IASB Agenda ref 23C

Business Combinations under Common Control

Methods of accounting

IASB Meeting - December 2017

IFRS®

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Project	**Business Combinations under Common Control (BCUCC)**		
Paper topic	Methods of accounting		
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Objectives of this session

Education	Provide the Board with an overview of the initial considerations on the methods of accounting for transactions in the scope of the project
Feedback	Update the Board on feedback received from ASAF and EEG members on these initial considerations
Discussion	Give Board members an opportunity to ask questions and share their initial reactions on the considerations presented

⚠ **This paper is for information only and there are no questions for the Board.**

Content

- **Identifying alternatives (slides 5-8)**
- **Selecting a starting point (slides 9-14)**
- **Selecting an accounting method for particular transactions (slides 15-16)**
  - **Identifying the factors to be considered (slide 17)**
  - **Process for assessing the factors (slides 18-22)**
  - **Discussion and analysis (slides 23-35)**

Identifying alternatives

Sources of guidance

Conceptual Framework → **Assists the Board** in developing IFRS Standards based on consistent concepts

IAS 8 Hierarchy →

- **IFRS Standards** dealing with similar and related issues
- **Other** standard-setters' guidance and accounting literature
- Accepted industry **practices**

Feedback received

Identified alternatives

Acquisition method	Predecessor method	Fresh start method	Allocation of cost
Described in IFRS	**Not described in IFRS**	**Not described in IFRS**	**Described in IFRS**
Net assets of the acquired entity at fair values.	Net assets of all combining entities at carrying amounts.	Net assets of all combining entities at fair values.	Consideration transferred allocated to the acquired net assets.
Comparative information for the acquirer only.	Comparative information for the acquirer only or for all entities?	No comparative information?	Comparative information for the acquirer only.

Use as a starting point (Acquisition method, Predecessor method)

Consider as project progresses (Fresh start method, Allocation of cost)

Further observations

Acquisition method	Predecessor method
✓ Transaction **is viewed as an acquisition** from the perspective of the entity identified as **the acquirer**.	✓ Transaction **can be viewed differently** depending on which perspective is taken: ❖ **the acquirer**; ❖ **the combining entities**; or ❖ **the controlling party**.
✓ **Asymmetric** in how it treats net assets and comparative information of the combining entities.	✓ **Not necessarily asymmetric** in how it treats net assets and comparative information of the combining entities.

Selecting a starting point

Selecting an accounting method

Which method(s)
should be applied to transactions in the scope of the BCUCC project?

Identify a starting point

single method
for all transactions within the scope?

different methods
for different transactions?

how to chose which method to apply to which transactions?

Different methods only if:

- the method used in each case produces the most useful information in that case; and
- unambiguous boundaries could be set to distinguish when one method is to be applied instead of another.

Approach ➊—start with acquisition method

Acquisition method as the starting point

Are the transactions in the scope of BCUCC project substantially **different** from business combinations **not** under common control?

Staff preliminary view

	NO	YES, ALL	YES, SOME
One or more methods?	ONE	more than ONE?	more than ONE!
Which method(s)?	ACQUISITION METHOD	METHOD(s) ≠ ACQUISITION METHOD	METHOD(s) + ACQUISITION METHOD
Further questions?	none	which METHOD(s)?	which METHOD(s)? TRANSACTIONS?

Approach ❷—start with predecessor method

Predecessor method as the starting point

- **IFRS 3 excludes BCUCC from its scope**. Accordingly, some argue that the acquisition method set out in IFRS 3 is not an appropriate starting point.
- **BCUCC are different** from business combination not under common control in that **there is no change in ultimate control** over the transferred business(es).
- Given the **continuity of control**, some argue that it would normally be appropriate to **retain carrying amounts** (predecessor method).
- However, using **fair values** for the transferred business(es) can provide more useful information **in particular circumstances** (eg when the change in the ownership interest in the transferred business is significant).

