

# Business Combinations under Common Control

Slide deck **1**

*Background,  
research and outreach,  
next steps*

Emerging Economies Group Meeting  
Sao Paulo, Brazil, December 2017

# Meeting agenda

**Background**

**Research and  
outreach**

**Next steps**

Slide deck ①

**Scope of  
the project**

Slide deck ②

**Methods of  
accounting**

Slide deck ③



# Disclaimer

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<b>Project</b>	<b>Business Combinations under Common Control (BCUCC)</b>		
<b>Paper topic</b>	Background, research and outreach, next steps		
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# Overview of Slide deck ①

## Content

- **Background (slides 6-9)**
- **Research and outreach (slides 11-15)**
- **Next steps (slides 17-23)**
- **Attachments**
  - Attachment 1—April 2016 AP23 *Cover paper*
  - Attachment 2—April 2016 AP23A *Method(s) of accounting for BCUCC*
  - Attachment 3—April 2016 AP23B *Application of the predecessor method*

## Objective

The objective of the session is to provide you with an update on the project, including findings from research and outreach and next steps

# Background

# Project history

Consultations with  
the Board's advisory bodies  
(ASAF, CMAC and GPF)

**2012** BCUCC project added to the research Agenda

**2014** Tentative decision on the scope of the BCUCC project

**2014-16** Research and outreach

**2016** BCUCC project confirmed on the research Agenda  
as a result of the 2015 Agenda Consultation

**2017** Clarification of the scope of the BCUCC project

# The issue

- Entities account for business combinations applying the acquisition method set out in IFRS 3 *Business Combinations*. Under that method the acquirer measures the net assets acquired at their fair values.
- **Business combinations under common control (BCUCC) are excluded from the scope of IFRS 3.** Therefore entities must apply IAS 8 and develop an accounting policy that results in useful information.
- In practice entities account for BCUCC using:
  - **the acquisition method as set out in IFRS 3**, by analogy; or
  - **the so-called predecessor method**, by reference to national GAAPs. Under that method the acquirer measures the net assets acquired at historical carrying amount; however, there is diversity in practice in how the method is applied.



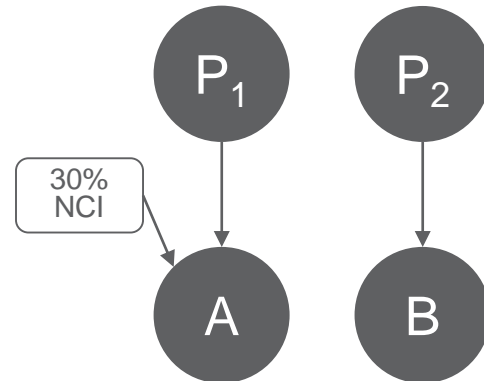
**Concerns about the diversity in practice raised by various interested parties, notably securities regulators.**

# The issue—illustration 1

## Before

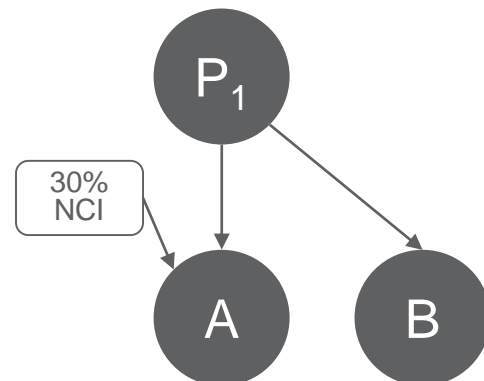
### Situation $\alpha$

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



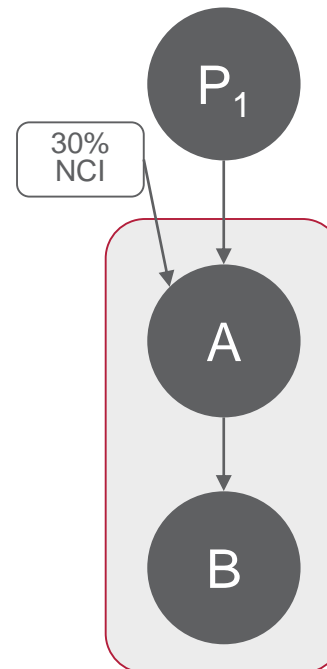
### Situation $\beta$

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



## After

### Entity A acquires Entity B



## Considerations

- ✓ **Business combination**
- ✓ **IFRS 3**
- ✓ **Acquisition method**  
B's net assets at fair value

