

IASB Agenda ref 23

Business Combinations under Common Control

Education session

IASB Meeting - September 2017

Disclaimer

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Project	Business Combinations under Common Control (BCUCC)		
Paper topic	Education session		
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Objectives of this session

Provide the Board with an overview of:



the status of the BCUCC project

the issues for the Board to consider

next steps

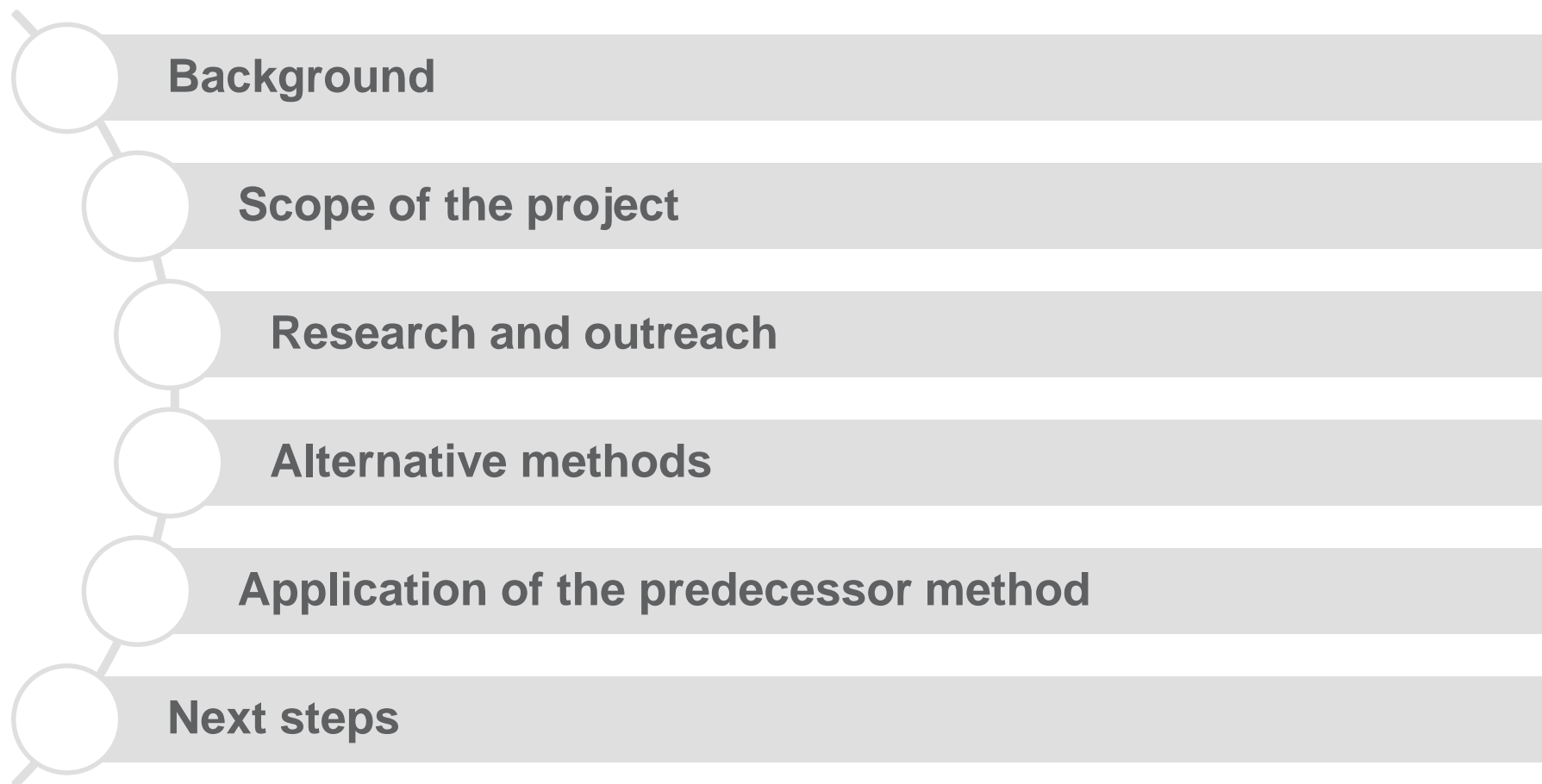


The staff expect that the next milestone on the project is the publication of a Discussion Paper (DP).



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

Content



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

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.



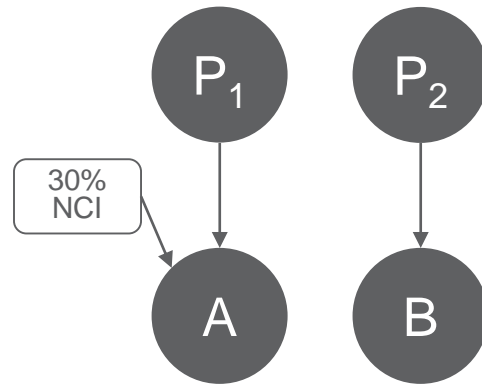
Concerns about the diversity in practice raised by various interested parties, notably security regulators.

