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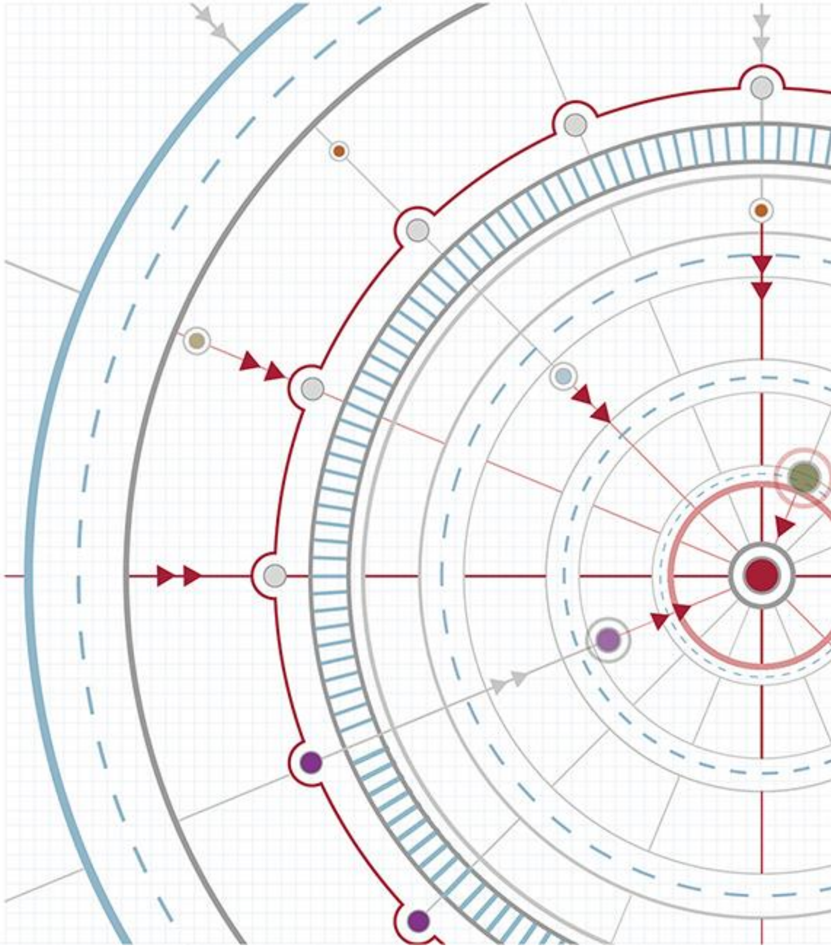

Business Combinations under Common Control

Accounting Standards Advisory Forum meeting
July 2018

ASAF agenda paper 6

Please print the slides in colour.

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Project	**Business Combinations under Common Control (BCUCC)**		
Paper topic	Measurement approaches		
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Overview

Purpose

The staff are seeking feedback from ASAF members on the approaches being developed by the staff for transactions within the scope of the project. The information provided by various approaches is illustrated in this slide deck using examples.

Questions for ASAF members

The staff have made an initial assessment of whether particular approaches provide useful information to various types of primary users of the receiving entity's financial statements at a cost that is justified by the benefits (**see slides 18, 23 and 30**). Do you agree with the staff's assessment for each approach? If not, why?

The staff plan to explore further two current value approaches (**see slide 24**) for transactions that affect non-controlling shareholders (subject to the discussion at the June 2018 IASB meeting). Which of those two approaches do ASAF members prefer and why?

Content

Recap

Previous discussions with the ASAF

Scope of the project	Measurement approaches
Previous ASAF advice Focus on pervasive application issues	**Previous ASAF advice** Focus on information needs of the primary users of financial statements & apply the *Conceptual Framework*
Reflected in the Board's **tentative decisions** to date (see slide 7)	**Work in progress** – reflected in the Board's discussions to date

2014

2015

2016

2017

Scope of the project—tentative decisions

focuses on transfers of **Business** (as defined in IFRS 3 *Business Combinations*) under common control

includes **more** transactions than just **BCUCC**

addresses financial reporting by the **receiving entity**

considers **application questions**

Measurement approaches

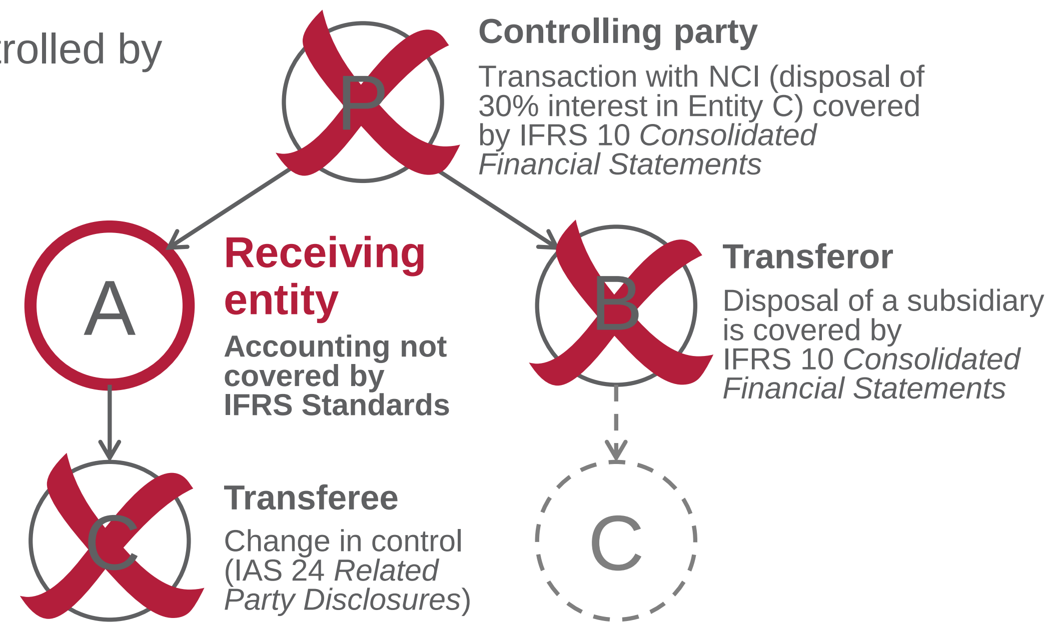
Who we are focusing on (1/2)

The project focuses on the receiving entity's financial statements.

Entity A acquires Entity C from Entity B.

Entities A, B and C are all controlled by Entity P.

Entity C is a business.



Who we are focusing on (2/2)

Primary users of the receiving entity's financial statements

Non-controlling shareholders	Lenders and creditors	Controlling party	Prospective capital providers
Indefinite interest in the receiving entity. Transaction may affect the value of their existing interest. Exposed to residual equity risks.	Finite interest in the receiving entity. Transaction may affect the value of their existing interest. Exposed to credit and liquidity risks.	Controls all combining entities before and after the transaction. Does not solely rely on the receiving entity's financial statements to meet its information needs.	No existing interest in any of the combining entities at the time of the transaction.

Information needs and cost-benefit analysis can be different for different primary users

Possible approaches for BCUCC

How should the receiving entity measure acquired assets and liabilities in a BCUCC?

