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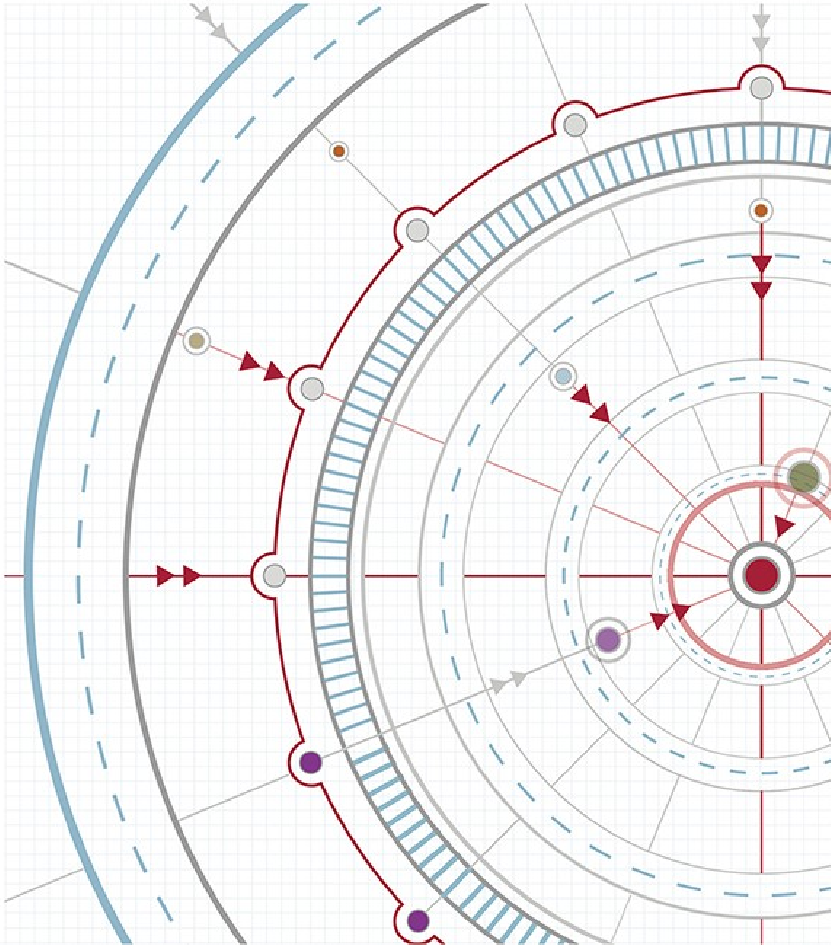

IASB Agenda ref 23

Business Combinations under Common Control

Follow up on the approaches being developed by the staff

IASB Meeting – May 2018

IFRS®

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Project	**Business Combinations under Common Control (BCUCC)**		
Paper topic	Follow up on the approaches being developed by the staff		
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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**

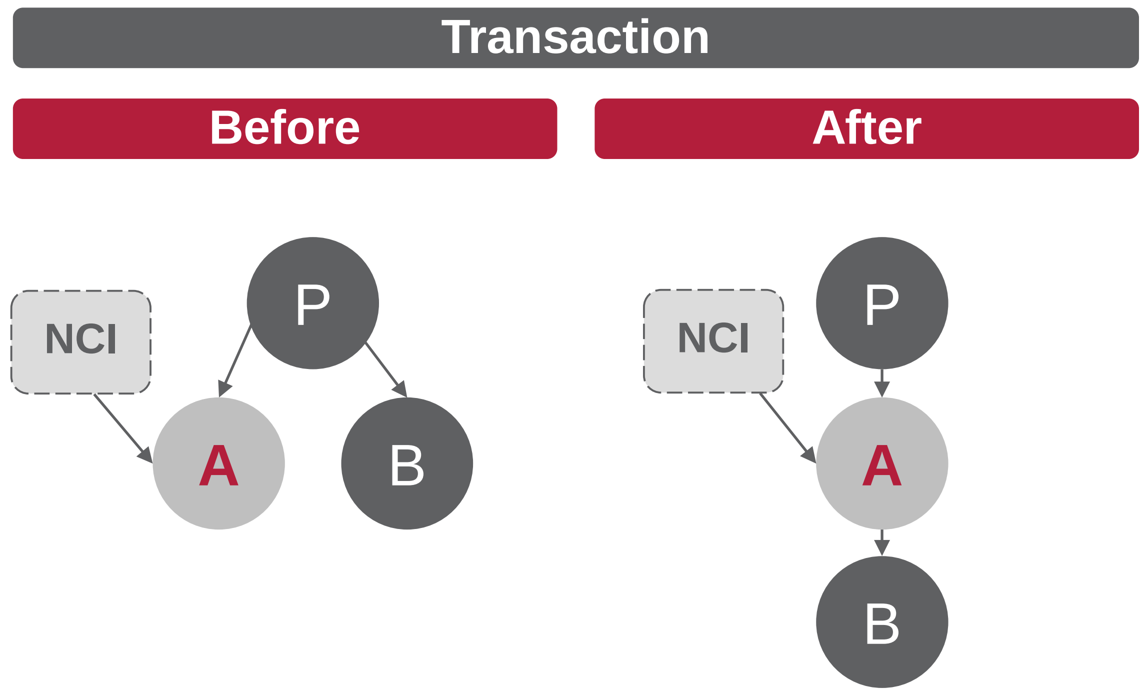
Recap of the *Full Fair Value* and *Ceiling* approaches

