STAFF PAPER

IASB meeting

Project	**Business Combinations under Common Control**
Paper topic	Application of the predecessor method

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Purpose of this paper

1. The purpose of this paper is to present to the International Accounting Standards Board® ('the Board') the results of research and outreach on how the predecessor method:
   (a) *is* applied in practice, and
   (b) *should be* applied.
2. This paper is for information only and there are no questions for the Board.

Structure of the paper

3. This paper is structured as follows:
   (a) application questions that the staff focussed on (paragraphs 4-7);
   (b) key messages (paragraphs 8-13);
   (c) feedback received on the request for information to national standard-setters (paragraphs 14-17);

(d) feedback received in other outreach activities (paragraphs 18-39); and

(e) findings from the review of relevant publications (paragraphs 40-46).

Application questions that the staff focussed on

4. 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 (BCUCC) took place (with no restatement of comparative information); or

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

5. In discussing those topics with interested parties, the staff noted that, in applying the predecessor method, measurement of consideration in the form of shares and recognition in equity of any difference between consideration and transferred net assets are both questions about presentation in equity. The staff noted that the Board generally does not prescribe particular presentation in equity. Accordingly, the staff expressed their preliminary view that the Board should not prescribe particular presentation in equity in applying the predecessor method.

6. The staff also noted that a new combined entity created by a BCUCC will not have existed before the date on which the BCUCC took place. Consequently, financial information about such an entity before that date would be information on a pro-forma basis and would not reflect the actual financial position and financial performance of that entity. Accordingly, the staff expressed their

preliminary view that the combining entities should be combined from the date on which the BCUCC took place and comparative information should not be restated.

7. The staff did not express a preliminary view on which predecessor carrying amounts should be used.

Key messages

8. The results of research and feedback from interested parties indicate that 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.

9. In particular, the research and outreach conducted by the staff indicates that 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.

10. 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 staff's preliminary 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.

11. Most interested parties who commented on the date of BCUCC 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 BCUCC with no restatement of comparative information is also observed.

12. Most regulators who provided their view on the date of BCUCC and presentation of comparative information agreed with the staff's preliminary view that a BCUCC 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.

13. Some standard-setters emphasised that the Board should establish a conceptual basis for accounting for BCUCC and that such a conceptual basis would determine both *which* method should be applied and *how* any particular method should be applied.

Request for information to national standard-setters

14. Some standard-setters responding to the staff request for information about reporting requirements for an entity that undertakes an initial public offering discussed particular aspects of how the predecessor method is applied in their jurisdictions.

15. Some respondents stated that different approaches are applied in practice in their jurisdictions:

    (a) In some cases the predecessor carrying amounts of the transferred entities are used and in other cases the predecessor carrying amounts recognised by the controlling party are used.

    (b) In some cases a BCUCC is accounted for at the date on which it takes place with no restatement of comparative information. In other cases the combining entities are presented as if they had always been combined and comparative information is presented on that basis.

16. Some respondents stated that a particular approach is applied in their jurisdictions. Those respondents typically stated that the predecessor carrying amounts recognised by the controlling party are used, the combining entities are presented as if they have always been combined and comparative information is presented on that basis. One respondent stated that the BCUCC is accounted for as if it had had taken place at the beginning of the current reporting period (as opposed to at the beginning of the comparative period).

17. One respondent stated that any difference between consideration and transferred net assets is recognised as a merger reserve (or merger deficit) in equity. One respondent stated that such a difference is recognised in additional paid-in-capital

and any remaining difference is recognised in retained earnings. One respondent stated that any such difference is recognised as goodwill or gain.

Other outreach

Feedback from standard-setters

18. The staff discussed application of the predecessor method:
    (a) at the June 2015 Asia-Oceania IFRS workshop for Standard-setters;
    (b) at the December 2015 meeting of the Accounting Standards Advisory Forum (ASAF); and
    (c) at the December 2015 meeting of the Emerging Economies Group (EEG).