Conceptual Framework

Historical cost	Current value	Predecessor carrying amounts
	Existing practice	**Existing practice**
Receiving entity will allocate the consideration across the acquired assets and liabilities (eg based on their relative fair values). No goodwill is recognised.	Receiving entity will reflect acquired assets and liabilities at their current values (eg at fair values). Goodwill is measured as a residual.	Receiving entity will reflect acquired assets and liabilities at their predecessor carrying amounts (eg the carrying amounts reflected in the transferee's financial statements).

Consistent with the acquisition method required by IFRS 3 for business combinations

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Illustrative scenario

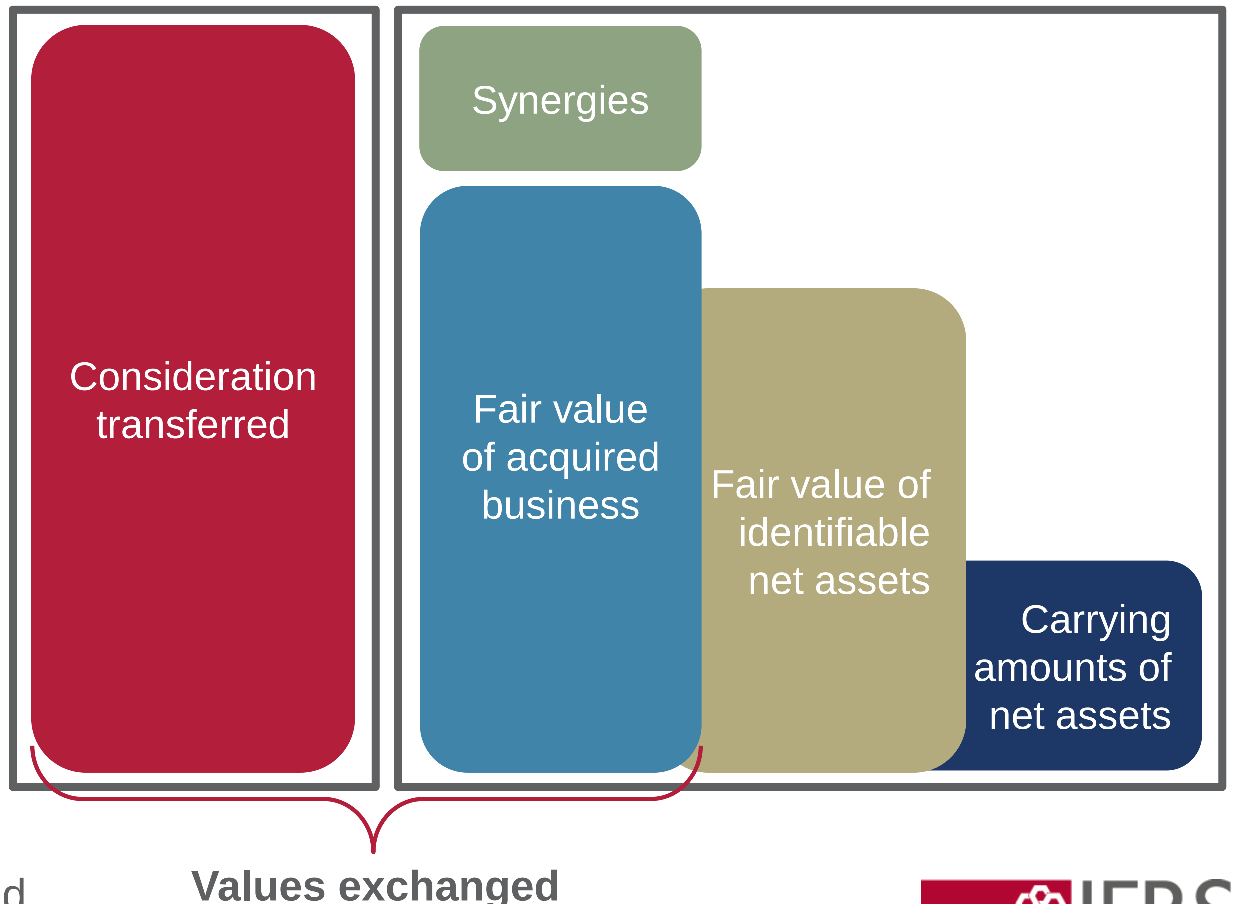
Let’s consider information about a business combination under common control provided by the measurement bases identified on slide 11 in the receiving entity’s financial statements.

The scenarios considered are:

- Equal values are exchanged;
- Higher value is given up;
- Higher value is received.

In all scenarios the following are kept constant:

- Any synergies arising from the combination;
- Fair value of the acquired business;
- Fair value of the acquired identifiable net assets; and
- Pre-combination carrying amounts of the acquired net assets.



Different scenarios result from changing consideration transferred.
For simplicity, assume the consideration is paid in cash.