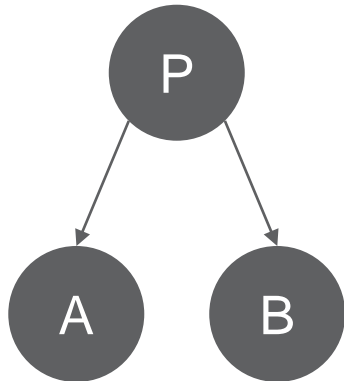
- ✓ **BCUCC**
- ✓ **Scoped out from IFRS 3**
- ✓ **Diversity in practice**  
B's net assets at fair value vs historical carrying amounts



# The issue—illustration 2

## Before

- Entity A and Entity B are controlled by Entity P;
- Entity A and Entity B are businesses.



Entity P reorganises the group to sell A and B in an IPO.

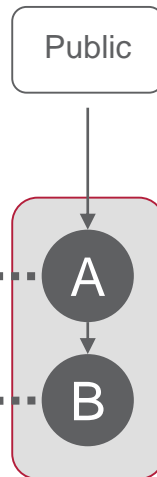
## After

### 1 If acquisition method applied:

If Entity A acquires Entity B:

historical carrying amount

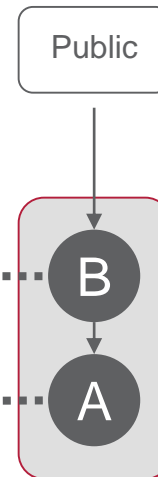
fair value



If Entity B acquires Entity A:

historical carrying amount

fair value



### 2 If predecessor method applied:

Both A's and B's net assets at historical carrying amounts (regardless of how P structures the pre-IPO acquisition).

## Considerations

**Different information** to public investors depending on:

- ✓ the accounting method applied to the pre-IPO acquisition;
- ✓ how P structured the pre-IPO acquisition— Entity A acquires Entity B vs Entity B acquires Entity A.

# Research and outreach

# Research and outreach

- The staff have performed a range of research and outreach activities with different types of interested parties from various jurisdictions, including **users of financial statements, regulators, standard-setters, preparers and accounting firms.**
- Those activities focussed on:

## Which method(s) ...

- ✓ **are** applied in practice to account for BCUCC;
- ✓ **should be** applied to provide useful information about BCUCC.

## How the predecessor method ...

- ✓ **is** applied in practice;
- ✓ **should be** applied to provide useful information about BCUCC.

Refer to Agenda Paper 23 *Cover paper* of the April 2016 IASB meeting (referenced as **Attachment 1** to Slide Deck 1 for the purpose of this meeting)

# Which method(s) (1/2)

- **There is diversity in practice in how BCUCC are accounted for and also different views on how BCUCC should be accounted for:**
  - in practice, BCUCC are typically accounted for using the predecessor method; however, the acquisition method is also used;
  - many interested parties support using the predecessor method as the ‘default’ method of accounting for BCUCC;

*cont. ...*

Refer to Agenda Paper 23A *Method(s) of accounting for BCUCC* of the April 2016 IASB meeting (referenced as **Attachment 2** to Slide Deck 1 for the purpose of this meeting)

# Which method(s) (2/2)

- *... cont.*
  - **users** of financial statements have different views on whether the predecessor method or the acquisition method would provide most useful information about BCUCC, and why;
  - some **regulators** asked the Board to consider whether the acquisition method or the so-called ‘fresh start’ accounting (ie measuring all assets and liabilities of all combining entities at fair values) may be appropriate in some circumstances;
  - some **standard-setters** suggested that different methods may be most appropriate in different circumstances (eg the ‘fresh start’ accounting in IPO scenarios); they also suggested the Board should establish a conceptual basis for determining how to report BCUCC.

Refer to Agenda Paper 23A *Method(s) of accounting for BCUCC* of the April 2016 IASB meeting (referenced as **Attachment 2** to Slide Deck 1 for the purpose of this meeting)

# Predecessor method (1/2)

- In researching and discussing application of the predecessor method the staff focussed on the following questions:

## Carrying amounts

Which predecessor carrying amount are/should be used?