The issue—illustration 1

Before

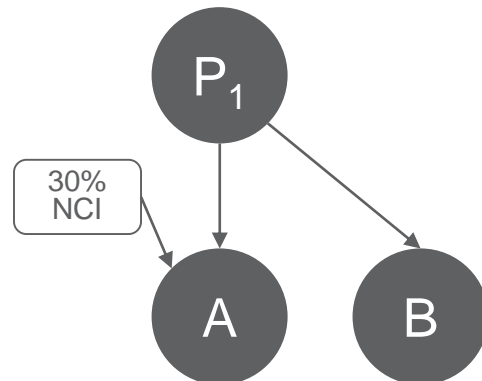
Situation α

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



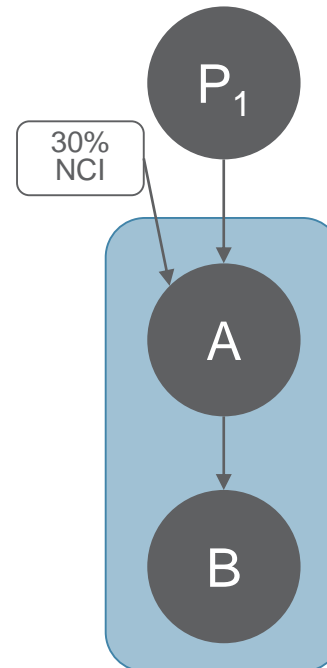
Situation β

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



After

Entity A acquires Entity B



Considerations

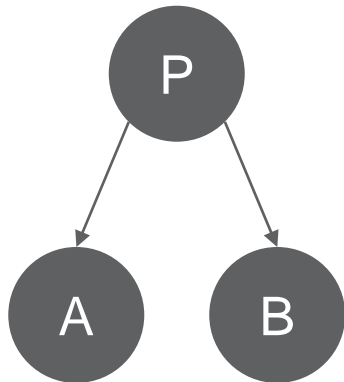
- ✓ **Business combination**
- ✓ **IFRS 3**
- ✓ **Acquisition method**
B's net assets at fair value

- ✓ **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

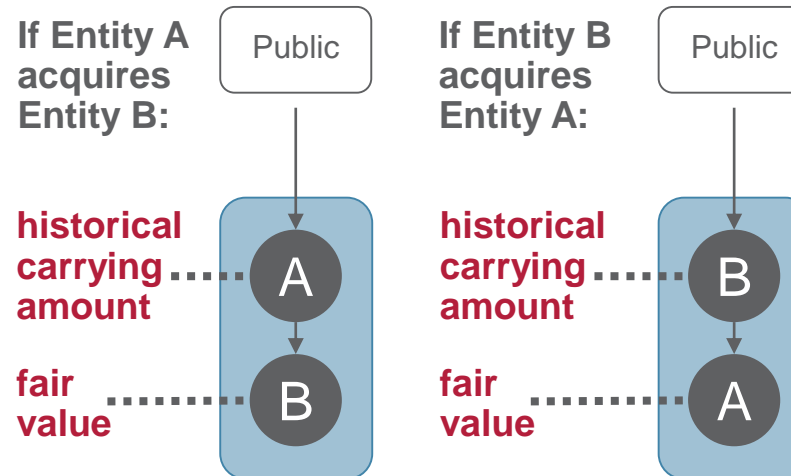
- Entity A and Entity B are controlled by Entity P;
- Entity A and Entity B are businesses.



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

After

1 If acquisition method applied:



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.