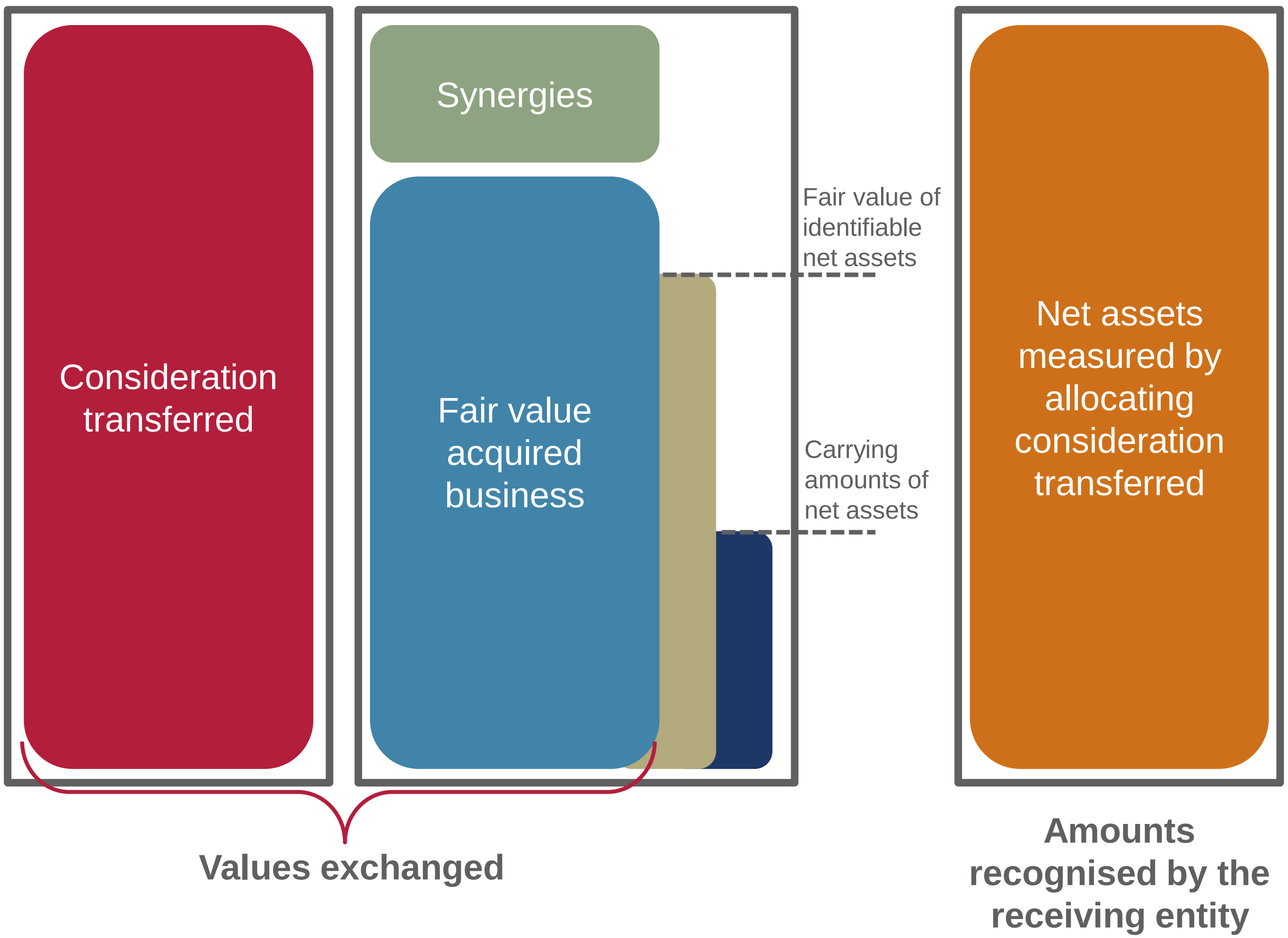
Health warning

- The staff acknowledge that a price in a business combination results from negotiations and **falls within a range** between the minimum price the seller will accept and the maximum price the buyer will pay. However, in principle, consideration transferred includes a payment for the acquired business and for combination synergies.
- The following **illustrations are simplified** and are designed to demonstrate whether and how different scenarios will be reflected under various approaches. The illustrations are not intended to suggest how often each scenario might happen and how different the amounts might be. They merely illustrate the mechanics. Finally, the illustrations assume that the items can be measured.

Measurement approaches
Historical cost

A historical cost approach (1/4)

If equal values are exchanged



If equal values are exchanged in a BCUCC, applying a historical cost approach could result in:

- recognising acquired net assets at amounts higher than both the pre-combination carrying amounts and fair values of those net assets;
- a need to perform an impairment test and likely recognition of an impairment loss; and
- not reflecting the fact that equal values are exchanged.

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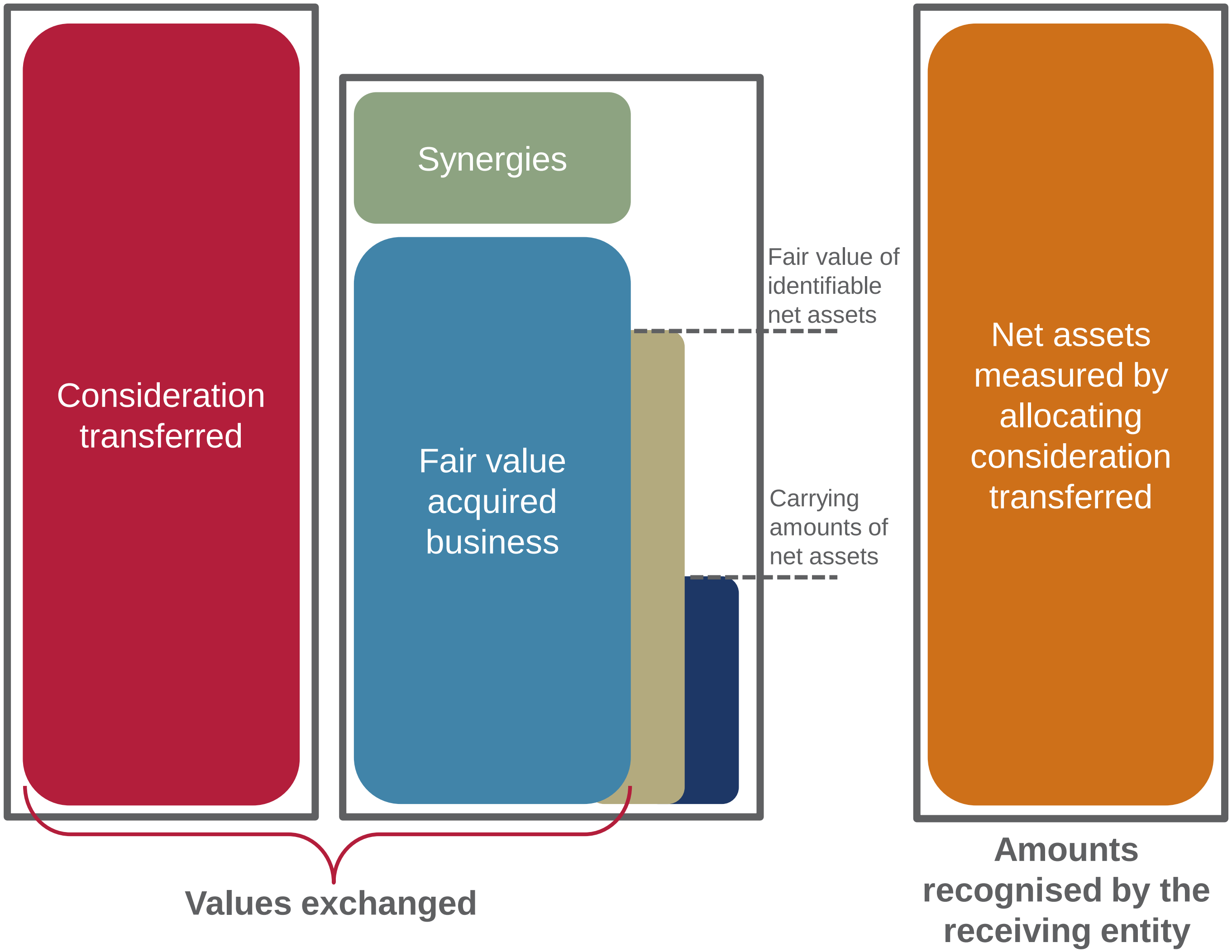
A historical cost approach (2/4)

