

STAFF PAPER

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Project	Business Combinations under Common Control		
Paper topic	Update on the staff's approach		
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Purpose of this paper

1. In March 2019, the International Accounting Standards Board (Board) discussed an overview of the staff's approach to developing measurement approaches for transactions within the scope of the Business Combinations under Common Control project (transactions within the scope of the project). The session was educational and the Board was not asked to make decisions.
2. This paper:
 - (a) provides a summary of the staff's approach (paragraphs 4–13);
 - (b) provides a summary of the input on the staff's approach received to date, including the March 2019 Capital Markets Advisory Committee (CMAC) and Emerging Economies Group (EEG) meetings (paragraphs 14–20); and
 - (c) sets out next steps and asks whether the Board agrees with the approach taken by the staff (paragraphs 21–23).
3. The overview of the staff's approach will also be discussed at the April 2019 Accounting Standards Advisory Forum (ASAF) meeting. The staff will provide the Board with an oral update on the input received at that meeting.

Summary of the staff's approach

4. The Business Combinations under Common Control project focuses on the information about the transaction provided in the general purpose financial statements of the *receiving entity*. It does not consider financial statements of the transferor, transferee or the controlling party because reporting by those parties is already addressed by the existing IFRS Standards.
5. In developing the measurement approaches for transactions within the scope of the project, the staff:
 - (a) consider the guidance in the *Conceptual Framework for Financial Reporting (Conceptual Framework)*, current reporting practice and applicable guidance in various jurisdictions as well as input from the Board's consultative bodies and other interested parties; and
 - (b) focus on whether and how transactions within the scope of the project can be different from business combinations that are not under common control, on what information would be useful to various primary users of the receiving entity's financial statements and on whether the benefits of providing particular information would justify the costs of providing that information. In addition, the staff aim to avoid unnecessary complexity and to minimise structuring opportunities.
6. In principle, the staff think the following points apply if the composition of primary users of financial statements is the same for transactions within the scope of the project as for business combinations that are not under common control:
 - (a) to the extent that transactions within the scope of the project are similar to business combinations that are not under common control, the same information should be provided. Specifically, if consideration transferred in a business combination under common control reflects the fair value of the acquired interest, in principle, the acquisition method set out in IFRS 3 *Business Combinations* would provide the most useful information.
 - (b) to the extent that transactions within the scope of the project are or can be different from business combinations that are not under common control,

different or additional information may need to be provided. For example:

- (i) in some cases, consideration transferred in a business combination under common control may not reflect the fair value of the acquired interest. In those cases, in the staff's view, the accounting treatment should, in principle, aim to depict a contribution to, or a distribution from, the receiving entity's equity in addition to depicting the business combination. This view is consistent with the requirements in IFRS 3 to identify any amounts that are not part of the exchange for the acquiree, for example, a payment for future employee services, and to account for such separate transactions in accordance with applicable IFRS Standards.
- (ii) in some cases, a transaction within the scope of the project may not satisfy a description of a business combination in IFRS 3. That could be the case, for example, if a new company (NewCo) is created to issue shares to acquire a single business under common control. In those circumstances, neither the NewCo nor the acquired business can be identified as the acquirer and hence the transaction is not a business combination. Accordingly, the acquisition method may not provide useful information about such transactions.

7. This approach is consistent with the following direction provided by the Board:

- (a) at the February 2018 meeting, the Board tentatively decided to use the acquisition method set out in IFRS 3 as the *starting point* in the analysis of transactions within the scope of the project. However, the Board noted that using that starting point would not determine whether the Board would ultimately propose applying the acquisition method to all, or even to many, transactions within the scope of the project.
- (b) at the June 2018 meeting, the Board directed the staff to develop an approach based on the acquisition method for transactions that affect non-controlling shareholders (NCI) in the receiving entity but to consider whether and how that method should be modified to provide the most useful information to NCI about those transactions. The Board noted that such modifications could include, for example:

- (i) recognising any excess identifiable net assets acquired as a contribution to equity, instead of recognising that excess as a gain; or
 - (ii) recognising any excess consideration over the fair value of the acquired interest as a distribution from equity instead of including it implicitly in the initial measurement of goodwill.
8. As stated in paragraph 6, the approach described above assumes the same composition of primary users of financial statements for transactions within the scope of the project as for business combinations that are not under common control. However, if the composition of primary users is different, the conclusion about which approach would provide most useful information may be different as well. This is because, as discussed in the *Conceptual Framework*, different types of primary users may have different or even conflicting information needs.
9. Thus, the staff think that the composition of primary users of the receiving entity's financial statements in various transactions within the scope of the project may affect the conclusion about the most appropriate measurement approach for those transactions. For example, the Board *could* conclude that:
- (a) a current value approach based on the acquisition method should be required for all or some transactions that affect NCI in the receiving entity; but
 - (b) a different approach, such as a form of predecessor approach, should be required for transactions between wholly owned entities that do not affect NCI. This is because the controlling party does not need to rely on the receiving entity's financial statements for meeting its information needs. The Board could also conclude that such a different approach would be appropriate even when transactions between wholly owned entities affect lenders and other creditors in the receiving entity or are undertaken in preparation for a sale of the combined entities, for example in an initial public offering (IPO).
10. Accordingly, in developing measurement approaches for transactions within the scope of the project, the staff consider separately:

- (a) transactions that affect NCI in the receiving entity (December 2018 IASB Agenda Paper 23 *Approach for transactions that affect non-controlling interest*); and
 - (b) transactions between wholly owned entities, including:
 - (i) transactions that affect lenders and other creditors in the receiving entity (March 2019 IASB Agenda Paper 23B *Lenders and other creditors in BCUCC* and April 2019 IASB Agenda Paper 23B *Update on lenders and other creditors in BCUCC*); and
 - (ii) transactions undertaken in preparation for a sale of the combining entities, for example, in an IPO (March 2019 IASB Agenda Paper 23A *Overview of the staff's approach*).
11. A need for a conclusion different from that in IFRS 3 may arise at least for some transactions within the scope of the project not just because of differences or conflicts in the information needs of different types of primary users, but also from the application of the cost constraint discussed in the *Conceptual Framework*. This is because the benefits of providing current value information may not always justify the costs if the composition of the primary users of information about transactions within the scope of the project differs greatly from the composition of the primary users of information about business combinations that are not under common control. For example, this may be the case if the percentage of ownership held by NCI of the receiving entity in a business combination under common control is insignificant.
12. Finally, in developing measurement approaches for transactions within the scope of the project the staff also consider the relative complexity of each approach and the structuring opportunities that could arise. For example, in December 2018 IASB Agenda Paper 23 *Approach for transactions that affect non-controlling interest* the staff observed that:
- (a) requiring current value information for transactions that affect NCI except when NCI is held by the related parties of the receiving entity or of its parent would be a simple approach to articulate, to apply and to understand; and

- (b) requiring current value information for transactions that affect NCI only when the receiving entity's equity instruments are traded in a public market would arguably minimise structuring opportunities.
- 13. In developing measurement approaches for transactions within the scope of the project the staff seek to avoid unnecessary complexity and to minimise structuring opportunities—rather than eliminate complexity and eliminate structuring opportunities altogether. This is because, in the staff's view:
 - (a) a degree of complexity is unavoidable in reflecting complex economic phenomena; and
 - (b) structuring opportunities are unavoidable, unless the Board decides to require a single approach—the acquisition method set out in IFRS 3 without modifications—for all business combinations, including all business combinations under common control.

Summary of input received to date

- 14. The staff have discussed their proposed approach at multiple meetings with various interested parties, including discussing:
 - (a) information needs of NCI in the receiving entity (paragraph 15):
 - (i) with ASAF at the December 2018 and July 2018 meetings;
 - (ii) with CMAC at the March 2019 and June 2018 meetings;
 - (iii) with Global Preparers Forum (GPF) at the June 2018 meeting;
 - (iv) with EEG at the March 2019 meeting; and
 - (v) at the June 2018 IFRS Conference and the September 2018 World Standard-setters conference;
 - (b) information needs of lenders and other creditors of the receiving entity (paragraph 16):
 - (i) with ASAF at the July 2018 meeting and will further discuss it with ASAF at the April 2019 meeting;
 - (ii) with CMAC at the March 2019 and June 2018 meetings;
 - (iii) with GPF at the June 2018 meeting;