Approach ❶ and ❷—implications

different methods → **how to chose which method to apply to which transactions?**

Factors

Regardless of the starting point, the same question needs to be answered: **when is each method appropriate?**

Transactions in the scope of the BCUCC project

Method considered as a starting point

App. ➀ **Acquisition method**

App. ➁ **Predecessor method**

Different method(s)

Feedback & discussion

- Staff will provide an **oral update on feedback** received from ASAF and EEG members on **the approaches** illustrated in the previous slides (Approach➊—acquisition method as a starting point *versus* Approach➋—predecessor method as a starting point).
- **Do Board members have any questions and/or initial reactions?**

Selecting an accounting method for particular transactions

Overview

Step 1	Step 2	Step 3
Identify factors to be considered in selecting an accounting method for particular transactions	**Decide on a process for assessing the impact of each factor on selecting an accounting method**	**Bringing it all together: consider each factor identified in Step 1 applying the assessment process described in Step 2**
Slide 17	*Slides 18-22*	*Slides 23-35*

Step 1—identify factors to be considered

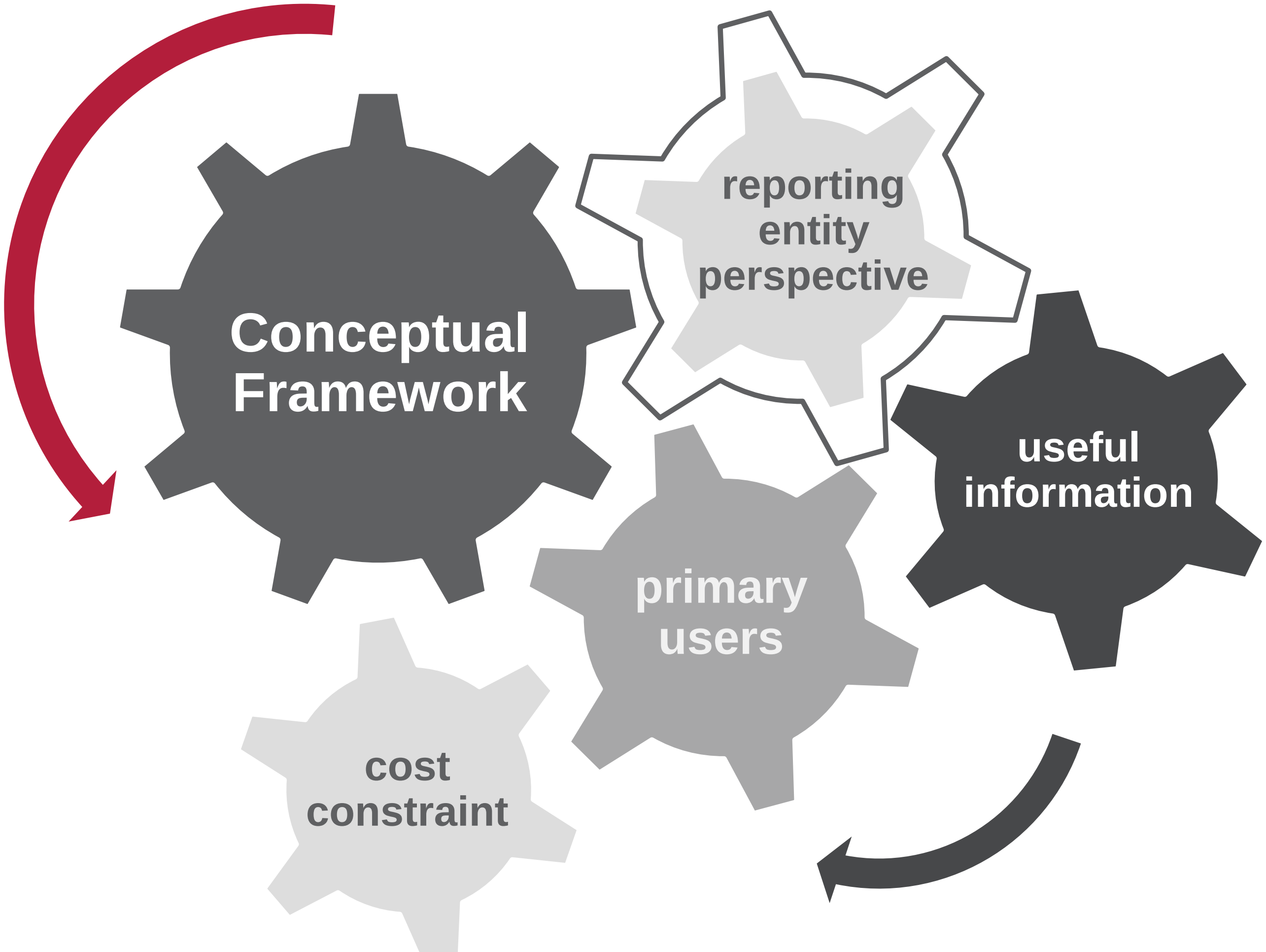
Other standard-setters' requirements

Published guidance on BCUCC

Feedback from outreach and discussion

- Decision making process
- Purpose of the transaction
- Consideration
  - Pricing of the consideration
  - Form of the consideration
  - Evidence of fair value
- Commercial substance
- …