If a higher value is given up

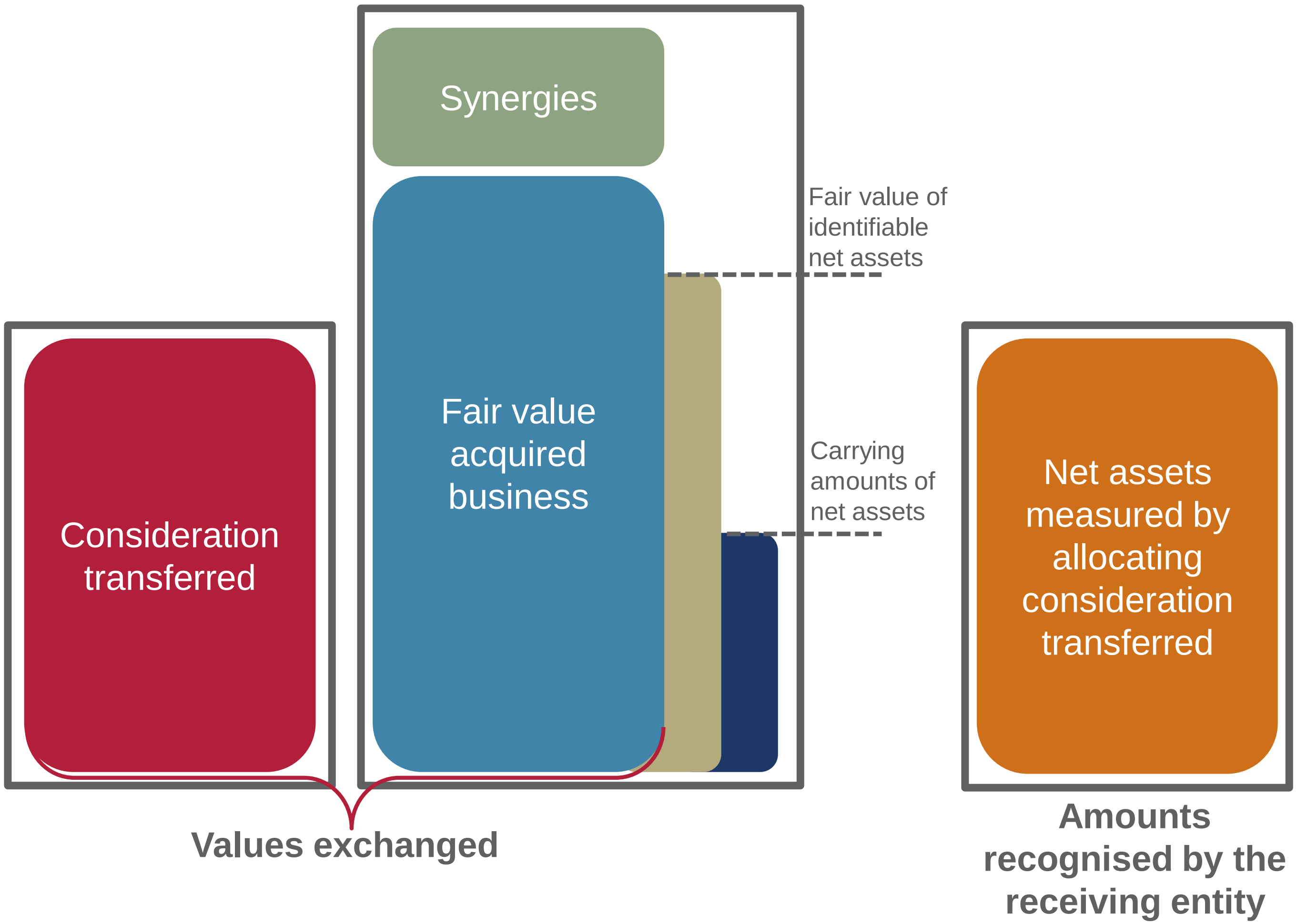


If a higher value is given up in a BCUCC, applying a historical cost approach could result in:

- recognising acquired net assets at amounts higher than both the pre-combination carrying amounts and fair values of those net assets;
- a need to perform an impairment test and likely recognition of an impairment loss; and
- not reflecting the fact that a higher value is given up.

A historical cost approach (3/4)

If a higher value is received



If a higher value is received in a BCUCC, applying a historical cost approach could result in:

- recognising acquired net assets at arbitrary allocated amounts; and
- not reflecting the fact that a higher value is received.

A historical cost approach (4/4)

Would a historical cost approach provide most useful information to the primary users of the receiving entity's financial statements at a cost that would be justified by the benefits?

Non-controlling shareholders	Lenders and creditors	Controlling party	Prospective capital providers
No	No	No	No

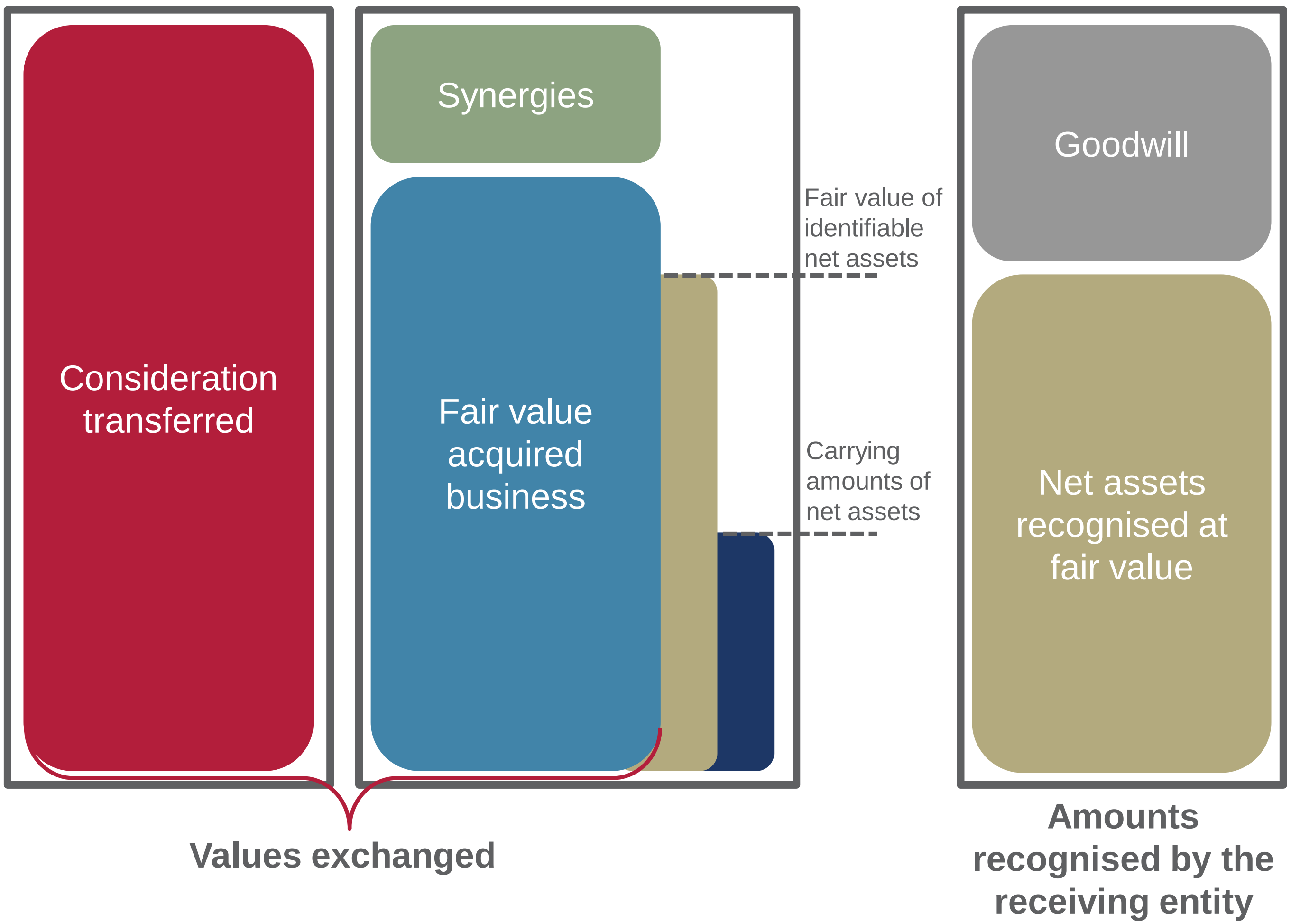
Staff's initial assessment

Do ASAF members agree with the staff's initial assessment? If not, why?