IFRS

Subset of transactions considered

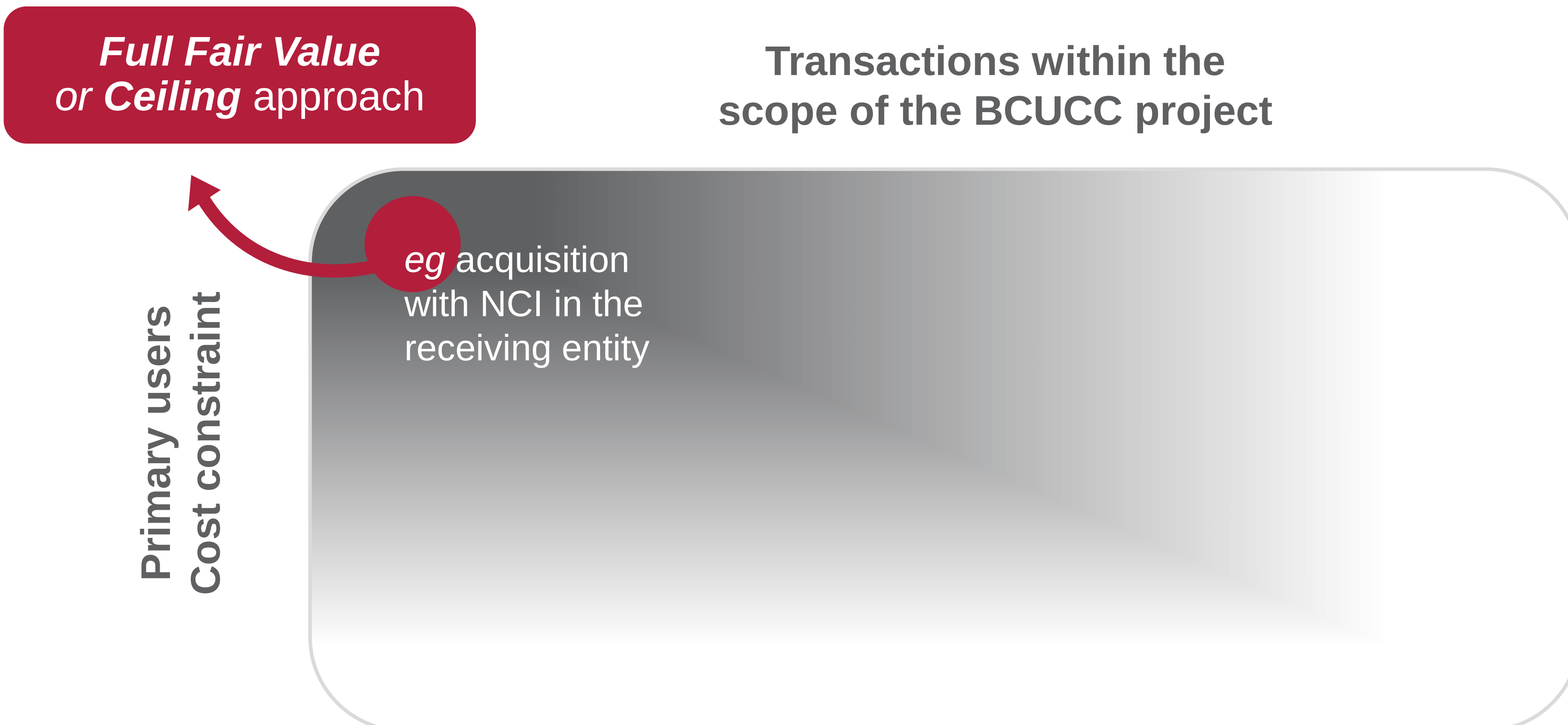
The analysis presented by the staff in April 2018:

- 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.



Approaches being developed

The Board discussed two approaches being developed by the staff for the **specific subset of transactions** within the scope of the project.



Underlying principles

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* and **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**.

Focus for further development

	Full Fair Value **approach**	***Ceiling*** **approach**
Cost and complexity	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.	
Measurement uncertainty	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.	
Synergies	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

	Full Fair Value	*Ceiling*	**Existing Standards**
Is determining the fair value of the acquired business required?	Determine in **ALL scenarios**	Determine **ONLY WHEN** FV Consideration > FV Identifiable Net Assets	**NEVER** required
Does the fair value of the acquired business affect recognition?	Affects recognition of goodwill and of equity transaction in **ALL scenarios**	Affects recognition of goodwill and of equity distribution **ONLY WHEN** FV Consideration > FV Business	**NEVER** affects recognition
Are synergies between the combining parties reflected?	**NOT reflected** as goodwill is calculated by reference to the fair value of the acquired business	**NOT reflected** as purchased goodwill is capped at the fair value of the acquired business	**CAPTURED** as purchased goodwill is allocated to all acquirer's CGUs that are expected to benefit

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.