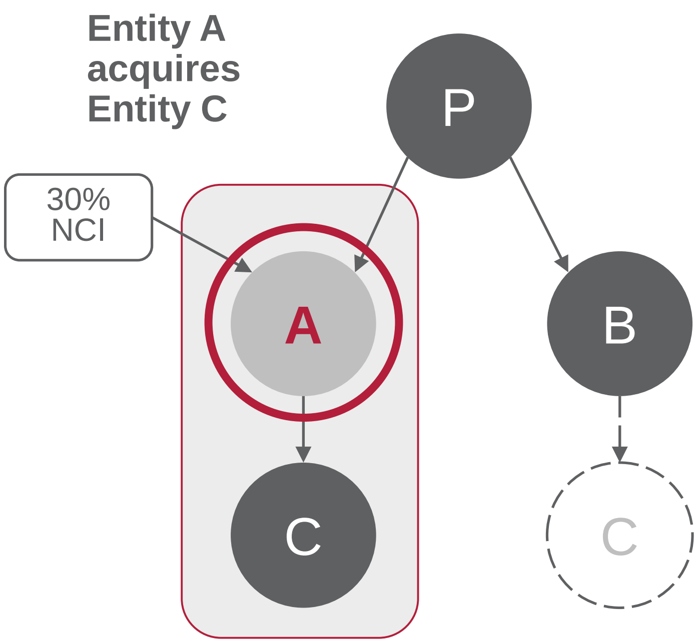
Step 2—process for assessing the factors



Refer to the guidance in the ***Conceptual Framework***.

Step 2 | Reporting entity

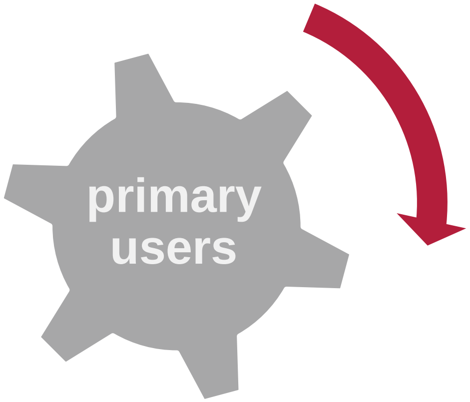
Financial statements provide information about transactions and other events **viewed from the perspective of the reporting entity**.
(Paragraph 3.9 of the *Conceptual Framework* ED)



In the **BCUCC** project, we **focus:**

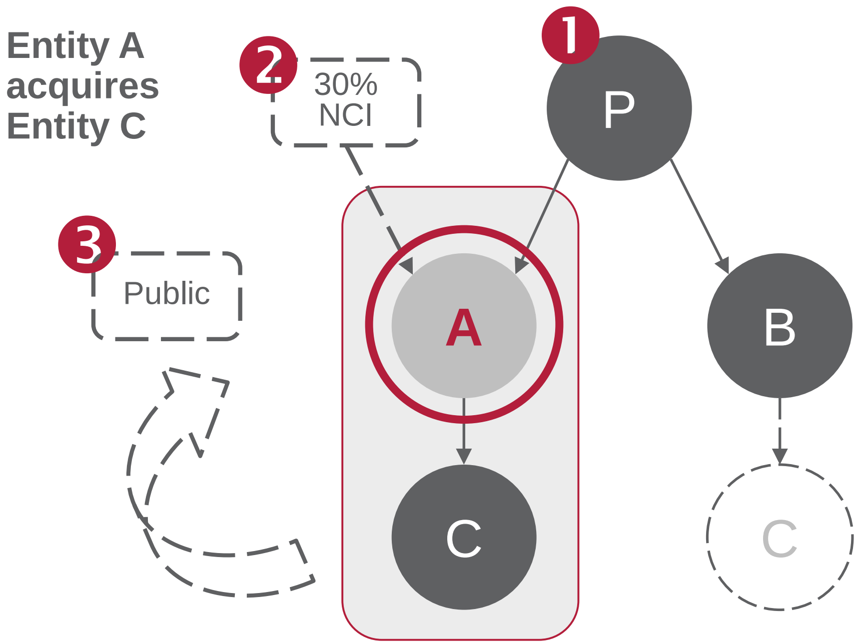
- on the **perspective of the combining parties**;
- **NOT on the controlling party's** perspective;
- **NOT on the transferring party's** perspective.