Measurement approaches
Current value

A current value approach (1/5)

If equal values are exchanged

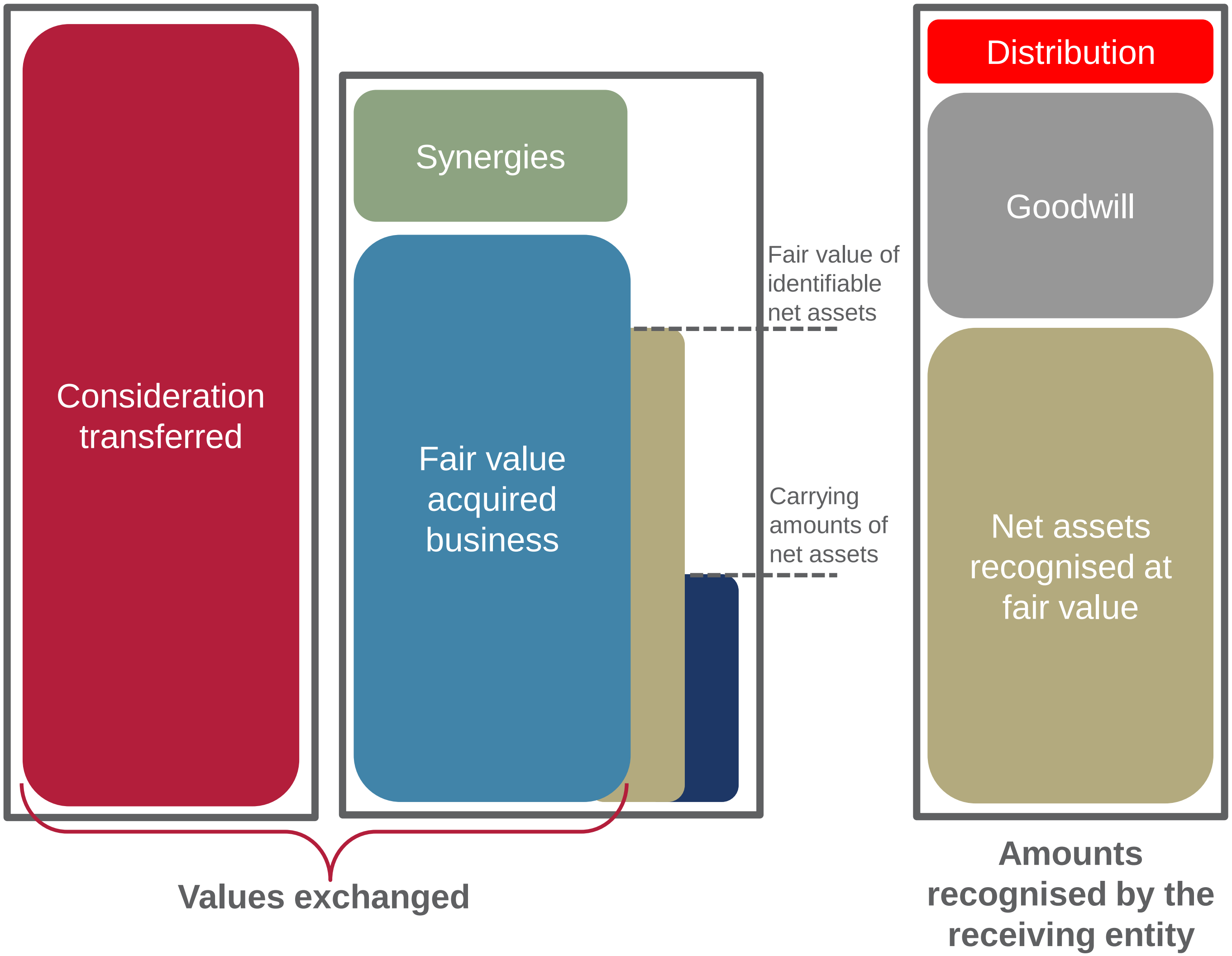


If equal values are exchanged in a BCUCC, applying a current value approach could result in:

- recognising acquired identifiable net assets at fair value;
- recognising goodwill that comprises both goodwill previously generated in the acquired business and any combination synergies;
- outcome that is consistent with IFRS 3; and
- reflecting the fact that equal values are exchanged.

A current value approach (2/5)