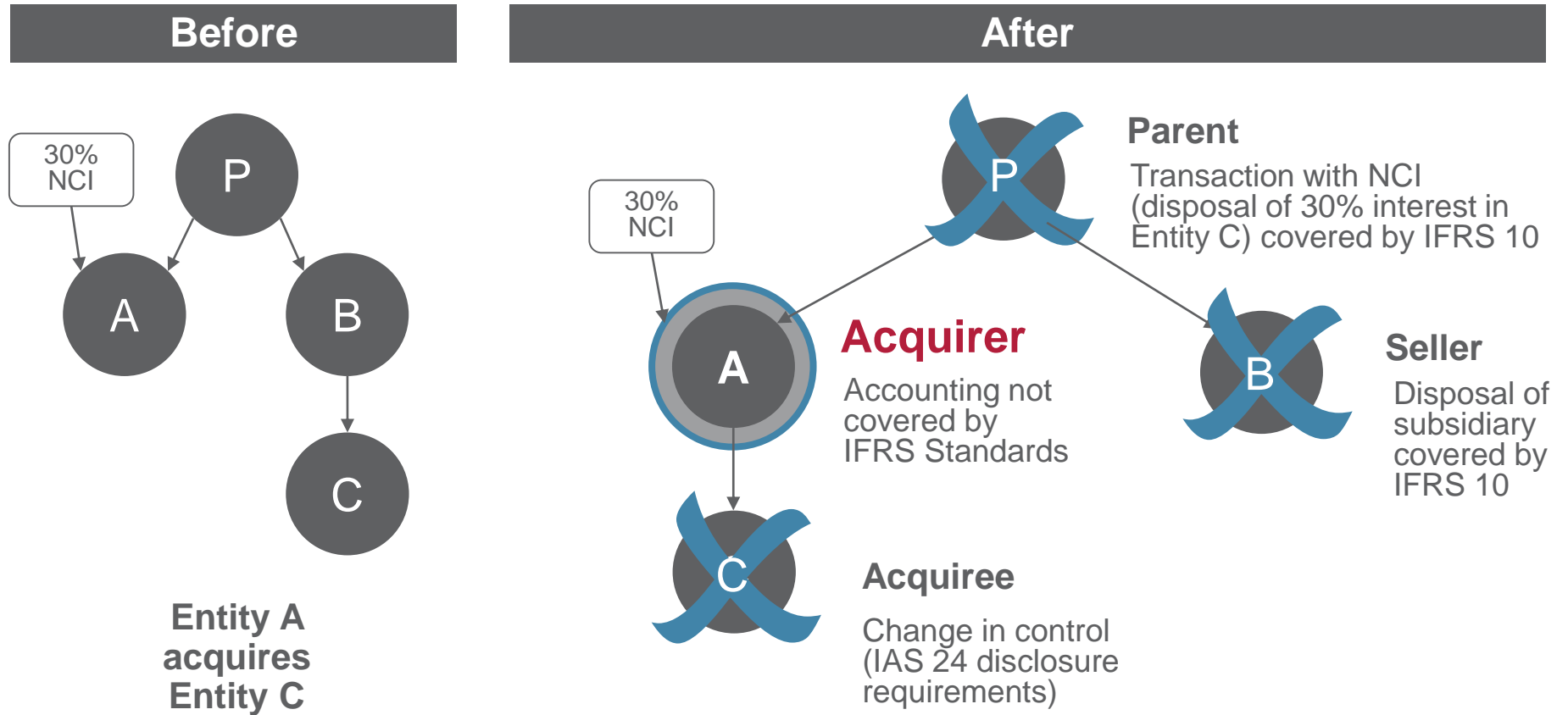
Scope

Transactions to consider

	NOT under common control	under common control
NOT involving transfer of a business	<p>Covered by applicable IFRS Standards</p> <p><i>For example</i> the transfer of assets in the acquirer's financial statements ➡ covered by IAS 16</p>	<p>Covered by applicable IFRS Standards (scope exclusion do not apply)</p> <p><i>For example</i> the acquisition of associates in the acquirer's financial statements ➡ covered by IAS 28*</p>
involving transfer of a business	<p>Covered by IFRS 3</p>	<p>Not covered by IFRS Standards</p>

* IC Agenda decision to be finalised.

Entities to consider



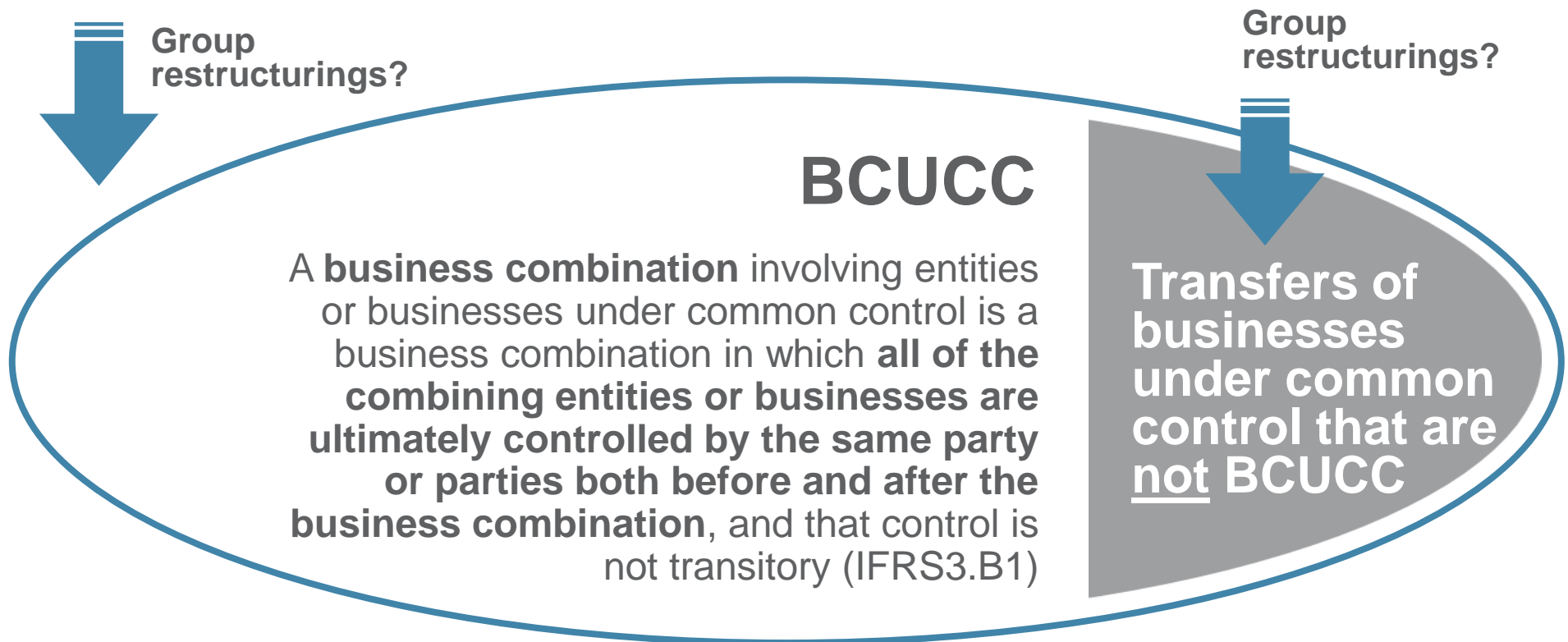
- The project focuses on the information needs of the primary users of the **acquirer's** financial statements.