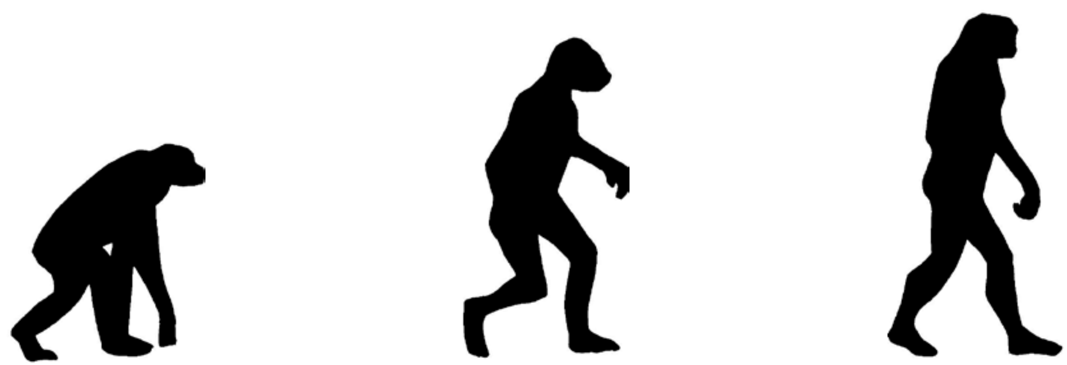
BCUCC

- 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

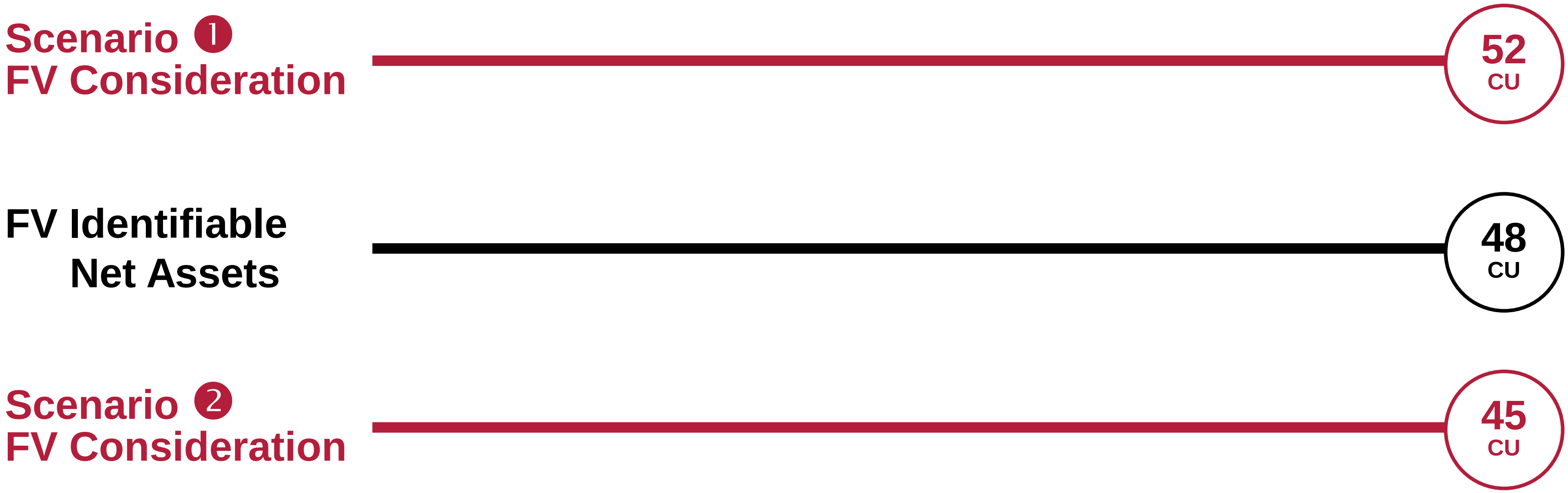


Full Fair Value | ***Ceiling*** | ***Revised Ceiling***

Illustrating the *Revised Ceiling* approach

Revised Ceiling approach

Possible scenarios



In these examples:

- the consideration transferred is cash; and
- the amounts are denominated in ‘currency units’ (CU).

Scenario ➊—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.

Scenario ❶—Initial accounting

	Revised Ceiling		IFRS 3	
Cr **Cash**		**52**		**52**
Dr **Identifiable Net Assets**	**48**		**48**	
Dr **Goodwill**	**4**		**4**	

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 ➊—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 ❶—Use the mechanics of IAS 36

Revised Ceiling **approach**

123 CU

120 CU

Recoverable amount > Carrying amounts

Scenario ❶A

Provisional goodwill is confirmed, no equity transaction to recognise

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119 CU

120 CU

Recoverable amount < Carrying amounts

Scenario ❶B

Provisional goodwill is adjusted and a distribution from equity is recognised

1 CU

Scenario ➊A—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 ❶A—Accounting is complete

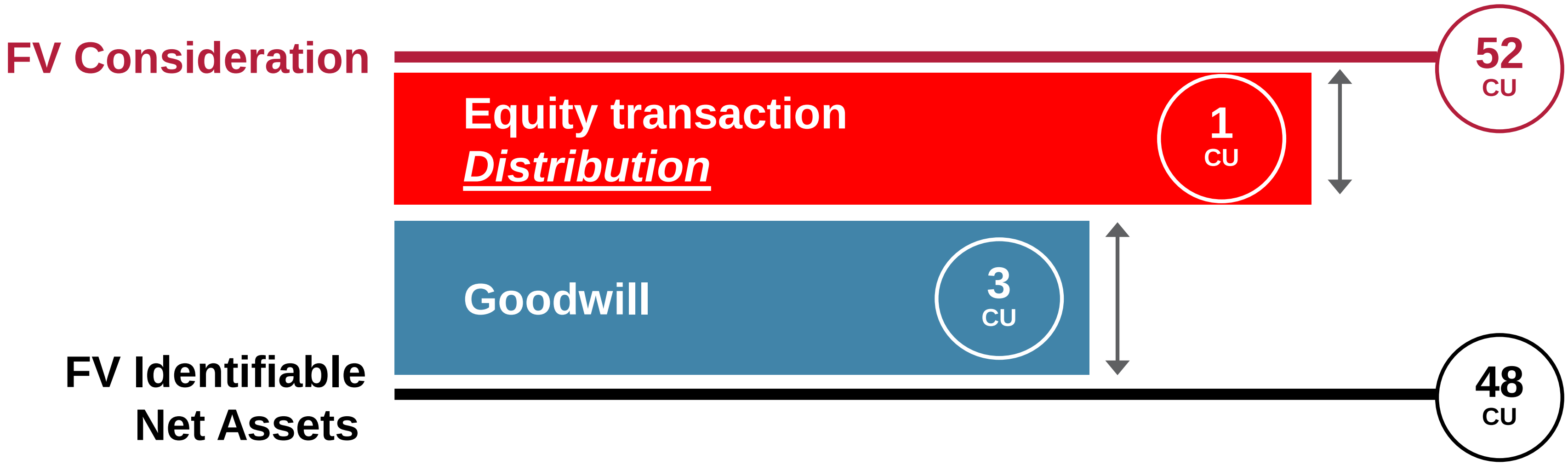
	Revised Ceiling		IFRS 3	
Cr **Cash**		**52**		**52**
Dr **Identifiable Net Assets**	**48**		**48**	
Dr **Goodwill**	**4**		**4**	

⚠ The provisional carrying amounts are confirmed.