If a higher value is given up

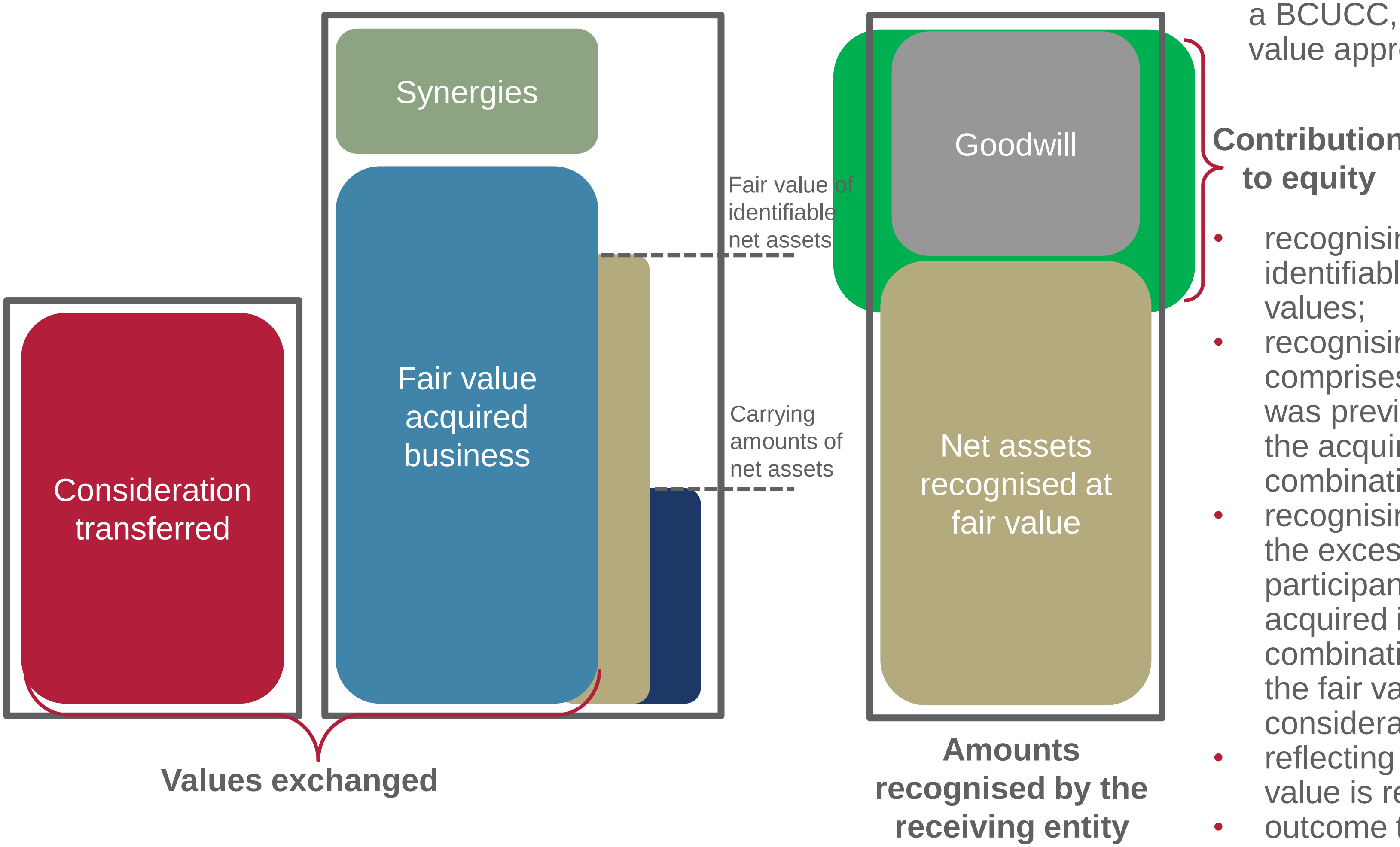


If a higher value is given up in a BCUCC, applying a current value approach could result in:

- recognising acquired identifiable net assets at fair values;
- recognising goodwill that comprises both goodwill that was previously generated in the acquired business and any combination synergies;
- recognising as a distribution the excess of the fair value of the consideration transferred over what a market participant would pay for the acquired interest (including any combination synergies);
- reflecting the fact that a higher value is given up; and
- outcome that is consistent with IFRS 3 and IAS 1 *Presentation of Financial Statements*.

A current value approach (3/5)

If a higher value is received



If a higher value is received in a BCUCC, applying a current value approach could result in:

- recognising acquired identifiable net assets at fair values;
- recognising goodwill that comprises both goodwill that was previously generated in the acquired business and any combination synergies;
- recognising as a contribution the excess of what a market participant would pay for the acquired interest (including any combination synergies) over the fair value of the consideration transferred;
- reflecting the fact that a higher value is received; and
- outcome that is consistent with both IFRS 3 and IAS 1.

A current value approach (4/5)

Would a current value provide most useful information to the primary users of the receiving entity's financial statements at a cost that would be justified by the benefits?

Non-controlling shareholders	Lenders and creditors	Controlling party	Prospective capital providers

Staff's initial assessment

Non-controlling shareholders	Lenders and creditors	Controlling party	Prospective capital providers
Yes (see slide 24)	No	No	Work in progress

Do ASAF members agree with the staff's initial assessment? If not, why?

A current value approach (5/5)

- The staff have considered a number of current value approaches for transactions that affect non-controlling shareholders. All those approaches build on the requirements in IFRS 3 and IAS 1 and aim both to reflect the values exchanged and to recognise any difference between those values as a contribution to, or a distribution from, the receiving entity's equity. However, those approaches use various mechanics to achieve those goals, involve various levels of measurement uncertainty and sometimes result in different outcomes.
- Subject to the discussion at the June 2018 IASB meeting, the staff plan to explore further two current value approaches that both apply IFRS 3 except any excess of **the fair value of the acquired identifiable net assets** over **the fair value of the consideration transferred** will be recognised as a contribution to equity rather than as a gain and in addition either:
  - goodwill will be capped at **the fair value of the acquired business**. Any excess of **the fair value of the consideration transferred** over **the fair value of the acquired business** will be recognised as distribution from equity (the so called *Ceiling approach* – see April 2018 Agenda Paper 23); or
  - an entity will be required to assess whether **the fair value of the consideration transferred** approximates **the fair value of the acquired interest** (including any combination synergies). If not, the entity will be required to recognise any excess consideration as a distribution from equity.

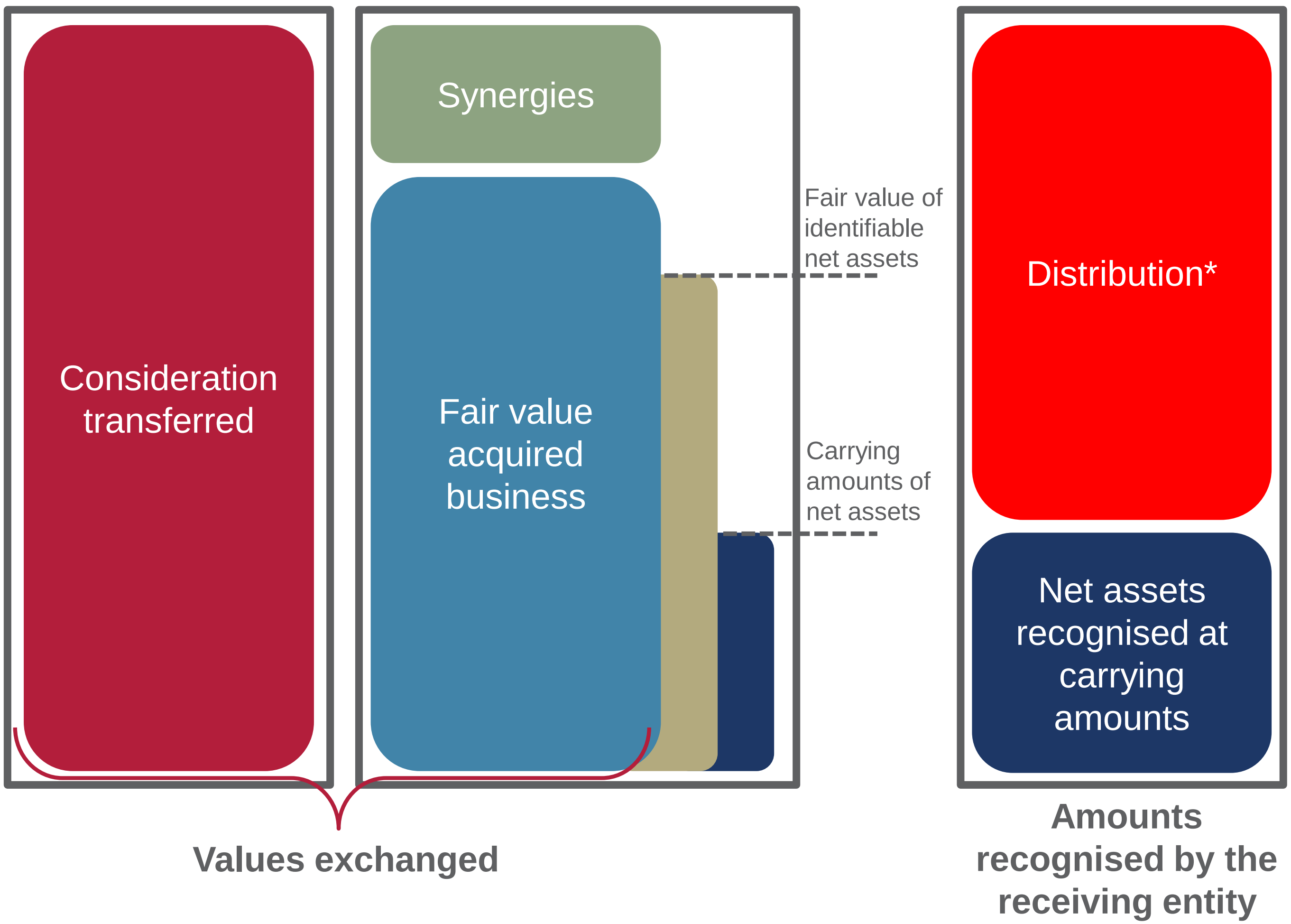
Which of the two current value approaches set out above do ASAF members prefer, and why?