Tentative decision on scope

- In June 2014, the Board discussed the scope of the BCUCC project and tentatively decided that the project should consider:
 - business combinations under common control that are currently excluded from the scope of IFRS 3;
 - group restructurings; and
 - the need to clarify the description of business combinations under common control, including the meaning of ‘common control’.
- The Board also tentatively decided to **give priority to considering transactions that involve third parties**, for example those undertaken in preparation for an IPO. This is an area of particular concern for securities regulators.

'Group restructurings'

- 'Group restructuring' is not a defined term and might be used differently by different parties.

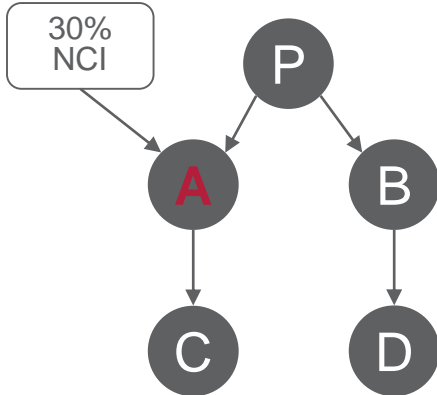


- Let's consider some examples (*see next slides*).

Scope—examples of transactions (1/2)

Before

- Entity A and Entity B are controlled by Entity P.
- Entity A controls Entity C while Entity B controls Entity D.
- There are NCI in Entity A.

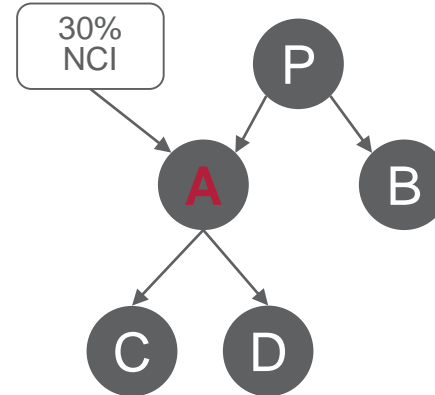


Focus on A's perspective

After

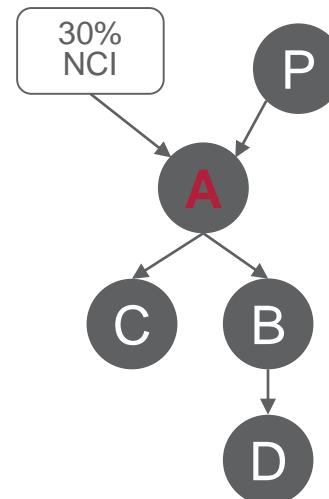
Example 1

Entity A acquires Entity D from Entity B.



Example 2

Entity A acquires Entity B from Entity P.



Scope

- ✓ BCUCC
- ✓ A's economic position changes

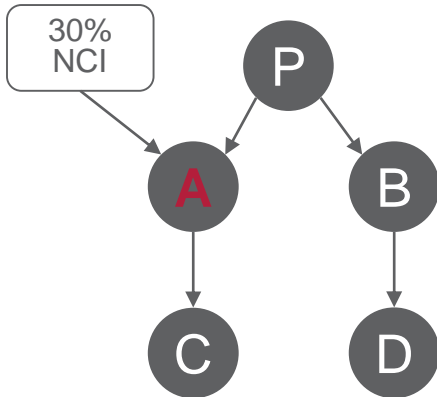
- ✓ BCUCC
- ✓ A's economic position changes

Scope—examples of transactions (2/2)

Before

Same as slide 15

- Entity A and Entity B are controlled by Entity P.
- Entity A controls Entity C while Entity B controls Entity D.
- There are NCI in Entity A.

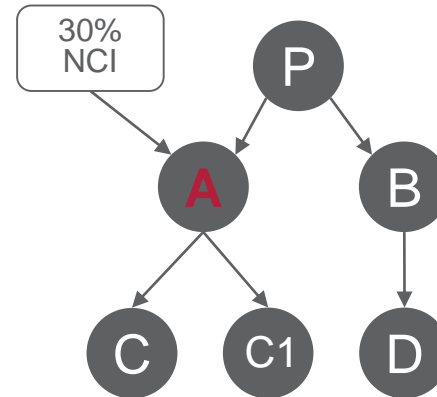


Focus on A's perspective

After

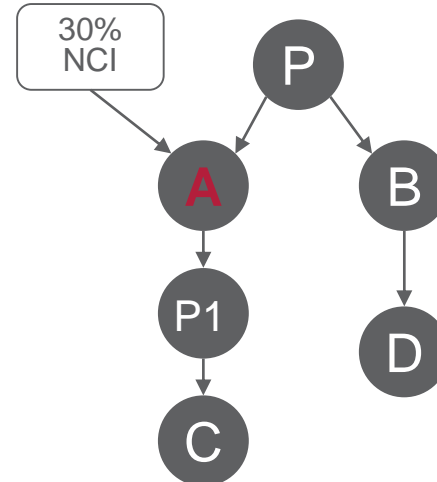
Example 3

Entity A demerges one of its business into a newly formed Entity C1 and retains control over it.



