International Financial Reporting Standards

Business combinations under common control (‘BCUCC’)

Accounting Standards Advisory Forum

8 December 2015

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Objective of the session

Our objectives are:

- to provide an update on the project to ASAF members, and
- to discuss how the predecessor method should be applied in order to provide most useful information.

Input from ASAF members

We seek input from ASAF members on:

- how the predecessor method should be applied in order to provide most useful information.

International Financial Reporting Standards

Project update

The views expressed in this presentation are those of the presenter,
not necessarily those of the IASB or IFRS Foundation

Research and outreach in 2015

- We seek to identify:
  - whether and when the acquisition method or the predecessor method should be applied in a BCUCC
  - how the predecessor method should be applied
- Targeted outreach with users, prepares, regulators, standard-setters and accounting firms
- Research of accounting literature and existing practice

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March 2015 ASAF meeting

- Discussed two illustrative scenarios of BCUCC that:
  - Involves existing NCI
  - Is undertaken in preparation for an IPO
- Discussed staff preliminary view that the predecessor method is most appropriate in those scenarios
- There was support from ASAF members for the predecessor method as a default method of accounting in a BCUCC; however, some ASAF members proposed considering exceptions to applying that method

Next steps

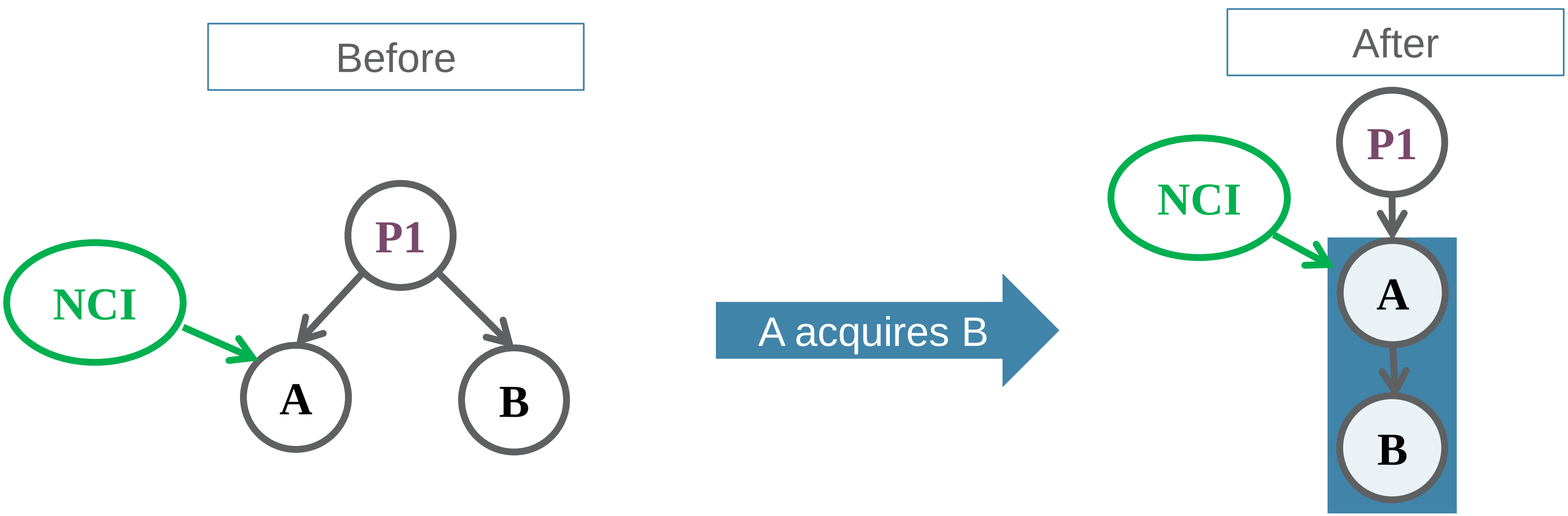
- IASB deliberations are expected to continue in 2016
- The next due process document is a Discussion Paper expected in 2016
- Eventual outcome could be a Standard on BCUCC or an amendment to IFRS 3

Illustrative examples for discussion

How should the predecessor method be applied?

Fact pattern

- Entities A and B are controlled by Entity P1. 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 P1.
- Fair value of issued shares is CU120, nominal value is CU20.
- Fair value of assets and liabilities of Entity B is CU118.



Fact pattern (continued)

- The following information is available immediately before the transaction:

	Entity P1	Entity A	Entity B	Cons A	Cons B	P1 group
Sub A	130			(130)		0
Sub B	100				(100)	0
Other net assets	200	150	110			460
Total net assets	430	150	110	(130)	(100)	460
Share capital	100	50	20	(50)	(20)	100
Retained earnings	330	100	90	(80)	(80)	360
Total equity	430	150	110	(130)	(100)	460

If the acquisition method is applied

Under IFRS 3:

- The difference between the consideration transferred and the acquired assets and liabilities is recognised as goodwill (or a gain on a bargain purchase)
- Consideration transferred is measured at fair value
- Acquired assets and liabilities are recognised at fair value
- Entities are combined from the date of the transaction and comparative information is not restated

If the acquisition method is applied

- In consolidated financial statements of Entity A:

	Entity A	Entity B	Cons B	A group
Sub B	120		(120)	0
Goodwill			2	2
Other net assets	150	110	8*	268
Total net assets	270	110	(110)	270
Share capital	170	20	(20)	170
Retained earnings	100	90	(90)	100
Total equity	270	110	(110)	270

*Per slide 9, fair value of acquired assets and liabilities is CU118.