The staff will provide a verbal update to the ASAF on the outcome of the June 2018 IASB meeting.

Measurement approaches
Predecessor
carrying amounts

A predecessor approach (1/5)

If equal values are exchanged



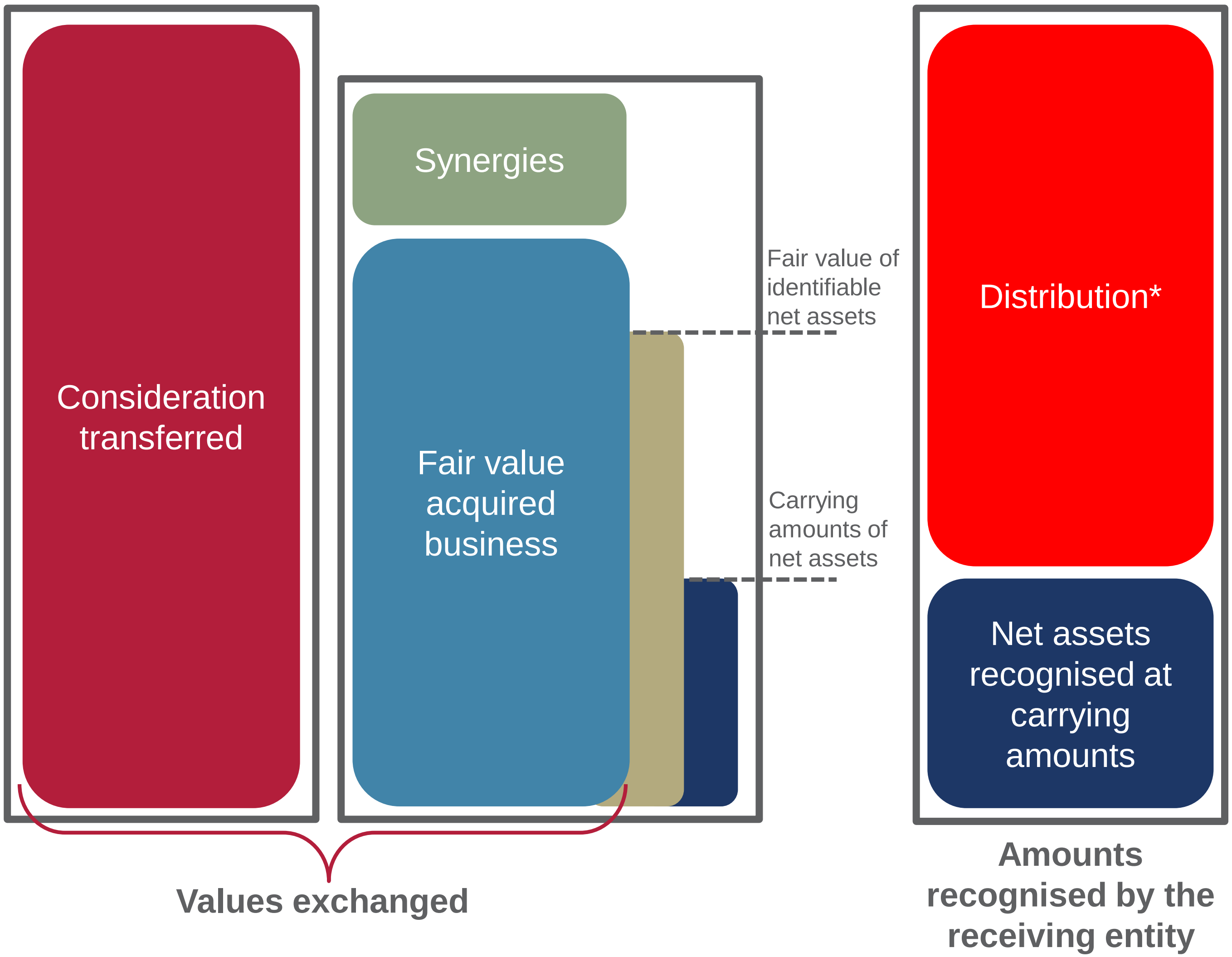
If equal values are exchanged in a BCUCC, applying a predecessor carrying amounts approach could result in:

- recognising acquired net assets at their pre-combination carrying amounts;
- recognising as a distribution the excess of the consideration transferred over the pre-combination carrying amounts of net assets; and
- not reflecting the fact that equal values are exchanged.

*A recognised distribution might not be as significant as the picture suggests.

A predecessor approach (2/5)

