STAFF PAPER

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Prepared for the Global Preparers Forum Meeting

Project	**Business Combinations under Common Control**		
Paper topic	Project update		
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The purpose of the session

1. At this session, the staff will:

   (a) provide an overview of the results of the research and outreach activities performed by the staff on business combinations under common control since the International Accounting Standards Board (the Board) made a tentative decision on the scope of the research project;

   (b) discuss the staff's preliminary views on reporting business combinations under common control;

   (c) seek initial reactions of Global Preparers Forum (GPF) members on the staff's preliminary views; and

   (d) set out the next steps of the Business Combination under Common Control project.

Background

2. Business combinations under common control, including those undertaken in preparation for initial public offerings (IPO), are excluded from the scope of IFRS 3 *Business Combinations*. In the absence of specific accounting requirements, entities are required to develop and apply an accounting policy that results in relevant information that faithfully represents those transactions. In

doing that, entities use the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and consider the requirements of IFRS Standards dealing with similar and related issues or the recent pronouncements of other standard-setting bodies and other accounting literature. As a result, in practice, entities account for business combinations under common control using:

(a) the ‘acquisition method’ as set out in IFRS 3 (by analogy); or

(b) the so-called ‘predecessor method’ (by reference to national GAAPs).

However, due to the different requirements in national GAAPs, there are differences in how the predecessor method is applied in practice.

3. Various interested parties, notably securities regulators, have raised concerns about the diversity in practice in accounting for business combinations under common control and have asked the Board to provide guidance in this area. This has been a particular concern for emerging economies.

4. In June 2014, the Board discussed the scope of the project on business combinations under common control and tentatively decided that the project should consider:

(a) business combinations under common control that are currently excluded from the scope of IFRS 3;

(b) group restructurings; and

(c) the need to clarify the description of business combinations under common control, including the meaning of ‘common control’.

5. Since the scope of the project was tentatively agreed by the Board, 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:

(a) the method(s) that:

(i) *are* applied in practice to account for business combinations under common control;

(ii) interested parties think *should be* applied to provide useful information about business combinations under common control;

(b) how the so-called predecessor method:

(i) *is* applied in practice; and

(ii) interested parties think *should be* applied to provide useful information about business combinations under common control.

6. In researching and discussing application of the predecessor method with interested parties, the staff focussed on the following questions:

(a) which predecessor carrying amounts are/should be used:

(i) those recognised by the transferred entity or business; or

(ii) those recognised by the controlling party;

(b) how consideration in the form of shares is/should be measured, and where in equity any difference between consideration and transferred net assets is/should be recognised; and

(c) from which date the combining entities are/should be combined and how comparative information is/should be presented:

(i) from the date on which the business combination under common control took place (with no restatement of comparative information); or

(ii) as if the combining entities had always been combined (with restatement of comparative information).

Overview of the results of research and outreach activities

7. The feedback received by the staff from various interested parties indicates that business combinations under common control are common in many jurisdictions, especially business combinations under common control in connection with an IPO. Many interested parties, including users of financial statements, believe that the Board should provide guidance on how to account for business combinations under common control.

8. Many interested parties, other than users of financial statements, support using the predecessor method as a default method of accounting for business combinations under common control. Users of financial statements have different views on whether the predecessor method or the acquisition method would provide most useful information about business combinations under common control, and why.

9. In practice, business combinations under common control are typically accounted for using the predecessor method. However, the acquisition method is also used in some jurisdictions.

10. There is diversity in practice in how the predecessor method is applied. There are also different views on how the predecessor method should be applied.

11. In particular, there is diverse practice and there are diverse views about which carrying amounts should be used—those recognised by the controlling party or those recognised by the transferred entity. There are also diverse requirements in national GAAPs and local guidance reviewed by the staff, and different approaches are generally accepted in the guidance published by accounting firms.

12. There is also diverse practice in determining where within equity to recognise any difference between consideration and transferred net assets. However, most interested parties participating in the outreach agreed with the view that the Board should not prescribe where in equity any such difference should be recognised and how consideration in the form of shares should be measured in applying the predecessor method.

13. Most interested parties who commented on the date of business combinations under common control and presentation of comparative information stated that, in practice, they typically see combining entities presented as if they had always been combined and comparative information presented on that basis. In some jurisdictions, combining entities from the date of the business combination under common control with no restatement of comparative information is also observed.