If the predecessor method is applied

1. Where in equity to recognise the difference between the consideration and the acquired assets and liabilities?
   – Share capital or retained earnings and reserves
2. How to measure consideration in the form of shares?
   – Fair value or nominal value of the shares transferred as consideration
3. Which historical carrying amounts to use?
   – Transferee [Entity B] or its parent before the transaction [Entity P1]
4. From what date to combine the entities and how to present comparative information?
   – Always combined with restated comparatives or from the date of transaction with no restatement

If the predecessor method is applied

1. Where in equity to recognise the difference between the consideration and the acquired assets and liabilities?
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   – Always combined with restated comparatives or from the date of transaction with no restatement

Where to recognise the difference? Alternative 1

- The difference could be recognised in share capital:

	Entity A	Entity B	Cons B	A group
Sub B	120		(120)	0
Other net assets	150	110		260
Total net assets	270	110	(120)	260
Share capital	170	20	(30)*	160
Retained earnings	100	90	(90)	100
Total equity	270	110	(120)	260

* CU30 is an aggregate of CU20 share capital of Entity B and CU10 the difference between consideration transferred and acquired assets and liabilities.

Where to recognise the difference? Alternative 2

- The difference could be recognised in retained earnings:

	Entity A	Entity B	Cons B	A group
Sub B	120		(120)	0
Other net assets	150	110		260
Total net assets	270	110	(120)	260
Share capital	170	20	(20)	170
Retained earnings	100	90	(100)*	90
Total equity	270	110	(120)	260

* CU100 is an aggregate of CU90 retained earnings of Entity B and CU10 the difference between consideration transferred and acquired assets and liabilities.

Where to recognise the difference? Alternative 3

- The difference could be recognised in reserves:

	Entity A	Entity B	Cons B	A group
Sub B	120		(120)	0
Other net assets	150	110		260
Total net assets	270	110	(120)	260
Share capital	170	20	(20)	170
Retained earnings	100	90	(90)	100
Other reserve			(10)	(10)
Total equity	270	110	(120)	260

Where to recognise the difference? Discussion question 1

- Do you agree that the IASB should not prescribe where in equity the difference between the consideration in a BCUCC and the acquired assets and liabilities should be recognised? If not, what do you believe the IASB should require, and why?

Staff preliminary view: the IASB should require that the difference is recognised in equity but should not prescribe where in equity

If the predecessor method is applied

1. Where in equity to recognise the difference between the consideration and the acquired assets and liabilities?
   – Share capital or retained earnings and reserves
2. How to measure consideration in the form of shares?
   – Fair value or nominal value of the shares transferred as consideration
3. Which historical carrying amounts to use?
   – Transferee [Entity B] or its parent before the transaction [Entity P1]
4. From what date to combine the entities and how to present comparative information?
   – Always combined with restated comparatives or from the date of transaction with no restatement

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How to measure consideration? Alternative 1

- Measure at the fair value of transferred shares:

	Entity A	Entity B	Cons B	A group
Sub B	120		(120)	0
Other net assets	150	110		260
Total net assets	270	110	(120)	260
Share capital	170	20	(20)	170
Retained earnings	100	90	(90)	100
Other reserve			(10)	(10)
Total equity	270	110	(120)	260

How to measure consideration? Alternative 2

- Measure at the nominal value of transferred shares:

	Entity A	Entity B	Cons B	A group
Sub B	20		(20)	0
Other net assets	150	110		260
Total net assets	170	110	(20)	260
Share capital	70	20	(20)	70
Retained earnings	100	90	(90)	100
Other reserve			90	90
Total equity	170	110	(20)	260

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How to measure consideration? Discussion question 2

- In your view, in a BCUCC, how should consideration in the form of shares be measured, and why?

Staff preliminary view: consideration in the form of shares should be measured at fair value. However, staff note that would not affect the net amount in equity nor recognised assets, liabilities, income and expenses

If the predecessor method is applied

1. Where in equity to recognise the difference between the consideration and the acquired assets and liabilities?
   – Share capital or retained earnings and reserves
2. How to measure consideration in the form of shares?
   – Fair value or nominal value of the shares transferred as consideration
3. Which historical carrying amounts to use?
   – Transferee [Entity B] or its parent before the transaction [Entity P1]
4. From what date to combine the entities and how to present comparative information?
   – Always combined with restated comparatives or from the date of transaction with no restatement

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Which carrying amounts to use? Variation to the fact pattern

- Suppose Entity P1 acquired Entity B from a third party a few years ago and reflected assets and liabilities of Entity B at their then fair values in accordance with IFRS 3.
- Carrying amounts of assets and liabilities of Entity B in Entity P1's consolidated financial statements just before the BCUCC reflect that fair value step up [CU5].