## Comparatives

From which date the combining entities are/should be combined and how comparative information is/should be presented?

## Consideration

How consideration in the form of shares is/should be measured?

## Difference

Where any difference between the consideration and transferred net assets is/should be recognised?

Refer to Agenda Paper 23B *Application of the predecessor method* of the April 2016 IASB meeting (referenced as **Attachment 3** to Slide Deck 1 for the purpose of this meeting)

# Predecessor method (2/2)

- In practice, the difference between the consideration transferred and the acquired net assets is accounted for in equity.
- However, there is diversity in practice and different views with respect to:
  - which **carrying amounts** of the acquired net assets to use (those reported by the controlling party or by the transferred entity);
  - from **which date** to combine the combining entities and how to present **comparative information**;
  - how to measure **the consideration** transferred; and
  - **where in equity** to recognise the difference between the consideration transferred and the acquired net assets. Most suggested that this is a matter commonly addressed by local legislation and should not be prescribed by the Board.

Refer to Agenda Paper 23B *Application of the predecessor method* of the April 2016 IASB meeting (referenced as **Attachment 3** to Slide Deck 1 for the purpose of this meeting)

# Next steps



# Next steps

- **Finalise discussion of the scope of the project**
  - December 2017 (see **Slide deck ②**)
- **Commence discussion of the appropriate accounting method(s) for the transactions within the scope of the project**
  - December 2017 (see **Slide deck ③**)
- **Consider how the predecessor method should be applied**
  - H1 2018 (see slides 17-22 of this slide deck)