Example 4

Entity P1, a newly created entity controlled by Entity A, now controls Entity C.



Scope

- ✓ Not a BCUCC
- ✓ Does A's economic position change?

- ✓ Not a BCUCC
- ✓ Does A's economic position change?

Next steps

- Future Agenda papers on the scope of the project will discuss:
 - transactions that are included in the scope of the project (eg Example ①-② *versus* ③-④);
 - the meaning of ‘common control’;
 - related projects and decisions.

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** (including ASAF), **preparers and accounting firms**. Those activities focussed on:

Topic 1

Which method(s) ...

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

Topic 2

How the predecessor method ...

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

Refer to Agenda ref 23 *Cover paper* from April 2016
(referenced as **Attachment 1 to Agenda ref 23** for the purpose of this meeting)

Topic 1

Alternative methods

Feedback (1/2)

Topic 1

- **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, in a few cases the acquisition method is also used;
 - many interested parties support using the predecessor method as a ‘default’ method of accounting for BCUCC;

cont. ...

Refer to Agenda ref 23A *Method(s) of accounting for BCUCC* from April 2016 (referenced as **Attachment 2 to Agenda ref 23** for the purpose of this meeting)

Feedback (2/2)

Topic 1

- *... 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.

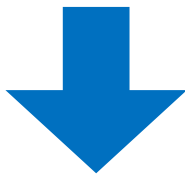
Methods to consider

Topic 1

Potential alternatives

Predecessor method

Net assets of all combining entities at historical carrying amounts



Commonly used in practice

Acquisition method

Net assets of the acquired entity at fair value



Required by IFRS 3 for business combinations

'Fresh start' accounting

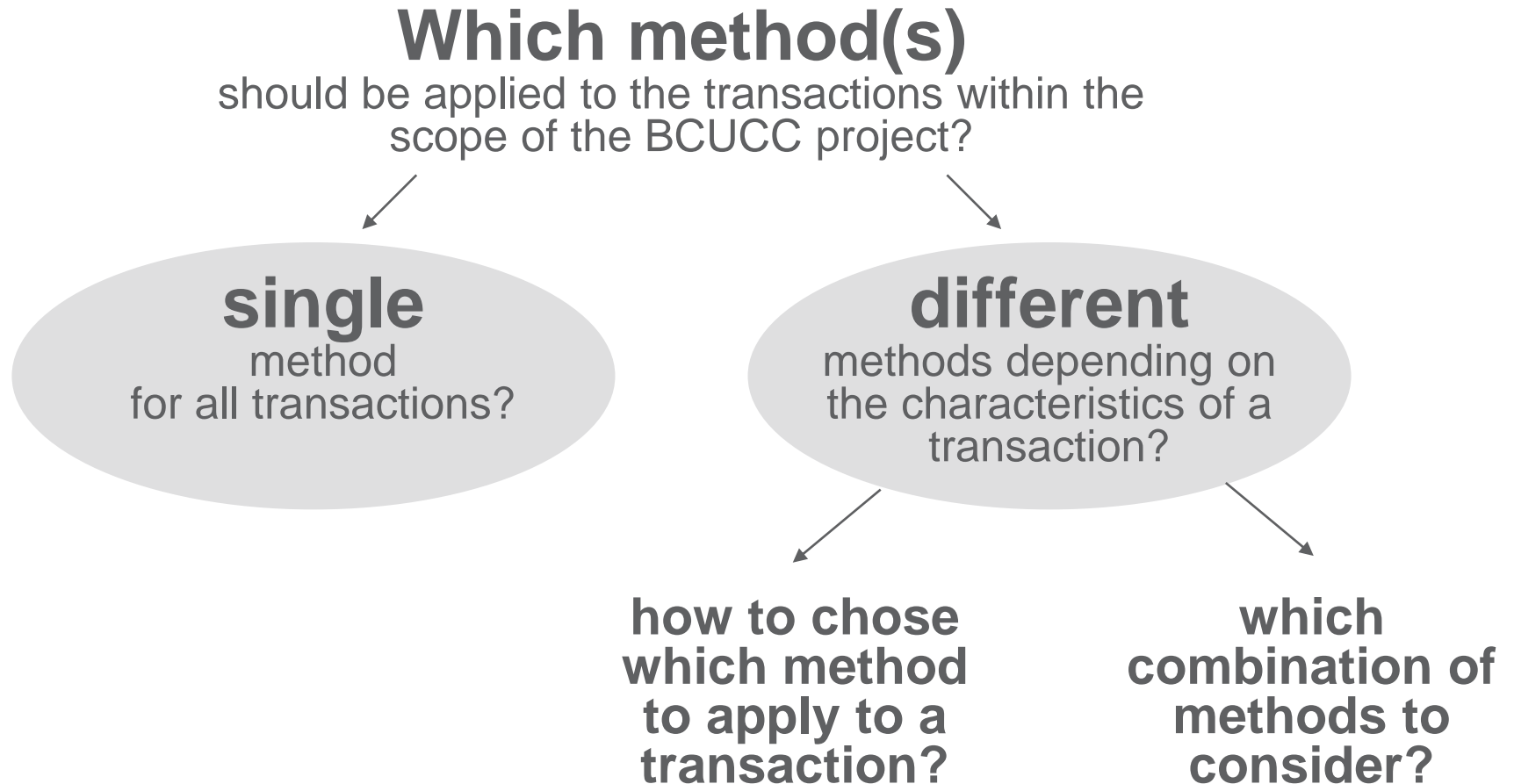
Net assets of all combining entities at fair values