	Entity P1	Entity A	Entity B	Cons A	Cons B	P1 group
Sub A	130			(130)		0
Sub B	100				(100)	0
Other net assets	200	150	110		5	465
Total net assets	430	150	110	(130)	(95)	465
Share capital	100	50	20	(50)	(20)	100
Retained earnings	330	100	90	(80)	(75)	365
Total equity	430	150	110	(130)	(95)	465

Which carrying amounts use? Alternative 1

- Carrying amounts in the financial statements of the transferred entity [Entity B]:

	Entity A	Entity B	Cons B	A group
Sub B	120		(120)	0
Other net assets	150	110		260
Total net assets	270	110	(120)	260
Share capital	170	20	(20)	170
Retained earnings	100	90	(90)	100
Other reserve			(10)	(10)
Total equity	270	110	(120)	260

Which carrying amounts to use? Alternative 2

- Carrying amounts in the financial statements of the parent of the transferred entity [Entity P1]:

	Entity A	Entity B	Cons B	A group
Sub B	120		(120)	0
Other net assets	150	110	5	265
Total net assets	270	110	(115)	265
Share capital	170	20	(20)	170
Retained earnings	100	90	(90)	100
Other reserve			(5)	(5)
Total equity	270	110	(115)	265

Which carrying amounts to use? Discussion question 3

- In your view, which carrying amounts should be used in applying the predecessor method in a BCUCC, and why?

If the predecessor method is applied

1. Where in equity to recognise the difference between the consideration and the acquired assets and liabilities?
   – Share capital or retained earnings and reserves
2. How to measure consideration in the form of shares?
   – Fair value or nominal value of the shares transferred as consideration
3. Which historical carrying amounts to use?
   – Transferee [Entity B] or its parent before the transaction [Entity P1]
4. From what date to combine the entities and how to present comparative information?
   – Always combined with restated comparatives or from the date of transaction with no restatement

Date of combination and comparatives Fact pattern – additional information

- Suppose Entity A acquired Entity B at the end of the reporting year.
- The following information is available about the current and preceding reporting years.

	Comparative year			Reporting year	
	Entity A	Entity B		Entity A	Entity B
Sub B				120	
Other net assets	135	100		150	110
Total net assets	135	100		270	110
Share capital	50	20		170	20
Retained earnings	85	80		100	90
Total equity	135	100		270	110
Profit or loss	8	3		15	10

Date of combination and comparatives Alternative 1

- Account for the newly created group from the date of transaction. Do not restate comparative information.

	Comparative year		Reporting year			
	Entity A		Entity A	Entity B	Cons B	A group
Sub B			120		(120)	0
Other net assets	135		150	110		260
Total net assets	135		270	110	(120)	260
Share capital	50		170	20	(20)	170
Retained earnings	85		100	90	(90)	100
Other reserve					(10)	(10)
Total equity	135		270	110	(120)	260
Profit or loss	8		15	10	(10)	15

Date of combination and comparatives Alternative 2

- Account for the newly created group as if it has always existed (or since first under common control, if later). Restate comparative information.

	Comparative year					Reporting year			
	Entity A	Entity B	Cons B	A group		Entity A	Entity B	Cons B	A group
Sub B	120		(120)	0		120		(120)	0
Other net assets	135	100		235		150	110		260
Total net assets	255	100	(120)	235		270	110	(120)	260
Share capital	170	20	(20)	170		170	20	(20)	170
Retained earnings	85	80		165		100	90		190
Other reserve			(100)	(100)				(100)	(100)
Total equity	255	100	(120)	235		270	110	(120)	260
Profit or loss	8	3		11		15	10		25

Date of combination and comparatives Alternative 2 – a variation

- Account for the newly created group as if it has always existed (or since first under common control, if later). Restate comparative information. Measure transferred shares at the nominal value.

	Comparative year					Reporting year			
	Entity A	Entity B	Cons B	A group		Entity A	Entity B	Cons B	A group
Sub B	20		(20)	0		20		(20)	0
Other net assets	135	100		235		150	110		260
Total net assets	155	100	(20)	235		170	110	(20)	260
Share capital	70	20	(20)	70		70	20	(20)	70
Retained earnings	85	80		165		100	90		190
Total equity	155	100	(20)	235		170	110	(20)	260
Profit or loss	8	3		11		15	10		25

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Date of combination and comparatives Discussion question 4

- In your view, from which date should the entities be combined in a BCUCC and how should comparative information be presented, and why?

Staff preliminary view: entities should be combined from the date of the transaction and comparative information should not be restated. However, selected information on a proforma basis could be disclosed.


individual comments
questions
comment
expressions of
individual views
comments
feedback
questions
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questions or comments
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expressions and viewpoints