of the acquired business. Instead, it uses the fair value of the consideration transferred as the basis for calculating goodwill on a presumption that the two amounts are usually equal (IFRS 3 par BC331). It also allows a measurement period of up to one year to complete accounting for a business combination (IFRS 3 par 45).

**BCUCC**

- Consistent with the requirements in IFRS 3, use the fair value of the consideration transferred as the basis for initial accounting for a BCUCC of the type addressed in this slide deck (see slides 6 and 7) and allow an appropriate measurement period to complete accounting for a BCUCC.
Building on existing IFRS Standards (2/2)

Step 2 – Completing accounting for the transaction

**Business combination NOT under common control**

- IAS 36 *Impairment of Assets* requires an entity to allocate goodwill acquired in a business combination to each of the acquirer’s CGUs that is **expected to benefit from the synergies of the combination** (IAS 36 par 80) in order to test goodwill for impairment.

**BCUCC**

- By the end of the measurement period, use the mechanics of the impairment test in IAS 36 to determine:
  - how much of the amount transferred in a BCUCC related to the fair value of the acquired business and to the **expected synergies**; and
  - whether the amount transferred included a distribution from equity.

Applies only when FV Consideration > FV Identifiable Net Assets.
Evolution of the approaches

Use **fair values exchanged** to calculate goodwill and to identify any equity transaction

Use IFRS 3 except for capping goodwill and identifying any equity distribution

Use IAS 36 to cap goodwill and to identify any equity distribution

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**Full Fair Value**  
**Ceiling**  
**Revised Ceiling**
Illustrating the *Revised Ceiling* approach
In these examples:
- the consideration transferred is cash; and
- the amounts are denominated in ‘currency units’ (CU).
Scenario 1—Initial accounting

Revised Ceiling approach

- Calculate **provisional carrying amount of goodwill** as the difference between the fair values of the consideration transferred and the fair value of the acquired identifiable net assets.

**FV Consideration**

52 CU

**FV Identifiable Net Assets**

48 CU

**Provisional goodwill**

4 CU
Scenario 1—Initial accounting

Applying IFRS 3, if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional carrying amounts for the items for which the accounting is incomplete. The measurement period shall not exceed one year from the acquisition date (paragraph 45 of IFRS 3).
Scenario 1—Use the mechanics of IAS 36

**Revised Ceiling approach**

By the end of the measurement period, use the mechanics in IAS 36 to confirm the carrying amount of goodwill and to identify any equity transaction:

- **allocate** the provisional goodwill to each of the receiving entity’s CGUs, or groups of CGUs, that is **expected to benefit from the synergies of the combination**;
- applying the requirements in IAS 36, measure the **recoverable amounts** of the CGU(s) to which the provisional goodwill has been allocated; and
- **compare** that **recoverable amount** of the CGU(s) **with the carrying amounts** of the CGU(s) to which the provisional carrying amount goodwill has been allocated.

Any excess of the carrying amounts of the CGU(s) to which the provisional carrying amount of goodwill has been allocated over the recoverable amounts of those CGUs results in **adjusting the provisional carrying amount of goodwill** and **recognising a distribution from equity**.
Scenario 1—Use the mechanics of IAS 36

**Revised Ceiling approach**

**Scenario 1A**
Provisional goodwill is **confirmed**, no equity transaction to recognise

**Scenario 1B**
Provisional goodwill is **adjusted** and a distribution from equity is **recognised**
Scenario 1A—Accounting is complete

Revised Ceiling approach

- The **provisional carrying amount of goodwill** (the difference between the fair value of the consideration transferred and the fair value of the acquired identifiable net assets) **is confirmed**. **No equity transaction** is recognised.
### Scenario A—Accounting is complete

<table>
<thead>
<tr>
<th></th>
<th>Revised Ceiling</th>
<th>IFRS 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><em>Cr</em></td>
<td>Cash</td>
<td>52</td>
</tr>
<tr>
<td><em>Dr</em></td>
<td>Identifiable Net Assets</td>
<td>48</td>
</tr>
<tr>
<td><em>Dr</em></td>
<td>Goodwill</td>
<td>4</td>
</tr>
</tbody>
</table>

⚠️ The provisional carrying amounts are confirmed.
**Scenario 1B—Accounting is complete**

**Revised Ceiling approach**

- **Provisional carrying amount of goodwill is adjusted** to reflect the recoverable amount of the cash-generating unit(s) to which the provisional goodwill had been allocated. The difference between the recoverable amount and the carrying amounts of those CGU(s) is recognised as a *distribution from equity*.