Scenario ❶B—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**.



Scenario ❶B—Accounting is complete

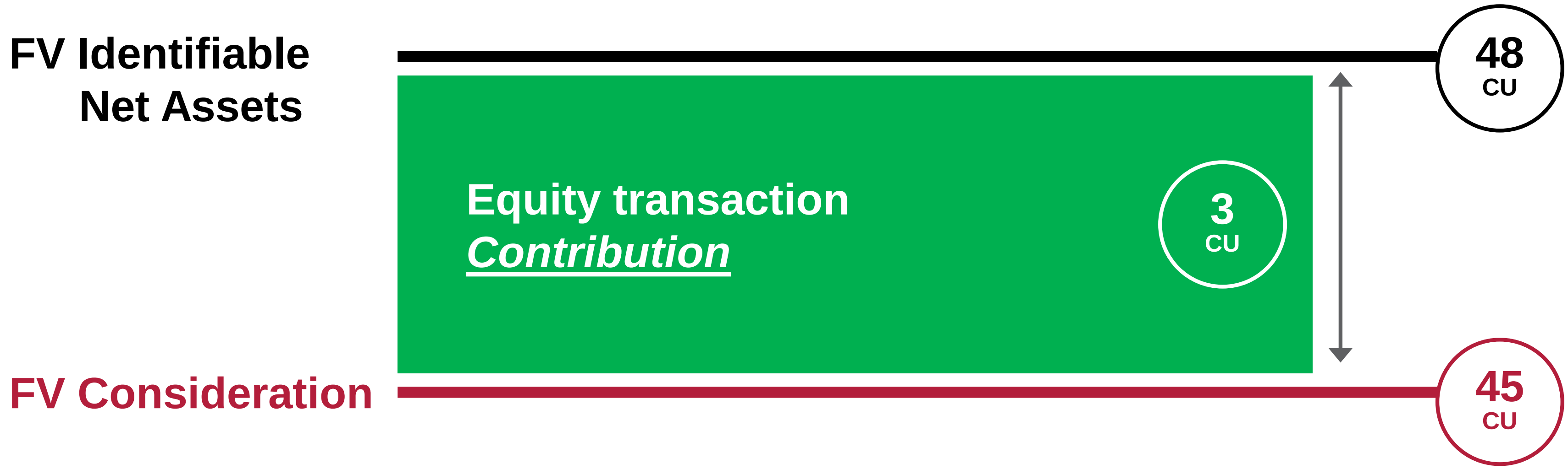
		Revised Ceiling		IFRS 3	
Cr	**Cash**		**52**		**52**
Dr	**Identifiable Net Assets**	**48**		**48**	
Dr	**Goodwill**	**3**		**4**	⚠ **1**
Dr	**Equity (*Distribution*)**	**1**		**-**	
Dr	**Impairment loss**	**-**		⚠ **1**	

⚠ 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.



Scenario ❷—Accounting is complete

	Revised Ceiling = Ceiling		IFRS 3	
Cr **Cash**		**45**		**45**
Dr **Identifiable Net Assets**	**48**		**48**	
Dr **Goodwill**	**-**		**-**	
Cr **Equity (*Contribution*)**		**3**		**-**
Cr **Gain on a bargain purchase**		**-**		**3**

Summarising the approaches

IFRS

Revised Ceiling approach—summary (1/3)

FV Consideration > FV I. Net Assets

An entity recognises:

Provisional goodwill

FV Consideration – FV I. Net Assets

Goodwill is allocated to CGU(s)
and tested for impairment

Rec. amt. > Car. amt.	Rec. amt. < Car. amt.
Goodwill	**Goodwill**
Provisional goodwill **confirmed**	Provisional goodwill **adjusted**
	Distribution

FV Consideration < FV I. Net Assets

An entity recognises:

Contribution

FV I. Net Assets – FV Consideration

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.

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.

Refresh

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	FV Consideration < FV Business
The receiving entity recognises:	The receiving entity recognises:
Distribution	**Contribution**
FV Consideration – FV Business	FV Business – FV Consideration
Goodwill	**Goodwill**
FV Business – FV Identifiable Net Assets	FV Business – FV Identifiable Net Assets

Refresh

Full Fair Value approach—summary (2/3)

- 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**.

Refresh

Full Fair Value approach—summary (3/3)

- ***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	***Ceiling***	***Revised Ceiling***

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.

Revised 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.