- (iv) with EEG at the March 2019 meeting; and
 - (v) at the June 2018 IFRS Conference and the September 2018 World Standard-setters conference; and
 - (c) information needs of prospective equity investors (paragraph 17):
 - (i) with ASAF at the July 2018 meeting and will further discuss it with ASAF at the April 2019 meeting;
 - (ii) with CMAC at the March 2019 and June 2018 meetings;
 - (iii) with GPF at the June 2018 meeting;
 - (iv) with EEG at the March 2019 meeting; and
 - (v) at the June 2018 IFRS Conference and the September 2018 World Standard-setters conference.
- 15. In discussing information needs of NCI in the receiving entity with various interested parties, that staff suggested that:
 - (a) in principle, a current value approach would provide the most useful information about business combinations under common control to those primary users;
 - (b) however, due to the cost constraint and structuring considerations, a current value approach should be required for some but not all transactions that affect NCI; and
 - (c) if a current value approach is required for some but not all transactions that affect NCI, requiring current value information only when equity instruments of the receiving entity are traded in a public market is a viable approach to explore.
- 16. In discussing information needs of lenders and other creditors in the receiving entity with various interested parties, that staff suggested that:
 - (a) the outcome of credit analysis would be largely unaffected by whether a current value approach or a form of predecessor approach is required for business combinations under common control; and
 - (b) there is no need to pursue a single approach that would apply both to transactions that affect NCI and those that affect lenders and other creditors but do not affect NCI in the receiving entity.

17. In discussing information needs of prospective equity investors, that staff suggested that a form of predecessor approach could be the most appropriate approach for transactions between wholly owned entities, including transactions undertaken in preparation for a sale of the combined entities, for example in an IPO.
18. Most interested parties, but not all, who commented on the staff's suggested approach set out in paragraphs 15–17 generally supported that approach. The staff will discuss input provided in detail in future papers for the Board but in summary:
 - (a) in discussing information needs of NCI of the receiving entity, most interested parties supported the use a current value approach when NCI is present in the receiving entity, in particular when NCI is 'substantive'. Some interested parties, including two CMAC members who commented on the topic, supported requiring current value information only when equity instruments of the receiving entity are traded in a public market. Other interested parties suggested that the use of a current value approach should not be restricted to those circumstances but acknowledged that distinguishing when to use a current value approach for private entities when NCI is present would be difficult.
 - (b) in discussing information needs of lenders and other creditors of the receiving entity, most interested parties, notably CMAC members, agreed that the outcome of the credit analysis would largely be unaffected by whether a current value approach or a form of predecessor approach is used to account for business combinations under common control.
 - (c) in discussing information needs of prospective equity investors, most interested parties who commented on the topic agreed that a form of predecessor approach would provide useful information about those transactions to prospective equity investors, regardless of the legal form of those transactions.
19. Some interested parties suggested other ways of developing measurement approaches for transactions within the scope of the project instead of focusing on information needs of primary users of the receiving entity's financial statements, for example, by considering whether the transaction has commercial substance. The staff agree that the substance of the transactions within the scope of the project should be

considered. In particular, as discussed in paragraph 6, that staff think it is important to consider whether the transaction satisfies the description of a business combination and whether consideration transferred reflects the fair value of the acquired interest.

20. The staff acknowledge that, from the perspective of the *controlling party*, some business combinations may have little commercial substance. However, this project focuses on the needs of the primary users of the *receiving entity's* financial statements. The staff think that all business combinations under common control have commercial substance for the receiving entity and for the primary users of its financial statements. Before the transaction, the receiving entity did not control the acquired business; after the transaction it does. Therefore, the staff think that a test based on the presence or absence of commercial substance will not provide a useful basis for distinguishing different types of business combination under common control.

Next steps and question for the Board

21. The staff plan to continue developing 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 structuring opportunities that could arise under various approaches.
22. At this meeting, the staff ask if the Board agrees that there is no need to pursue a single approach that would apply both to:
- (a) transactions that affect NCI in the receiving entity; and

- (b) transactions that affect lenders and other creditors but do not affect NCI in the receiving entity (*Agenda Paper 23B Update on lenders and other creditors in BCUCC*).

23. At future meetings, the staff will ask the Board to make decisions on:

- (a) whether a current value approach or a form of predecessor approach should be applied to:
 - (i) transactions that affect NCI in the receiving entity; and
 - (ii) transactions between wholly owned entities, including those that affect lenders and other creditors in the receiving entity and those undertaken in preparation for a sale of the combining entities, for example, in an IPO;
- (b) whether and how the acquisition method set out in IFRS 3 should be modified when applied to transactions within the scope of the project; and
- (c) how a predecessor approach should be applied.

Question for the Board

Does the Board agree with the staff's approach set out in paragraph 21? If not, what other approach to developing measurement approaches for transactions within the scope of the project should the staff explore?