19. Participants at those meetings expressed different views and reported different practices in different jurisdictions. Some noted that all approaches in applying the predecessor method present their own challenges. Some suggested that the Board should establish a conceptual basis for reporting BCUCC and that such a basis would determine both which method(s) should be applied and how any particular method should be applied.

Predecessor carrying amounts

20. Some participants expressed the view that the predecessor carrying amounts recognised by the controlling party should be used and noted that this is what they tend to see in practice. Some argued that using those amounts is appropriate because BCUCC are directed by the controlling party and accounting should reflect that party's perspective. Some noted that the transferred entity, or business, may not have prepared financial statements in accordance with the IFRS Standards, or may not have prepared any financial statements at all. Some asked the Board to consider the interaction between the predecessor method and the requirements set out in IFRS 1 *First-time Adoption of International Financial Reporting Standards.*

21. Other participants expressed the view that the carrying amounts recognised by the transferred entity should be used and noted that this is what they tend to see in

practice. Some argued that amounts recognised by the controlling party are irrelevant from the point of view of the combining entities. Some noted that the controlling party may not have prepared financial statements previously. One participant stated that in his jurisdiction many BCUCC typically occur under the control of the State.

22. Some participants stated that they see both the carrying amounts recognised by the transferred entity and the carrying amounts recognised by the controlling party used in applying the predecessor method in their jurisdictions.

23. One participant noted that outreach with users of financial statements in their jurisdiction indicated that there are different views about whether using the carrying amounts recognised by the controlling party in the financial statements of its subsidiaries provides useful information.

Presentation in equity

24. Participants reported different practices for presenting BCUCC in equity in their jurisdictions. Some stated that in their jurisdictions any difference between consideration and transferred net assets is recognised as a merger reserve or within other reserves. Others stated that such a difference is recognised in additional paid-in capital and that this is a part of the share capital.

25. However, most participants agreed with the staff's preliminary view that the Board should not prescribe:

   (a) where in equity any difference between consideration and transferred net assets should be recognised, and

   (b) how consideration in the form of shares should be measured in applying the predecessor method.

26. Some noted that presentation in equity is a legal question and that the relevant requirements differ between jurisdictions. Some suggested that the Board should consider requiring that entities follow consistent presentation of BCUCC in equity as an element of the entity's accounting policy.

Date of BCUCC and presentation of comparative information

27. Some participants agreed with the staff's preliminary view that combining entities should be combined from the date on which the BCUCC takes place, and comparative information should not be restated. They agreed that presenting combining entities as if they had always been combined would result in pro-forma information for a reporting entity that had never existed. They also noted that there can be operational challenges in preparing such pro-forma information.

28. Other participants expressed the view that combining entities in a BCUCC should be presented as if they had always been combined. Some argued that such an approach would reflect the perspective of the controlling party. Some argued that the resulting information would be most useful for users of financial statements.

29. Some stated that in their jurisdictions entities typically restate comparative information. Others stated that they see both approaches applied in practice.

Feedback from regulators

30. The staff discussed application of the predecessor method at the December 2015 European Enforcers Coordination Session (EECS).

Predecessor carrying amounts

31. Most participants commenting on the topic stated that in practice they typically see measurement that uses the carrying amounts recognised by the transferred entity. One participant stated that in practice he has seen measurement that uses the carrying amounts recognised by the controlling party.

32. Most participants expressed the view that carrying amounts of the transferred entity should be used. One participant argued that using carrying amounts recognised by the controlling party would be a form of so-called push-down accounting and did not think that such an approach is appropriate. Another participant believed that carrying amounts recognised by the controlling party would be more relevant for users of financial statements, because those amounts could be more up to date than the carrying amounts recognised by the transferred entity. However, he argued that if carrying amounts recognised by the controlling

party were used in applying the predecessor method, that approach should be used for all combining entities (ie the transferee and the transferred entity).