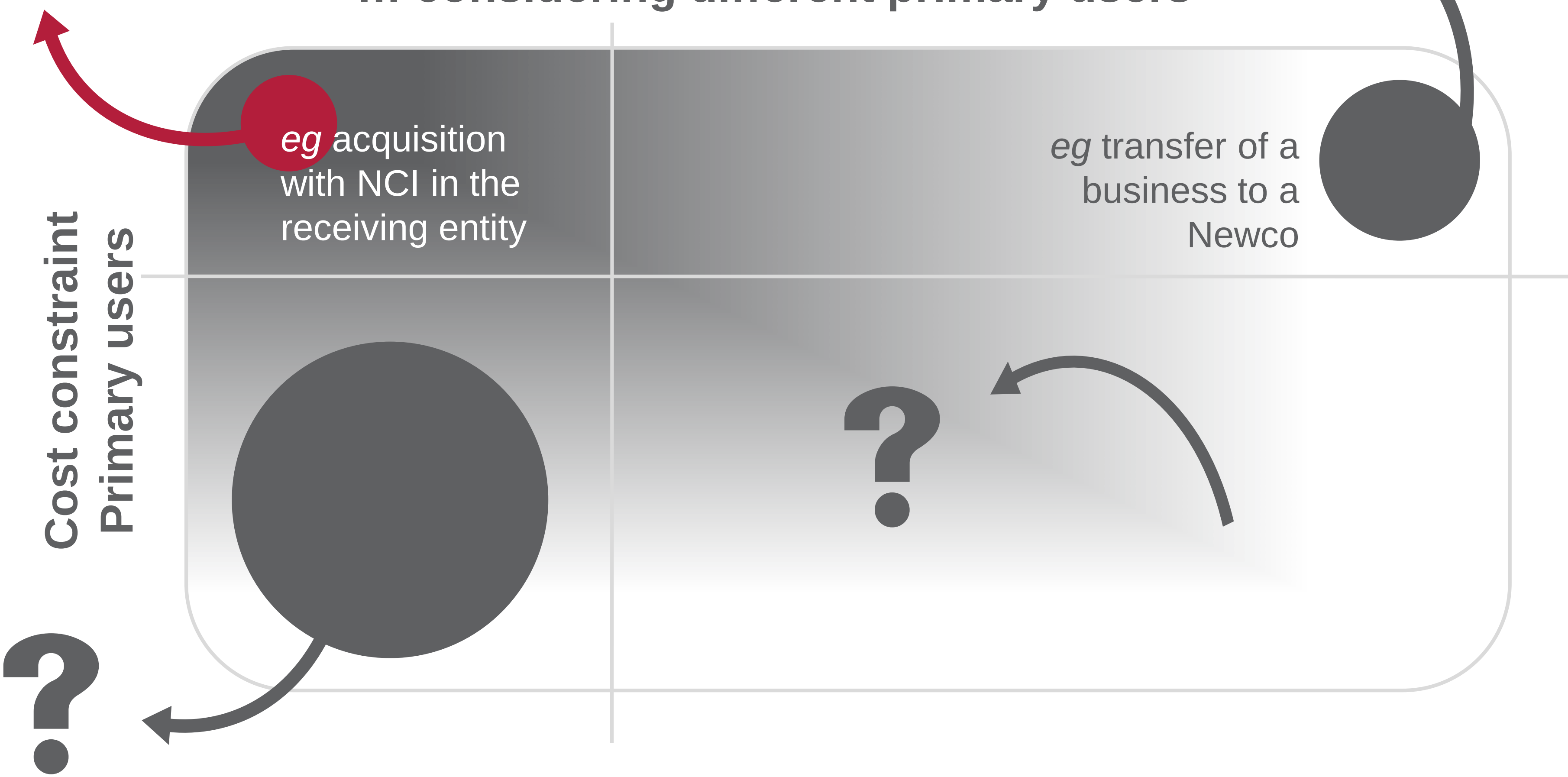
To be continued

To be continued

Full Fair Value
or
Revised Ceiling

Transactions within the scope of the BCUCC project

… considering different primary users



Feedback and discussion

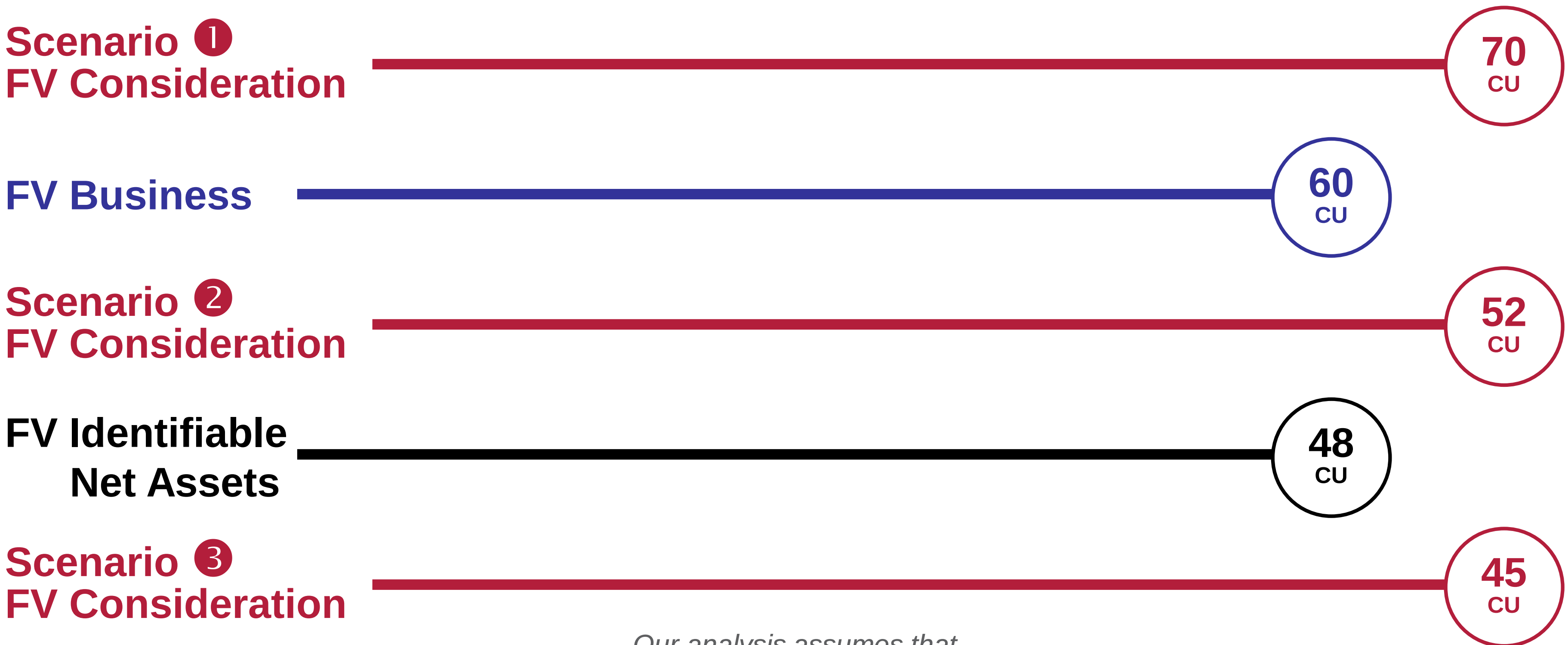
- **Do Board members have any questions and/or comments on the *Revised Ceiling* approach?**