No permitted under exist. IFRS Standards and initial outreach indicates little support

Different approaches (1/2)

Topic 1



Different approaches (2/2)

Topic 1

Which method(s)

```
graph TD; A[Which method(s)] --> B[single]; A --> C[different];
```

single

- ✓ simplicity;
- ✓ provides consistent information for all transactions included in the scope; but
- ✓ all transactions are accounted for in the same way regardless of their characteristics.

different

- ✓ might provide information that is most useful for a particular type of transaction;
- ✓ achieves better comparability between transactions with similar characteristics; but
- ✓ difficult to define the subsets of transactions to which the different methods are applied.

Next steps

- **Future Agenda papers on the alternative methods will discuss:**
 - which method(s) should be explored in the DP (single method or different methods, and which method(s)?);
 - how to define the subsets of transactions to which different methods are applied.

Topic 2

Application of the predecessor method

Feedback (1/2)

Topic 2

- In practice, the difference between the consideration and the acquired net assets is accounted for in equity.
- However, there is diversity in practice and different views with respect to:
 - **carrying amounts** of the acquired net assets (those recognised by the controlling party or those recognised by the transferred entity?);
 - from **which date** to combine the combining entities and how to present **comparative information**;
 - **measurement of the consideration**; and

cont. ...

Refer to Agenda ref 23B *Application of the predecessor method* from April 2016 (referenced as **Attachment 3 to Agenda ref 23** for the purpose of this meeting)

Feedback (2/2)

Topic 2

- *... cont.*
 - **where in equity** to recognise the difference between the consideration 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.

Application questions

Topic 2

How the predecessor method should be applied?

Carrying
amounts



Different
alternatives
to explore



Comparatives



Different
alternatives
to explore



Consideration



Different
alternatives
to explore



Difference

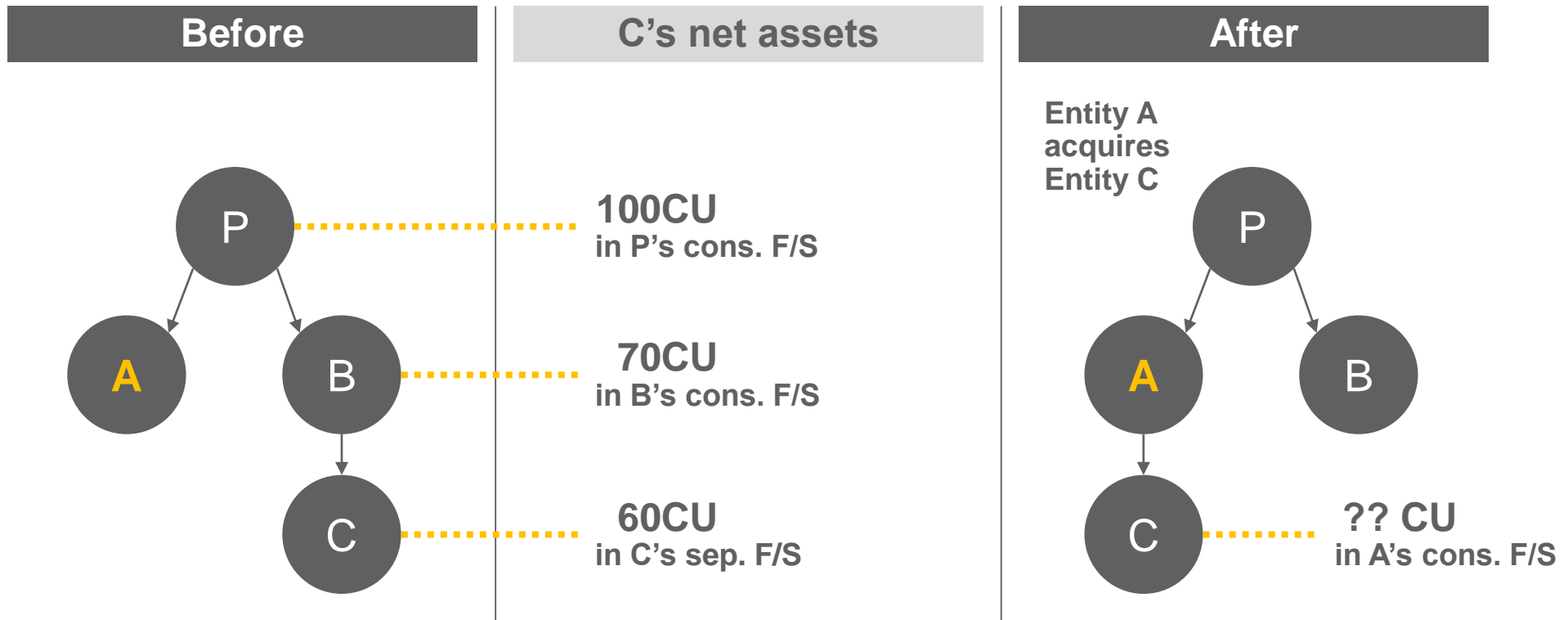


Presentation
in equity
generally not
prescribed
by the Board

Application questions—carrying amounts

Topic 2

Which predecessor carrying amounts should be used?