14. Most regulators who provided their view on the date of business combinations under common control and presentation of comparative information agreed with the view that a business combination under common control should be accounted for on the date on which it takes place and comparative information should not be

restated. Standard-setters who commented on that question expressed mixed views.

15. Some standard-setters emphasised that the Board should establish a conceptual basis for accounting for business combinations under common control and that such a conceptual basis would determine both *which* method should be applied and *how* any particular method should be applied.

16. The scope of the research and outreach activities performed by the staff and the results of those activities are discussed in detail in Agenda Papers 23-23B for the April 2016 Board meeting.

The staff's preliminary views

Method(s) of accounting for BCUCC

17. In the light of the results of the research and outreach to date, the staff think that the following broad approaches could be explored if the Board were to decide to proceed with a Discussion Paper on business combinations under common control:

    (a) Approach 1—apply the predecessor method to *all* business combinations under common control and group restructurings; and

    (b) Approach 2—apply the predecessor method as the default method to business combinations under common control and group restructurings *except* for transactions that exhibit particular characteristics (for example, those that exhibit characteristics of an arm's-length transaction); apply the acquisition method set out in IFRS 3 to transactions that exhibit those characteristics.

18. The staff think that the main advantages of Approach 1 are its simplicity and that it would provide consistent information about business combinations under common control and group restructurings. Approach 2 could arguably provide information that is most useful for a particular type of transaction and achieve better comparability for transactions with similar economic characteristics. That is, business combinations under common control that exhibit characteristics of

business combinations that are *not* under common control would be accounted for in the same way as those transactions.

19. However, the staff do not think that it is possible to define in a meaningful way a subset of business combinations under common control to which the acquisition method should be applied. The staff think that any such distinction:

    (a) would either be arbitrary and not achieve better comparability between similar transactions compared to Approach 1; or

    (b) would be imprecise, require the exercise of judgement in practice and could result in inconsistent application.

20. Nevertheless, the staff think that both approaches have merit and should be explored.

21. The staff do not think that applying the acquisition method set out in IFRS 3 to all business combinations under common control and group restructurings, or applying that method as the default method except for when specified conditions are met, would result in the most useful information. This is because business combinations under common control and group restructurings *could* exhibit economic characteristics that are very different compared to business combinations that are not under common control. Specifically, they could be undertaken for different reasons and on different terms compared to arm’s length transactions between third parties. In those cases, the staff do not think that measuring consideration and transferred net assets at fair value and recognising goodwill or gain would faithfully represent those transactions.

22. The staff acknowledge that fair value information about such transactions could also be useful. However, the staff think that fair value information could be provided via disclosure.

Application of the predecessor method

23. Arguably, there is a conceptual interaction between aspects of the predecessor method. Specifically:

    (a) using the predecessor carrying amounts reported by the controlling party and treating the combining entities as if they had always been combined (including restating comparative information) provides information from the perspective of the controlling party;[1] while

(b) using the predecessor carrying amounts reported by the transferred entity and treating the combining entities as combined from the date on which the business combination under common control took place (with no restatement of comparative information) provides information from the perspective of the combining entities.

24. The staff think that an entity's financial statements should reflect the perspective of that entity. Accordingly, the staff continue to think that, in applying the predecessor method, the combining entities should be treated as combined from the date on which the business combination under common control took place and that comparative information should not be restated. The staff also think that the carrying amounts used in applying the predecessor method should be those reported by the transferred entity. The staff do not think that the carrying amounts recognised by the controlling party, including any goodwill that might have arisen on past acquisition of the transferred entity by that controlling party, are relevant from the perspective of the combining entities.

25. The staff also think that, within the context of applying the predecessor method, the Board should not prescribe:

(a) where in equity to recognise any difference between consideration in business combinations under common control and transferred net assets; and

(b) how to measure consideration in the form of shares.

Question for GPF members
Do you have any questions or comments on the staff preliminary views set out in paragraphs 17-25?

[1] To be internally consistent, such an approach should arguably require using the predecessor carrying amounts recognised by the controlling party for all combining entities (ie the transferee and the transferred entity).

Next steps

26. The Board's 2015 Agenda Consultation confirmed the importance and urgency of providing guidance on business combinations under common control. Accordingly, as discussed in the November 2016 *Feedback Statement on the 2015 Agenda Consultation*, the Board decided to retain the project on business combinations under common control on its research agenda. Further work on the project is expected to recommence in Q2 of 2017.