Thank you

Appendix 1

Illustration of the *Full Fair Value* and *Ceiling* approaches (Extract from April 2018 Agenda Paper 23)

Appendix 1
Possible scenarios



Our analysis assumes that
FV Business is always ≥ FV Identifiable Net Assets

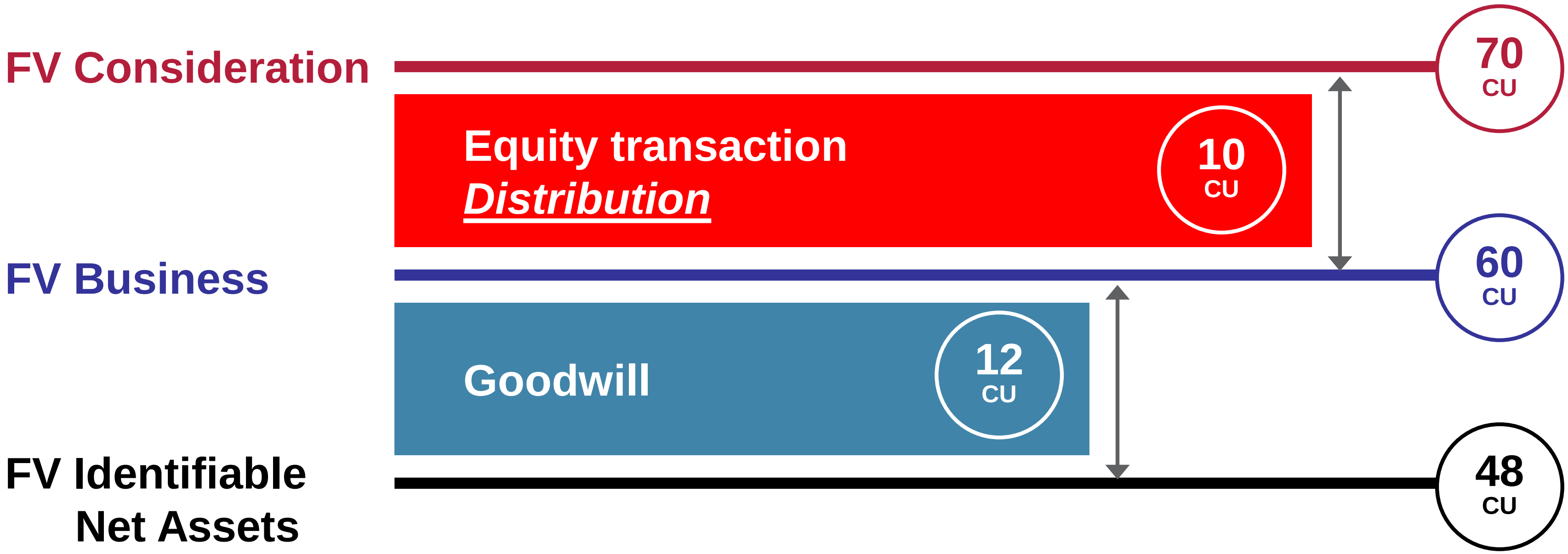
In these examples:

- the consideration transferred is cash; and
- the amounts are denominated in 'currency units' (CU).

Appendix 1
Scenario ➊

The fair value of the consideration transferred is more than the fair value of the acquired business.

***Full Fair Value* approach = *Ceiling* approach**



Appendix 1
Scenario ➊—debits and credits

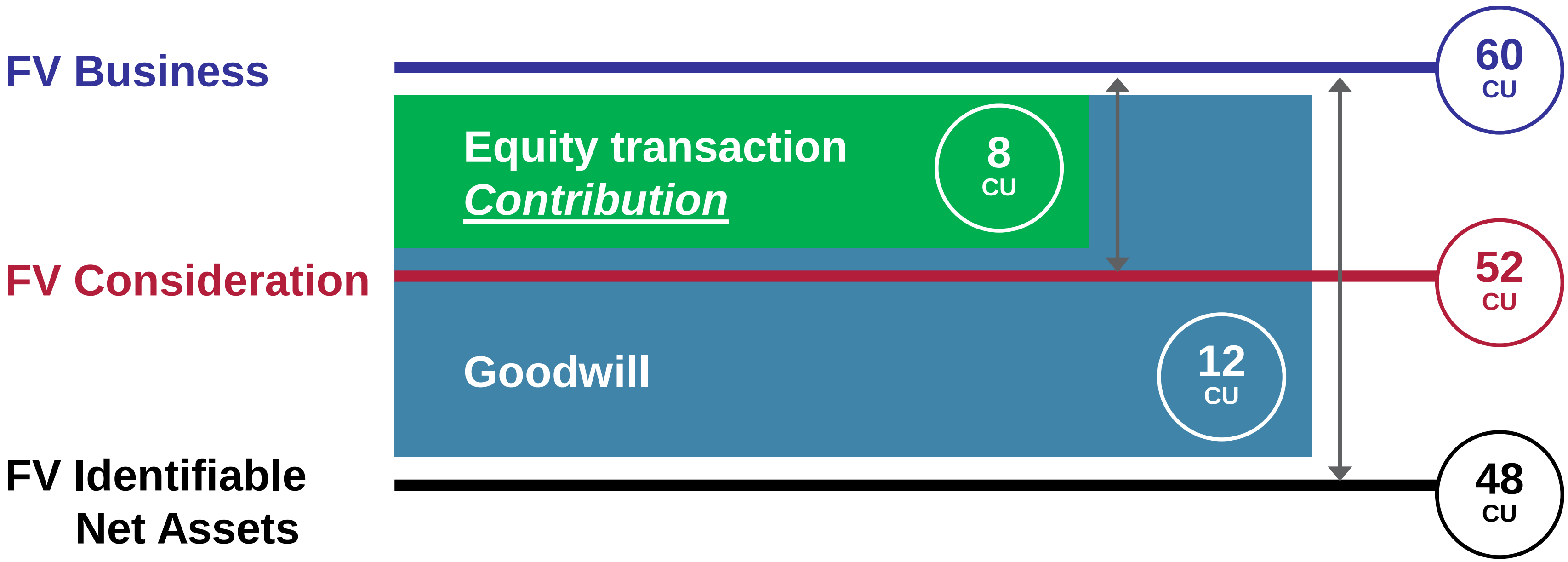
		Full Fair Value = Ceiling		IFRS 3	
Cr	Cash		70		70
Dr	Identifiable Net Assets	48		48	
Dr	Goodwill	12		22	⚠
Dr	Equity (*Distribution*)	10		-	
Dr	Impairment loss	-		⚠	