Step 2 | Primary users



Primary users of financial statements are potential and existing investors, lenders and other creditors.
(Paragraph OB5 of the *Conceptual Framework*)

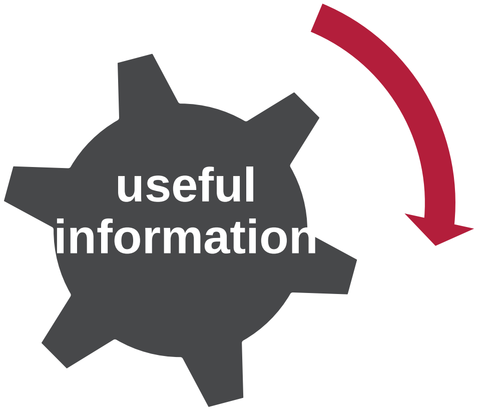
In a transaction within the scope of the BCUCC project, primary users include:



1. **controlling party(ies)**;
2. **non-controlling interest**;
3. **potential investors** in a prospective **IPO**;
4. **lenders** and **other creditors**.

In the BCUCC project, we focus on external parties
(see slide 23).

Step 2 | Useful information



The objective of general purpose financial reporting is to provide financial **information** about a reporting entity that is **useful** to the primary users of the entity's financial statements in making decisions relating to providing resources to the entity.
(Paragraph OB2 of the *Conceptual Framework*)

useful

relevant

faithfully represent the substance

comparable

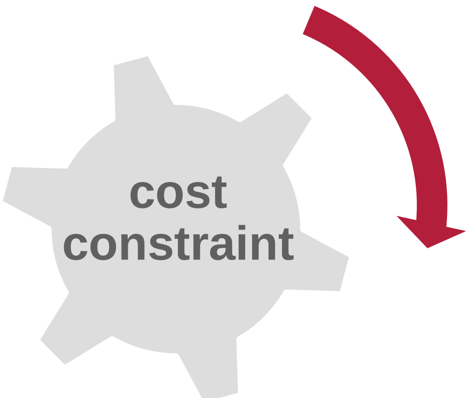
verifiable

timely

understandable

When selecting an accounting method, it is important to **consider the information that the method will produce in both the statement of financial position and the statement(s) of performance of the reporting entity** *(see slide 7).*

Step 2 | Cost constraint



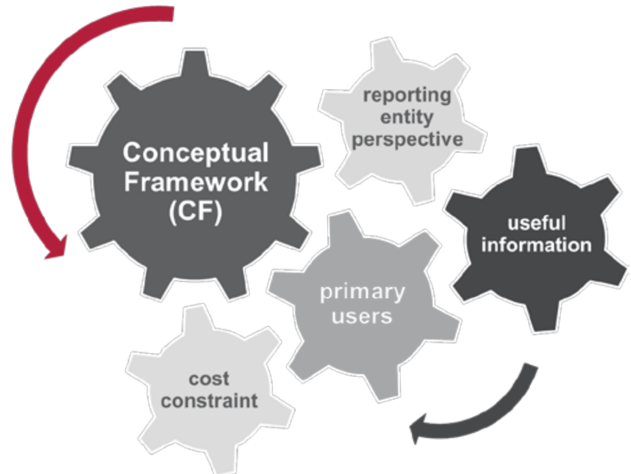
Cost may constrain the selection of an accounting method: in selecting an accounting method it is important to consider **whether the benefits** of the information provided to users of financial statements will **outweigh the costs** of providing and using that information.
(Paragraph QC35 of *Conceptual Framework*)

	Acquisition method	Predecessor method
Cost constraint	Fair values may not be readily available and entities may be required to perform business valuation (often, no observable fair value inputs): **more costly and time consuming.**	Carrying amounts are readily available: **easier and faster to apply and does not require keeping two sets of accounting records.**

Step 3—discussion and analysis

Identified factors

- **Decision making process**
- **Purpose of the transaction**
- **Consideration**
- **Commercial substance**
- **…**



How to assess factors

In the BCUCC project we focus on external parties, rather than parties that have access to information without relying on the reporting entity's financial statements

Which method would provide the most useful information for the primary users of the reporting entity's financial statements, at a cost that can be justified by the benefits of that information?

Step 3—discussion and analysis

- For **each factor** the staff will provide an **oral update on feedback** received from ASAF and EEG members on **whether and how** the factor **influences the decision about which method should be applied** to a particular transaction, and why.