33. Some participants stated that they do not have a preferred approach. They noted that it is difficult to assess which carrying amounts would provide most useful information to users of financial statements. One participant suggested that if there is no clear consensus about which approach would provide most useful information to users of financial statements the Board should consider which approach is easier to apply from the preparers' perspective.

Presentation in equity

34. Participants stated that they typically see any difference between consideration and transferred net assets recognised in retained earnings or reserves. They have never seen such a difference recognised in share capital.

35. Most participants agreed with the staff's preliminary view that the Board should not prescribe where in equity to recognise any difference between consideration and transferred net assets, and should not prescribe how consideration in the form of shares should be measured. Many stated that presentation of equity is a legal matter. However, most also expressed the view that it would be least appropriate to recognise any such difference in share capital.

36. One participant asked the Board to provide some direction on where to present the effects of BCUCC within equity.

Date of BCUCC and presentation of comparative information

37. Most participants who commented on the topic agreed with the staff's preliminary view that:

    (a) combining entities should be combined from the date on which the BCUCC takes place and comparative information should not be restated; and

    (b) presenting combining entities as if they had always been combined would result in pro-forma information and stated that preparing such information could involve operational challenges.

38. Some suggested that selected information on a pro-forma basis could be required to be disclosed.

39. One participant noted that in practice they typically see combining entities presented as if they had always been combined and comparative information presented on that basis.

Research

40. The staff reviewed a sample of national GAAPs and local guidance, as well as recent publications by standard-setters and guidance published by accounting firms, in order to understand the existing and proposed requirements and guidance on applying the predecessor method.

41. Those requirements and guidance are diverse. Some national GAAPs and local guidance require the use of the carrying amounts recognised by the controlling party. Others require the use of the carrying amounts recognised by the transferred entity. There are also different requirements for where in equity to recognise any difference between consideration and transferred net assets and how to measure consideration in the form of shares. However, all national GAAPs and local requirements reviewed by the staff require presenting the combining entities as if they had always been combined and presenting comparative information on that basis.

42. The staff reviewed the findings discussed in the research report No. 33 *Critical Perspectives in Accounting for Business Combinations under Common Control* published by the Korea Accounting Standards Board in April 2013. The report states that different carrying amounts are used in applying the predecessor method in the jurisdictions that provided input for the report. In some jurisdictions, the carrying amounts recognised by the controlling party are used. In other jurisdictions, the carrying amounts recognised by the transferred entity are used.

43. The staff reviewed the proposals for the application of the so-called modified pooling of interests method in Exposure Draft 60 *Public Sector Combinations*, published by the International Public Sector Accounting Standards Board in January 2016. The Exposure Draft proposes that:

(a) the carrying amounts recognised by the combining entities are used (adjusted for any differences in accounting policies); and

(b) the transaction is recorded on the date it takes place. As a consequence, no restatement of comparative information is required under the proposals.

44. The staff reviewed a sample of guidance on applying the predecessor method published by accounting firms. Some of that guidance suggests that in applying the predecessor method, an entity could use the carrying amounts recognised by the transferred entity or the carrying amounts recognised by the controlling party. Some of that guidance suggests that it is generally most appropriate to use the carrying amounts recognised by the controlling party. Other guidance suggests that it is generally most appropriate to use the carrying amounts recognised at the level of the highest entity that has common control.

45. Some of the guidance published by accounting firms suggests that presentation in equity of any difference between consideration and transferred net assets may be influenced by the legal or regulatory requirements in a particular jurisdiction. Some of the guidance simply states that any such difference should be recognised in equity and does not provide any further detail.

46. The guidance published by accounting firms suggests that an entity has an accounting policy choice whether to combine the combining entities from the date on which the BCUCC takes place or present the combining entities as if they had always been combined and present comparative information on that basis. The selected accounting policy should be applied consistently to all similar transactions.