⚠ **Subject to impairment test!**

Appendix 1
Scenario ❷

The fair value of the consideration transferred is <u>less</u> than the fair value of the acquired business but <u>more</u> than the fair value of the acquired identifiable net assets.

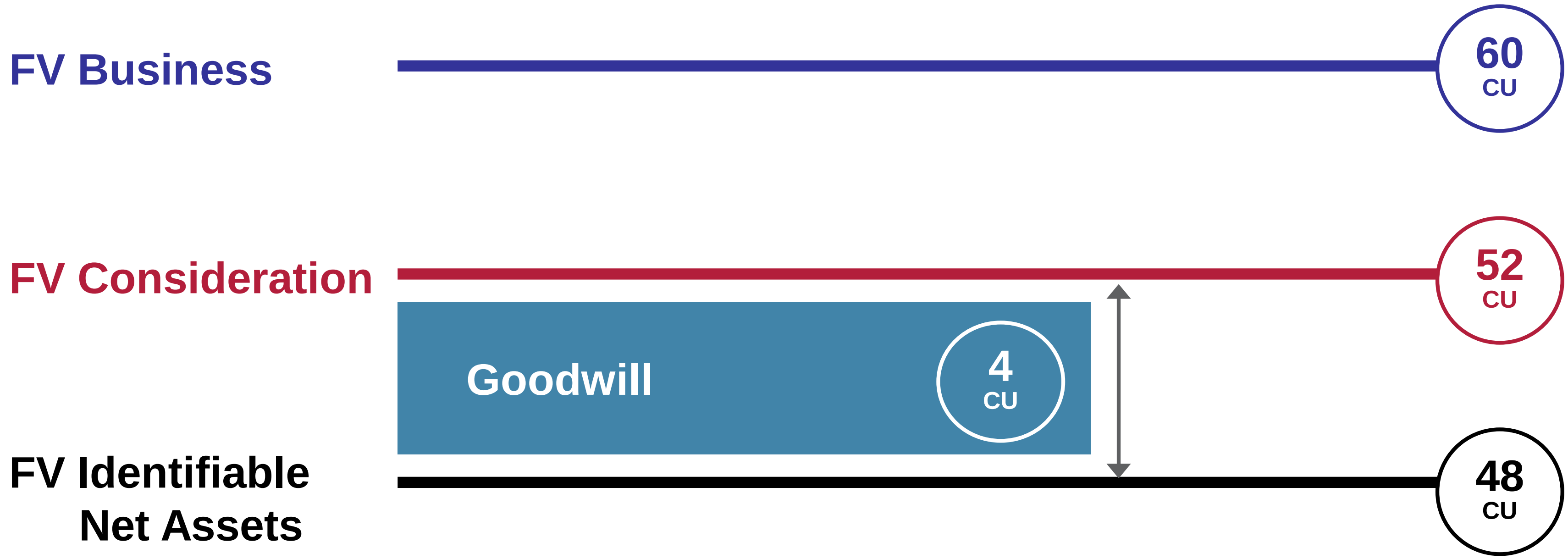
***Full Fair Value* approach**



Appendix 1
Scenario ❷

The fair value of the consideration transferred is <u>less</u> than the fair value of the acquired business but <u>more</u> than the fair value of the acquired identifiable net assets.