Step 3 | Decision making process (1/2)

Decision making process

What do we mean?

- Some transactions may be initiated and negotiated by the combining entities which may also involve a formal tender process.
- Other transactions may be initiated and directed by the controlling party without any party to the combination being involved in the decision-making process.
- In some cases, even if the transaction is initiated by the combining parties, the controlling party approves the combination and/or determines the terms of the transaction.

Step 3 | Decision making process (2/2)

Has the transaction been negotiated by the combining entities or directed by the controlling party?

Combining entities

Controlling party

Which method would provide most useful information for the primary users of the reporting entity's financial statements, at a cost that can be justified by the benefits of that information?

- NCI
- Investors in IPO
- Lenders & creditors
- Controlling party

feedback & discussion

feedback & discussion

Step 3 | Purpose of the transaction (1/2)

Purpose

What do we mean?

A transaction might be conducted for the **benefit of**:

- **the combining entities** (eg a vertical integration—a transaction brings the reporting entity additional distribution channels for its products);
- **the controlling party and/or other entities controlled by that controlling party** (eg a transaction conducted for tax efficiency purposes for the group).

The combining entities' **existing activities** and **how these activities are managed** may help assessing the purpose of the transaction (eg activities that can efficiently be integrated).

Step 3 | Purpose of the transaction (2/2)

Does the transaction mainly benefit the combining entities or the controlling party?

Combining entities	Controlling party

Which method would provide most useful information for the primary users of the reporting entity's financial statements, at a cost that can be justified by the benefits of that information?

	Combining entities	Controlling party
NCI Investors in IPO Lenders & creditors Controlling party	feedback & discussion	feedback & discussion

Step 3 | Consideration (1/4)

Consideration

What do we mean?

- **Pricing of the consideration**—the consideration transferred in the transaction is determined using the same assumptions that market participants would use when pricing the transferred business(es) if those market participants act in their economic best interest.
- **Form of the consideration** (shares, cash, assets, debt …).
- **Evidence of fair value**—the fair value of the consideration is supported by independent evidence such as:
  - independent appraisals/valuations by appropriately qualified parties that are not related to the combining entities;
  - comparable recently quoted market prices, in an open and unrestricted market;
  - comparable independent bids on the same transaction; or
  - comparable amounts of similar transactions actually undertaken with unrelated parties.

Step 3 | Consideration (2/4)

Is the consideration determined using the same assumptions that market participants would use?

YES

NO

Which method would provide most useful information for the primary users of the reporting entity's financial statements, at a cost that can be justified by the benefits of that information?

- NCI
- Investors in IPO
- Lenders & creditors
- Controlling party

YES: feedback & discussion

NO: feedback & discussion

Step 3 | Consideration (3/4)

Has the consideration been transferred in a form other than shares?

YES	NO
feedback & discussion	feedback & discussion

Which method would provide most useful information for the primary users of the reporting entity's financial statements, at a cost that can be justified by the benefits of that information?

- NCI
- Investors in IPO
- Lenders & creditors
- Controlling party

Step 3 | Consideration (4/4)

Can the fair value of the consideration be supported by independent evidence?

YES	NO

Which method would provide most useful information for the primary users of the reporting entity's financial statements, at a cost that can be justified by the benefits of that information?

- NCI
- Investors in IPO
- Lenders & creditors
- Controlling party

YES	NO
feedback & discussion	feedback & discussion

Step 3 | Commercial substance (1/2)

Commercial substance

What do we mean?

- Significant changes in the reporting entity cash flows as a result of the transaction. This concept is already described in IFRS Standards (IAS 16.24 and IAS 38.46).
- The assessment focusses on the combining entities' cash flows, not on the overall cash flows of all entities controlled by the controlling party.

Step 3 | Commercial substance (2/2)

Does the transaction have commercial substance for the combining entities?

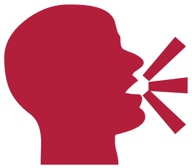
YES	NO

Which method would provide most useful information for the primary users of the reporting entity's financial statements, at a cost that can be justified by the benefits of that information?

- NCI
- Investors in IPO
- Lenders & creditors
- Controlling party

YES	NO
feedback & discussion	feedback & discussion

Step 3—feedback & discussion



- The staff will provide an **oral update on feedback** received from ASAF and EEG members on whether there are any **additional factors** that should be considered.
- **Do Board members have any questions and/or initial reactions?**

Thank you