<table>
<thead>
<tr>
<th>FV Consideration</th>
<th>Equity transaction</th>
<th>1 CU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill</td>
<td><em>Distribution</em></td>
<td>3 CU</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FV Identifiable</th>
<th>52 CU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Assets</td>
<td></td>
</tr>
</tbody>
</table>

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**IFRS**
### Scenario B—Accounting is complete

<table>
<thead>
<tr>
<th></th>
<th>Revised Ceiling</th>
<th>IFRS 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cr Cash</strong></td>
<td></td>
<td>52</td>
</tr>
<tr>
<td><strong>Dr Identifiable Net Assets</strong></td>
<td>48</td>
<td>48</td>
</tr>
<tr>
<td><strong>Dr Goodwill</strong></td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td><strong>Dr Equity (Distribution)</strong></td>
<td>1</td>
<td>-</td>
</tr>
<tr>
<td><strong>Dr Impairment loss</strong></td>
<td>-</td>
<td>1</td>
</tr>
</tbody>
</table>

Applying existing IFRSs, goodwill arising in a business combination is **subsequently** tested for impairment.
**Scenario ②**

*Revised Ceiling approach*

- No modification to the *Ceiling* approach discussed by the Board in April 2018 is necessary when the fair value of the consideration transferred is less than the fair value of the acquired identifiable net assets.

![Diagram with blue and green rectangles and numbers: 48 CU, 3 CU, 45 CU.}]
## Scenario 2—Accounting is complete

<table>
<thead>
<tr>
<th></th>
<th>Revised Ceiling = Ceiling</th>
<th>IFRS 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cr</strong> Cash</td>
<td>45</td>
<td>45</td>
</tr>
<tr>
<td><strong>Dr</strong> Identifiable Net Assets</td>
<td>48</td>
<td>48</td>
</tr>
<tr>
<td><strong>Dr</strong> Goodwill</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Cr</strong> Equity <em>(Contribution)</em></td>
<td>3</td>
<td>-</td>
</tr>
<tr>
<td><strong>Cr</strong> Gain on a bargain purchase</td>
<td>-</td>
<td>3</td>
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</table>
Summarising the approaches
### Revised Ceiling approach—summary (1/3)

<table>
<thead>
<tr>
<th><strong>FV Consideration</strong> &gt; <strong>FV I. Net Assets</strong></th>
<th><strong>FV Consideration</strong> &lt; <strong>FV I. Net Assets</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>An entity recognises:</strong></td>
<td><strong>An entity recognises:</strong></td>
</tr>
<tr>
<td><strong>Provisional goodwill</strong></td>
<td><strong>Contribution</strong></td>
</tr>
<tr>
<td><strong>FV Consideration – FV I. Net Assets</strong></td>
<td><strong>FV I. Net Assets – FV Consideration</strong></td>
</tr>
<tr>
<td>Goodwill is allocated to CGU(s)</td>
<td></td>
</tr>
<tr>
<td>and tested for impairment</td>
<td></td>
</tr>
<tr>
<td><strong>Rec.amt. &gt; Car.amt.</strong></td>
<td><strong>Rec.amt. &lt; Car.amt.</strong></td>
</tr>
<tr>
<td><strong>Goodwill</strong></td>
<td><strong>Goodwill</strong></td>
</tr>
<tr>
<td>Provisional goodwill confirmed</td>
<td>Provisional goodwill adjusted</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Distribution</strong></td>
<td></td>
</tr>
</tbody>
</table>
Revised Ceiling approach—summary (2/3)

• Under the *Revised Ceiling* approach:
  – consistent with IFRS 3, **goodwill** is initially calculated as the excess of the fair value of the consideration transferred over the fair value of the acquired identifiable net assets (provisional goodwill);
  – within the measurement period and using the mechanics of IAS 36, provisional goodwill is allocated to CGU(s) that are expected to benefit from the BCUCC and tested in order to confirm the provisional amount and to identify any distribution from equity;
  – any excess of the carrying amount over the recoverable amount of the CGU(s) to which the provisional goodwill had been allocated is recognised as a **distribution from equity**; and
  – a **contribution to equity** is recognised when the fair value of the consideration transferred is less than the fair value of the acquired identifiable net assets. A **gain** is **never recognised**.
**Revised Ceiling** approach—summary (3/3)

- **Revised Ceiling** approach is further aligned with the mechanics of existing IFRS Standards (IFRS 3, IAS 36, IAS 1); however, the timing of applying the requirements can be different.