***Ceiling* approach**



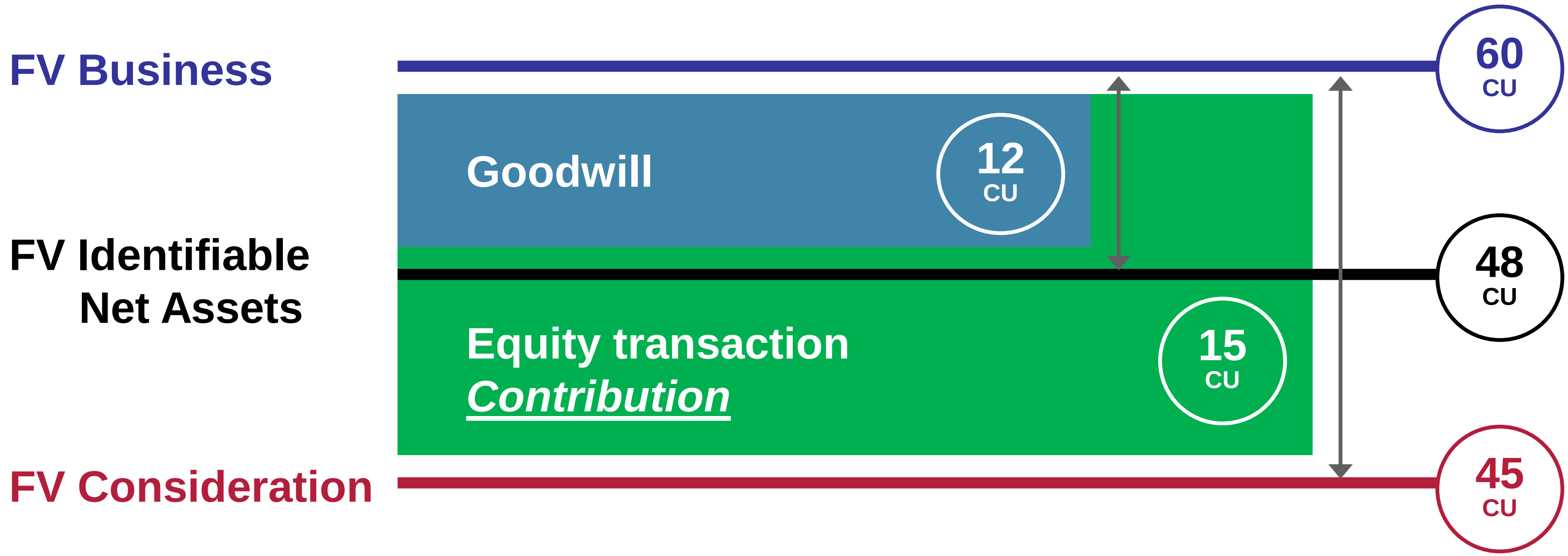
Appendix 1
Scenario ❷—debits and credits

	Full Fair Value		Ceiling		IFRS 3	
Cr Cash		52		52		52
Dr Identifiable Net Assets	48		48		48	
Dr Goodwill	12		4		4	
Cr Equity (*Contribution*)		8		-		-

Appendix 1
Scenario ❸

The fair value of the consideration transferred is <u>less</u> than the fair value of the acquired business and <u>less</u> than the fair value of the acquired identifiable net assets.

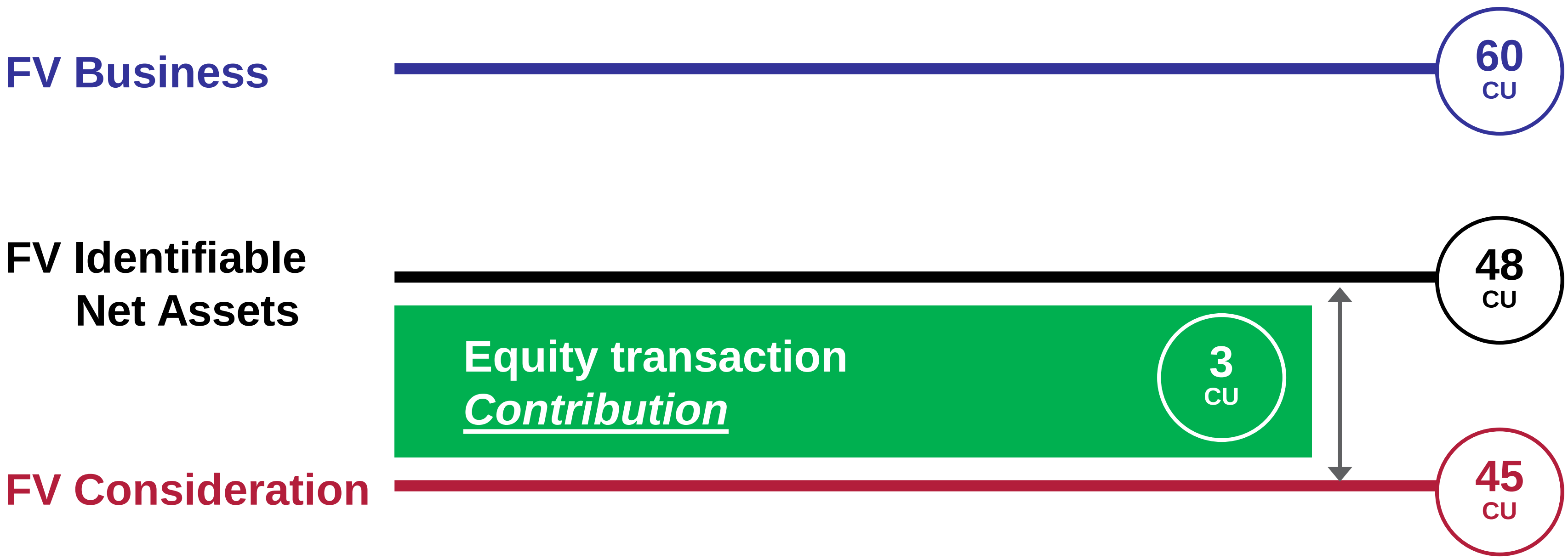
***Full Fair Value* approach**



Appendix 1
Scenario ❸

The fair value of the consideration transferred is <u>less</u> than the fair value of the acquired business and <u>less</u> than the fair value of the acquired identifiable net assets.

Ceiling approach



Appendix 1
Scenario ❸—debits and credits

		Full Fair Value		Ceiling		IFRS 3	
Cr	Cash		45		45		45
Dr	Identifiable Net Assets	48		48		48	
Dr	Goodwill	12		-		-	
Cr	Equity (*Contribution*)		15		3		-
Cr	Gain on a bargain purchase	-	-	-	-		3

Appendix 2
Board's tentative decisions to date

IFRS

Appendix 2
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 2

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 2
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 2
Board's tentative decisions to date

Feb 2018

Starting point in the analysis

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.