Application questions—carrying amounts

Topic 2

Which predecessor carrying amounts should be used?

... those recognised by the transferred entity or business



The predecessor 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, might be irrelevant from the perspective of the combining entities.

... those recognised by a controlling party



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



An illustrative example is provided in the Appendix (slides 41-42 and 43-44)

Application questions—comparatives

Topic 2

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, the structure of the transaction could affect which comparative information is provided (*see next slide*).

... retrospective approach

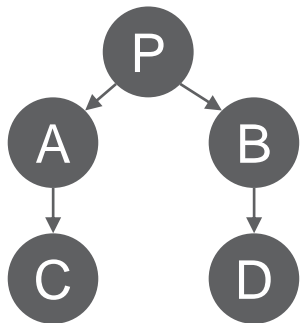


Presenting the new combined entity as if it had always been combined reflects the perspective of the controlling party.

Application questions—comparatives

Before

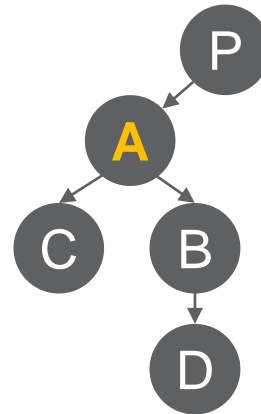
- Entity A and Entity B are controlled by entity P.
- Entity A controls Entity C while Entity B controls entity D.
- No NCI.
- Entity P wants to sell A, B, C and D in an IPO.



After

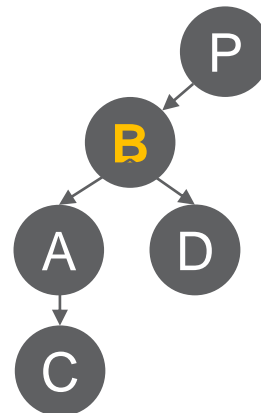
Example 1

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 questions—consideration

Topic 2

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.



An illustrative example is provided in the Appendix (slides 41-42 and 45-46)

Next steps

- Future Agenda papers on the application of the predecessor method will discuss:
 - which predecessor carrying amounts should be used;
 - from which date the combining entities should be combined and how comparative information should be presented;
 - how to measure the consideration transferred.