- It **reduces the challenges** arising under the *Full Fair Value* and *Ceiling* approaches related to:
  - the significant **measurement uncertainty** and the **costs** and **complexity** involved in determining the fair value of the acquired business—the *Revised Ceiling* approach uses the mechanics of **IAS 36** to cap goodwill and to identify any distribution from equity; and
  - reflecting the existence of **potential synergies** between the receiving entity and the acquired business—the *Revised Ceiling* approach requires the receiving entity to allocate any provisional goodwill to each of its CGUs that is expected to benefit from the synergies of the combination.

**Caution**: Considers the exchange from the **entity-specific perspective**. Results in recognition of **purchased goodwill** capped by the recoverable amount. **Reflects the expected synergies** between the combining parties.
Full Fair Value approach—summary (1/3)

- Requires the receiving entity to measure the fair value of the acquired business and to compare it with the fair value of the consideration transferred in all scenarios.
- Fair value of the acquired business affects recognition of goodwill and of equity transactions.

**FV Consideration > FV Business**

The receiving entity recognises:

- **Distribution**: 
  \[ \text{FV Consideration} - \text{FV Business} \]
- **Goodwill**: 
  \[ \text{FV Business} - \text{FV Identifiable Net Assets} \]

**FV Consideration < FV Business**

The receiving entity recognises:

- **Contribution**: 
  \[ \text{FV Business} - \text{FV Consideration} \]
- **Goodwill**: 
  \[ \text{FV Business} - \text{FV Identifiable Net Assets} \]
• Under the **Full Fair Value** approach:
  – **goodwill** is always calculated as the difference between the fair value of the acquired business and the fair value of the acquired identifiable net assets; and
  – any difference between the fair value of the acquired business and the fair value of the consideration transferred is recognised as an equity transaction:
    - a distribution from equity (FV Consideration > FV Business); or
    - a contribution to equity (FV Business > FV Consideration). A **gain** is **never** recognised.
**Full Fair Value** approach aims to reflect the economics of the transaction.

- However, it involves **significant measurement uncertainty** as it requires, in all scenarios, **recognition** of amounts that depend on a **single estimate** of the fair value of the acquired business.
- In addition, it involves additional **costs** and is also **operationally complex** for transactions **not priced at fair value** as it requires determining the fair value of the acquired business.

⚠️ Considers the combination from the **market participant perspective**. Results in recognition of **goodwill that was internally generated in the acquired business**. **Does not reflect the expected synergies** between the combining parties.
Summary

Full Fair Value

- Uses the principles in IFRS 3 and IAS 1 but does not fully rely on the mechanics of existing Standards.
- Considers the combination from the market participant perspective.
- Results in recognition of goodwill that was internally generated in the acquired business.
- Does not reflect the expected synergies between the combining parties.

Ceiling

- Uses both the principles and the mechanics of existing Standards.
- Considers the combination from the entity-specific perspective.
- Results in recognition of purchased goodwill capped by the recoverable amount.
- Reflects the expected synergies between the combining parties.

Revised Ceiling
To be continued

Transactions within the scope of the BCUCC project
... considering different primary users

*Full Fair Value or Revised Ceiling*

**Cost constraint**

**Primary users**

*eg acquisition with NCI in the receiving entity*

*eg transfer of a business to a Newco*
Feedback and discussion

• Do Board members have any questions and/or comments on the Revised Ceiling approach?
Thank you
Appendix 1

Illustration of the *Full Fair Value* and *Ceiling* approaches
(Extract from April 2018 Agenda Paper 23)
In these examples:
- the consideration transferred is cash; and
- the amounts are denominated in ‘currency units’ (CU).

Our analysis assumes that
FV Business is always \( \geq \) FV Identifiable Net Assets
The fair value of the consideration transferred is more than the fair value of the acquired business.