**The staff expect that the next milestone on the project is the publication of a Discussion Paper (H2 2018)**

# Application of predecessor method (1/6)

## Application questions

Carrying  
amounts



Different  
alternatives  
to explore



Comparatives



Different  
alternatives  
to explore



Consideration



Different  
alternatives  
to explore



Difference

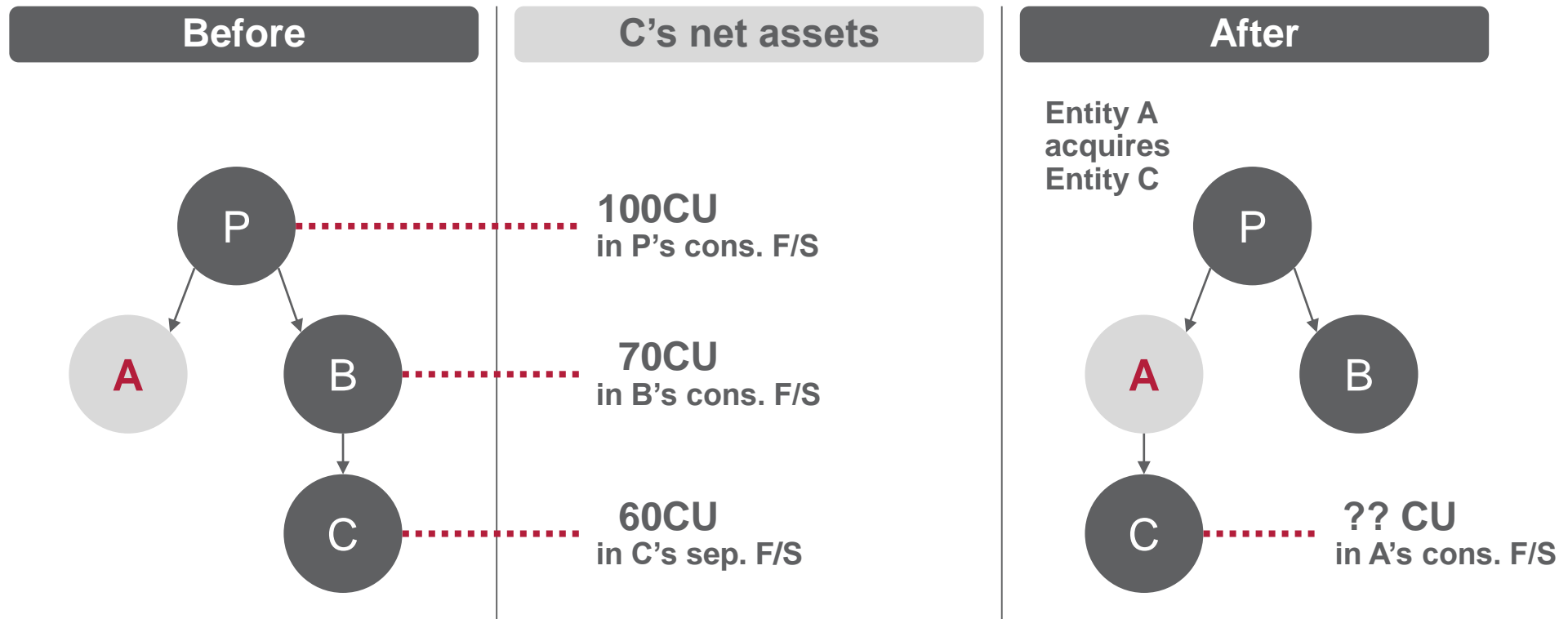


Presentation  
in equity  
generally not  
prescribed  
by the Board

# Application of predecessor method (2/6)

## Application questions—carrying amounts

Which predecessor carrying amounts should be used?



# Application of predecessor method (3/6)

## Application questions—carrying amounts

Which predecessor carrying amounts should be used?

**... those reported by the transferred entity or business**



The predecessor carrying amounts reported by the controlling party may include goodwill and fair value uplifts that arose on past acquisition of the transferred entity by the controlling party. These amounts are arguably irrelevant from the perspective of the combining entities.

**... those reported by a controlling party**



BCUCC could be directed by a controlling party. The predecessor carrying amounts reported by the controlling party reflect the perspective of that party.

# Application of predecessor method (4/6)

## Application questions—comparatives

From which date should the combining entities be combined and how should comparative information be presented?

### ... prospective approach



The new combined entity created by a BCUCC had not existed before the date on which the BCUCC took place. Financial information about such an entity before that date would be pro-forma information. However, under this approach, the structure of the transaction could affect which comparative information is provided (*see next slide*).

### ... retrospective approach

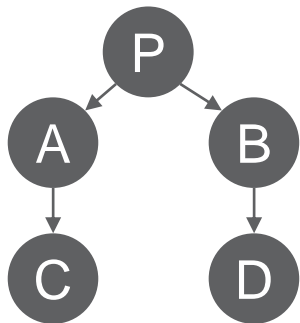


Presenting the new combined entity as if it had always been combined reflects the perspective of the controlling party. However, under this approach, the structure of the transaction would not affect which comparative information is provided.

# Application of predecessor method (5/6)

## Before

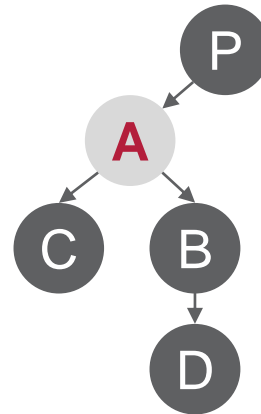
- Entity A and Entity B are controlled by entity P.
- Entity A controls Entity C while Entity B controls entity D.
- No NCI.
- Entity P wants to sell A, B, C and D in an IPO.



## After

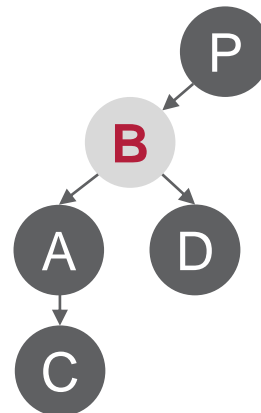
### Example 1

In preparation of the IPO, Entity A acquires Entity B.



### Example 2

In preparation of the IPO, Entity B acquires Entity A.



## Comparatives

If comparative information is **NOT** restated:

- in Example 1: users of financial statements of A-B-C-D will have **comparative information for A-C**, but not for B-D;
- in Example 2: users of financial statements of A-B-C-D will have **comparative information for B-D**, but not for A-C.

Depending on how Entity P organises the transaction, users of financial statements of A-B-C-D will receive different comparative information.

# Application of predecessor method (6/6)

## Application questions—consideration

The consideration transferred might consist of cash, shares, assets transferred by the acquirer, liabilities incurred or a combination of the above.

How to measure the consideration transferred?

... fair value

... carrying amount

**The staff note that the measurement basis adopted to measure the consideration in the form of issued shares would not affect the net amount recognised in equity nor recognised assets, liabilities, income and expenses.**

**However, the measurement basis adopted for other form of consideration could affect them.**

# Questions and comments





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