If a higher value is given up



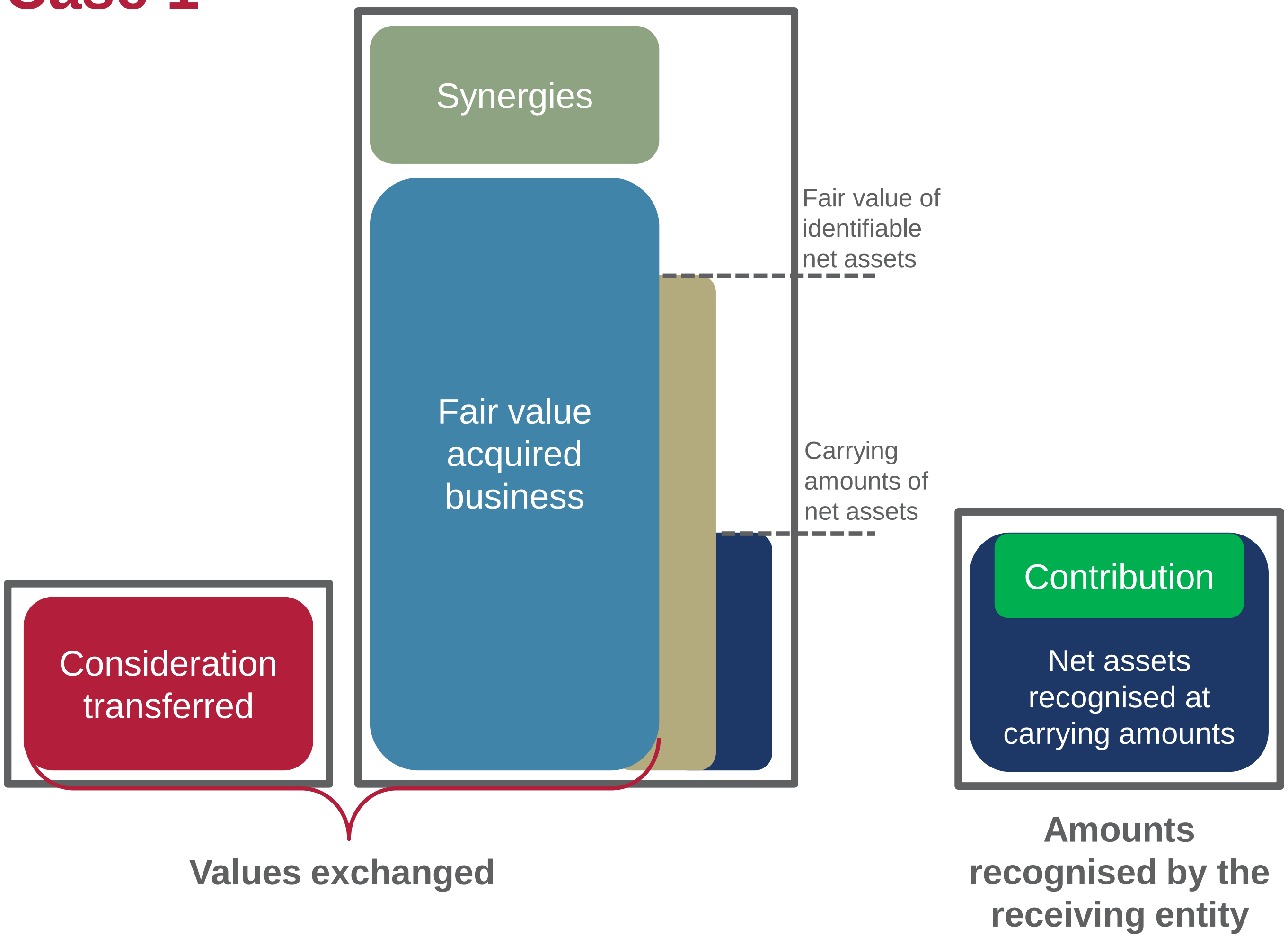
If a higher value is given up in a BCUCC, applying a predecessor carrying amounts approach could result in:

- recognising acquired net assets at their pre-combination carrying amounts; and
- recognising as a distribution the excess of the consideration transferred over the pre-combination carrying amounts of net assets.

*A recognised distribution might not be as significant as the picture suggests.

A predecessor approach (3/5)

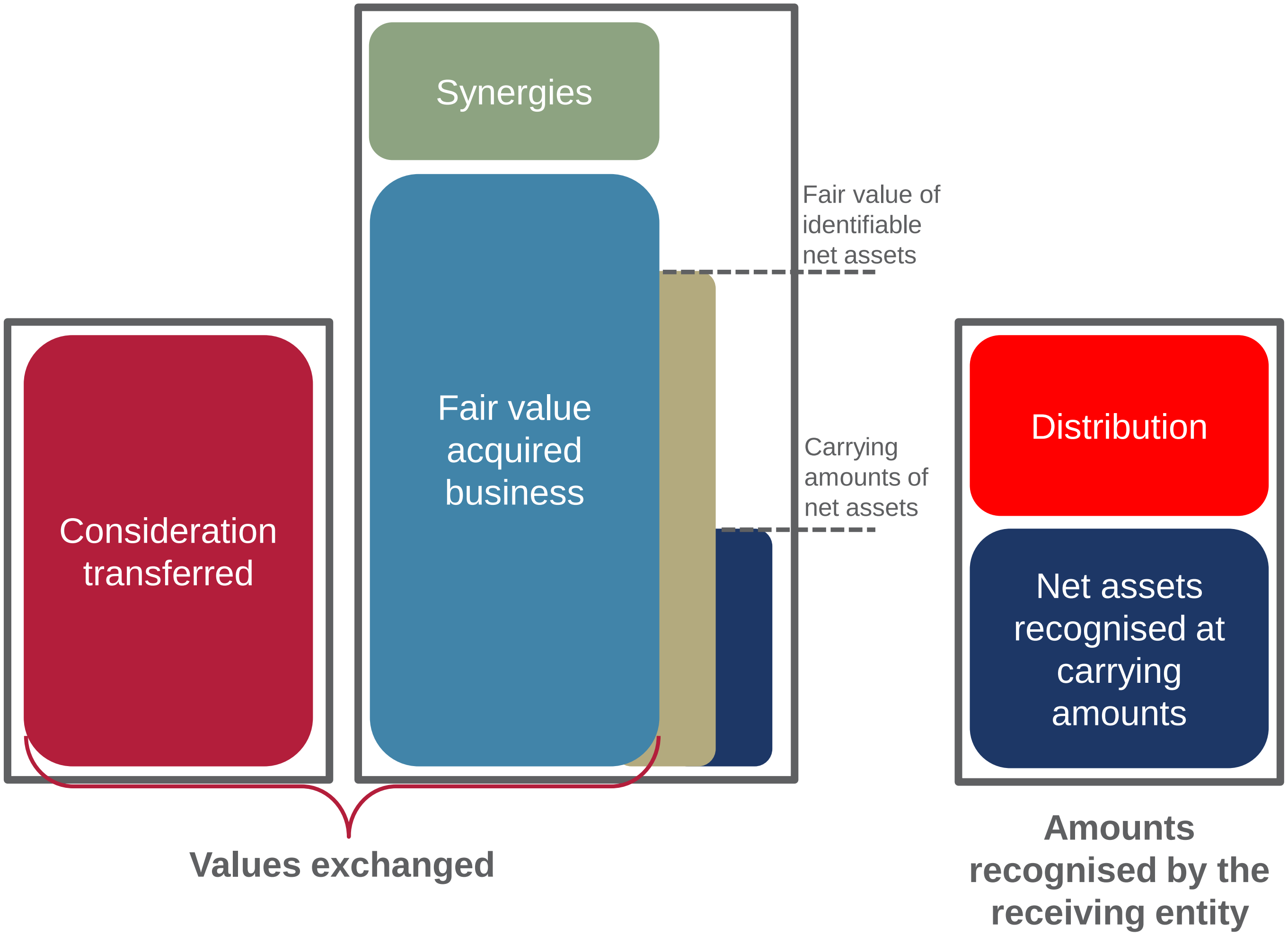
If a higher value is received
Case 1



If a higher value is received in a BCUCC, applying a predecessor carrying amounts approach could result in recognising a contribution if the consideration transferred is less that the pre-combination carrying amounts of net assets but…(see Case 2 on slide 29).

A predecessor approach (4/5)

If a higher value is received
Case 2



If a higher value is received in a BCUCC, applying a predecessor carrying amounts could result in recognising a distribution if the consideration transferred is more than the pre-combination carrying amounts of net assets, …even though the consideration transferred is below the value received.

A predecessor approach (5/5)

Would a predecessor carrying amounts provide most useful information to the primary users of the receiving entity's financial statements at a cost that would be justified by the benefits?

Non-controlling shareholders	Lenders and creditors	Controlling party	Prospective capital providers
Staff's initial assessment			
No	Work in progress	Yes	Work in progress

Do ASAF members agree with the staff's initial assessment? If not, why?

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