Next steps

Next steps

● *Education session*

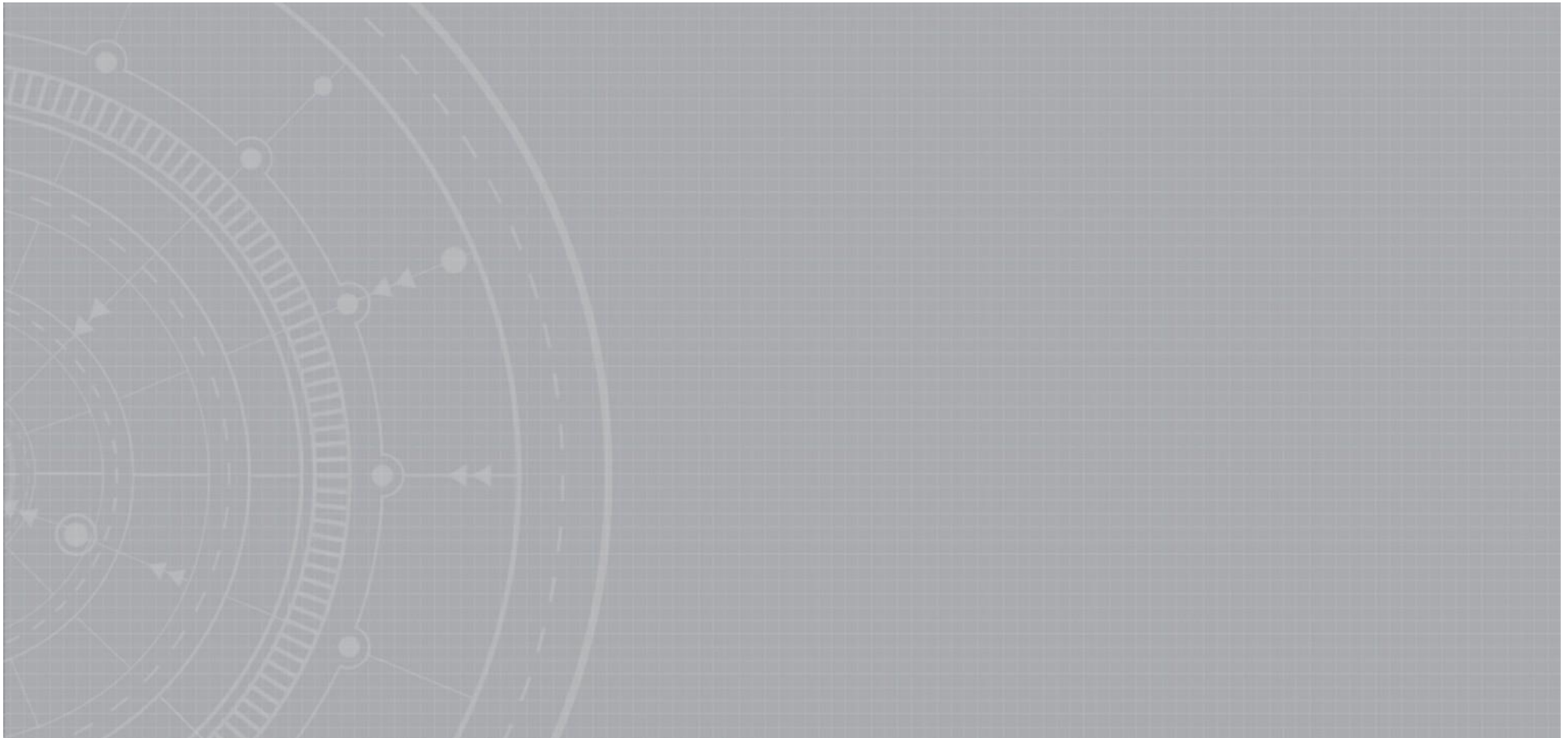
● Clarify the scope of the project

● Consider which method(s) should be applied

● Consider how the predecessor method should be applied

● Publish the DP

Thank you



Appendix

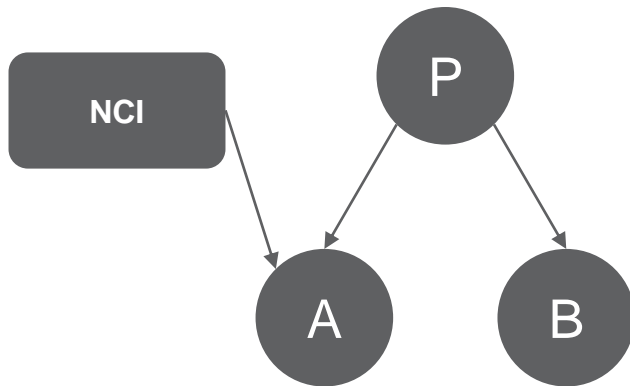
Illustrative example of application of the predecessor method

Illustrative example—fact pattern (1/2)

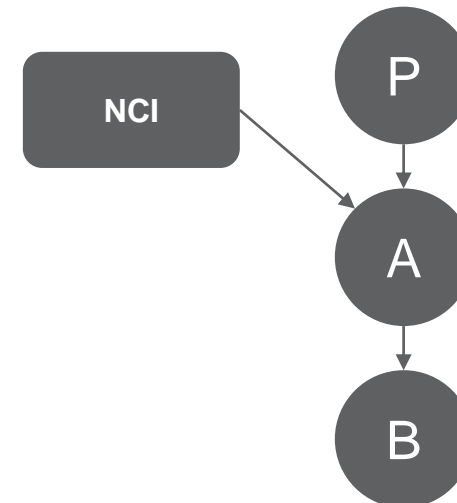
Fact pattern

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

Before



After



Illustrative example—fact pattern (2/2)

Fact pattern (cont.)

- Entity P acquired Entity B from a third party a few years ago and reflected assets and liabilities of Entity B at their fair value at the time of that acquisition in accordance with IFRS 3 (fair value 'step up' of CU5).
- The following information is available immediately before the BCUCC presented in slide 41:

	Entity P	Entity A	Entity B	Cons A	Cons B	P 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

Illustrative example—carrying amounts (1/2)

Which predecessor carrying amounts should be used by Entity A?

- Carrying amounts recognised by 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

CU120 is the fair value of issued shares.

CU170 is an aggregate of:

- CU50, share capital of Entity A before the acquisition; and
- CU120, the fair value of issued shares.

Assumptions:

- issued shares measured at fair value; and
- difference recognised in other reserve.

Illustrative example—carrying amounts (2/2)

Which predecessor carrying amounts should be used by Entity A? (cont.)

- Carrying amounts recognised by the **parent entity** [Entity P]:

	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

CU5 is the 'fair value step-up' recognised in entity P when it acquired Entity B.

Assumptions:

- issued shares measured at fair value;*
- difference recognised in other reserve; and*
- fair value 'step-up' unchanged since Entity P acquired Entity B from a third party.*

Illustrative example—consideration (1/2)

How to measure consideration?

- Measured 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

CU120 is the fair value of issued shares.

CU170 is an aggregate of:

- CU50, share capital of Entity A before the acquisition; and
- CU120, the fair value of issued shares.

Assumption:

- o difference recognised in other reserve.

(CU10) is the difference between consideration transferred (CU120) and the carrying amount of the acquired net assets (CU110).

Illustrative example—consideration (2/2)

How to measure consideration? (cont.)

- Measured 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

CU20 is the nominal value of issued shares.

CU70 is an aggregate of:

- CU50, share capital of Entity A before the acquisition; and
- CU20, the nominal value of issued shares.

Assumption:

- o difference recognised in other reserve.

CU90 is the difference between consideration transferred (CU20) and the carrying amounts of the acquired net assets (CU110).