**Full Fair Value approach = Ceiling approach**

- **FV Consideration**: 70 CU
  - **Equity transaction**
    - **Distribution**: 10 CU
  - **Goodwill**: 12 CU

- **FV Business**: 60 CU

- **FV Identifiable Net Assets**: 48 CU
## Appendix 1

### Scenario 1—debits and credits

<table>
<thead>
<tr>
<th></th>
<th>Full Fair Value = Ceiling</th>
<th>IFRS 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cr</strong></td>
<td>Cash</td>
<td>70</td>
</tr>
<tr>
<td><strong>Dr</strong></td>
<td>Identifiable Net Assets</td>
<td>48</td>
</tr>
<tr>
<td><strong>Dr</strong></td>
<td>Goodwill</td>
<td>12</td>
</tr>
<tr>
<td><strong>Dr</strong></td>
<td>Equity <em>(Distribution)</em></td>
<td>10</td>
</tr>
<tr>
<td><strong>Dr</strong></td>
<td>Impairment loss</td>
<td>-</td>
</tr>
</tbody>
</table>

*Subject to impairment test!*
The fair value of the consideration transferred is **less** than the fair value of the acquired business but **more** than the fair value of the acquired identifiable net assets.

**Full Fair Value approach**

- **FV Business**: 60 CU
- **FV Consideration**: 52 CU
- **FV Identifiable Net Assets**: 48 CU

Equity transaction

- **Contribution**: 8 CU
- **Goodwill**: 12 CU
The fair value of the consideration transferred is less than the fair value of the acquired business but more than the fair value of the acquired identifiable net assets.

Ceiling approach

FV Business 60 CU

FV Consideration

Goodwill 4 CU

FV Identifiable Net Assets 48 CU
## Appendix 1

### Scenario 2—debits and credits

<table>
<thead>
<tr>
<th></th>
<th>Full Fair Value</th>
<th>Ceiling</th>
<th>IFRS 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cr</strong></td>
<td>Cash</td>
<td>52</td>
<td>52</td>
</tr>
<tr>
<td><strong>Dr</strong></td>
<td>Identifiable Net Assets</td>
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</tr>
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<td><strong>Dr</strong></td>
<td>Goodwill</td>
<td>12</td>
<td>4</td>
</tr>
<tr>
<td><strong>Cr</strong></td>
<td>Equity (Contribution)</td>
<td>8</td>
<td>-</td>
</tr>
</tbody>
</table>
The fair value of the consideration transferred is less than the fair value of the acquired business and less than the fair value of the acquired identifiable net assets.

**Full Fair Value approach**

- **FV Business**: 60 CU
- **FV Identifiable Net Assets**: 48 CU
- **Equity transaction Contribution**: 15 CU
- **FV Consideration**: 45 CU
- **Goodwill**: 12 CU
The fair value of the consideration transferred is **less** than the fair value of the acquired business and **less** than the fair value of the acquired identifiable net assets.

**Ceiling approach**

- **FV Business**: 60 CU
- **FV Identifiable Net Assets**: 48 CU
- **Equity transaction Contribution**: 3 CU
- **FV Consideration**: 45 CU
### Appendix 1

**Scenario 3** — debits and credits

<table>
<thead>
<tr>
<th>Debit/Credit</th>
<th>Description</th>
<th>Full Fair Value</th>
<th>Ceiling</th>
<th>IFRS 3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cr</strong></td>
<td>Cash</td>
<td>45</td>
<td>45</td>
<td>45</td>
</tr>
<tr>
<td><strong>Dr</strong></td>
<td>Identifiable Net Assets</td>
<td>48</td>
<td>48</td>
<td>48</td>
</tr>
<tr>
<td><strong>Dr</strong></td>
<td>Goodwill</td>
<td>12</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Cr</strong></td>
<td>Equity <em>(Contribution)</em></td>
<td>15</td>
<td>3</td>
<td>-</td>
</tr>
<tr>
<td><strong>Cr</strong></td>
<td>Gain on a bargain purchase</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
Appendix 2
Board’s tentative decisions to date
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’.
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.
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.
The Board tentatively decided to use the acquisition method set out in IFRS 3 *Business Combinations* as the starting point in its analysis of transactions within the scope of the project. Using that starting point will not determine whether the Board will ultimately propose applying the acquisition method to all, or even to many, transactions within the scope of the project.