Business Combinations under Common Control

Agenda ref: WSS6

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World Standard-setters Conference 2018

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Agenda

- Background and scope of the project
- Measurement approaches for business combinations under common control
- Ways forward for transactions affecting non-controlling shareholders (NCI)
  – exploring current value approaches

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Background and scope of the project

Why this project?

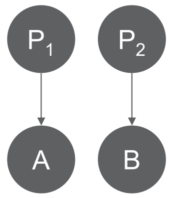
Select the appropriate answer(s)…

- ☐ Lack of specific guidance on how to account for BCUCC
- ☐ Diversity in practice in how entities account for BCUCC
- ☐ BCUCC is identified as a priority project in the recent 2011 and 2015 Agenda Consultations

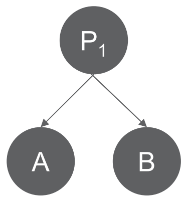
The issue: diversity in practice

Before

Scenario 1
- Entity A and Entity B are controlled by different parties;
- Entity B is a business.

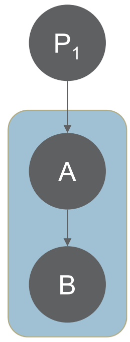


Scenario 2
- Entity A and Entity B are controlled by the same party;
- Entity B is a business.



After

Entity A acquires Entity B



Observations

Scenario 1
- The transaction is a **business combination**
- IFRS 3 *Business Combinations* requires the **acquisition method**
- Entity A reflects identifiable assets and liabilities of Entity B at **fair value**

Scenario 2
- The transaction is a **business combination under common control**
- IFRS Standards do not specify how to account for such transactions which leads to **diversity in practice**
- Entity A reflects identifiable net assets of Entity B at **fair value** or at **predecessor carrying amounts**

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Scope of the project

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

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

addresses financial reporting by the **receiving entity**

considers **application questions**

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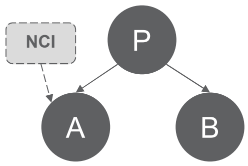
Example 1—Basic

Before

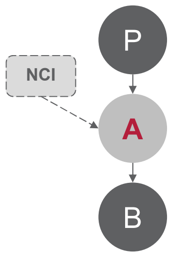
Entity A and Entity B are controlled by Entity P.

Entity A and Entity B are businesses.



Transaction

Entity A acquires Entity B.



Observations

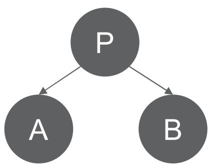
Accounting by Entity A is …

Example 2—Newco

Before

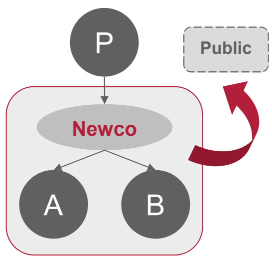
Entity A and Entity B are controlled by Entity P.

Both Entity A and Entity B are businesses.



Transaction

Entity P forms a Newco and transfers Entity A and Entity B to that Newco.



Observations

Accounting by Newco is …

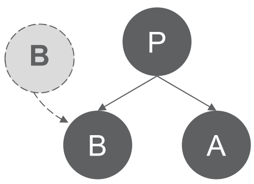
Example 3—Transitory control

Before

Entity A is controlled by Entity P.

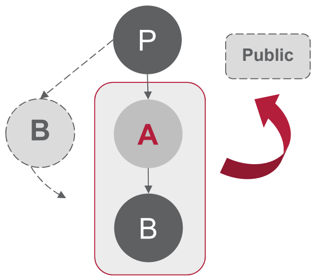
Entity P acquires Entity B from external parties.

Both Entity A and Entity B are businesses.



Transaction

Entity A acquires Entity B from Entity P.



Observations

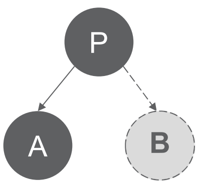
Accounting by Entity A is …

Example 4—Associates

Before

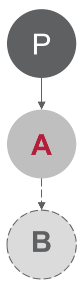
Entity P controls Entity A.

Entity P has a significant influence over Entity B.



Transaction

Entity P transferred Entity B to Entity A.



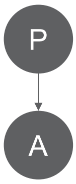
Observations

Accounting by Entity A is …

Example 5—One business

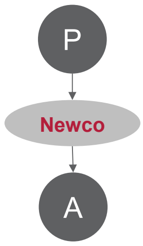
Before

Entity A is controlled by Entity P.
Entity A is a business.



Transaction

Entity P forms a Newco and transfers Entity A to that Newco.



Observations

Accounting by Newco is …

Scope of the project–recap

Accounting for transactions under common control that involve a transfer of one or more businesses from the perspective of the receiving entity, regardless of whether:

– the receiving entity can be identified as the 'acquirer', if IFRS 3 were applied to the transaction;

– the transaction is conditional on a loss of control over the combining parties, for example as a result of a future sale or an IPO;

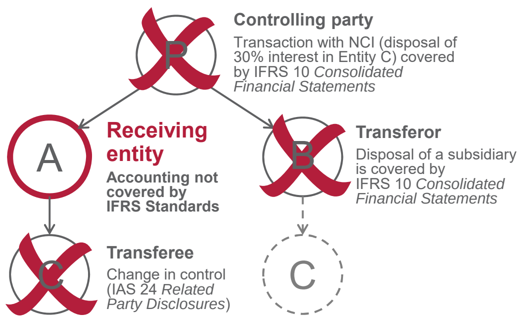
– the transaction is either preceded by an external acquisition or followed by an external sale of one or more of the combining parties, or both.

Measurement approaches

Who we are focusing on

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

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



Entity A acquires Entity C from Entity B. Entities A, B and C are all controlled by Entity P. Entity C is a business.

Information needs of primary users

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

Existing practice: Current value; Predecessor carrying amounts

Historical cost	Current value	Predecessor carrying amounts
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).

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

Illustrative scenario

Let’s consider information about a business combination under common control provided by the measurement bases identified on slide 9 in the receiving entity’s financial statements.

The scenarios considered are:

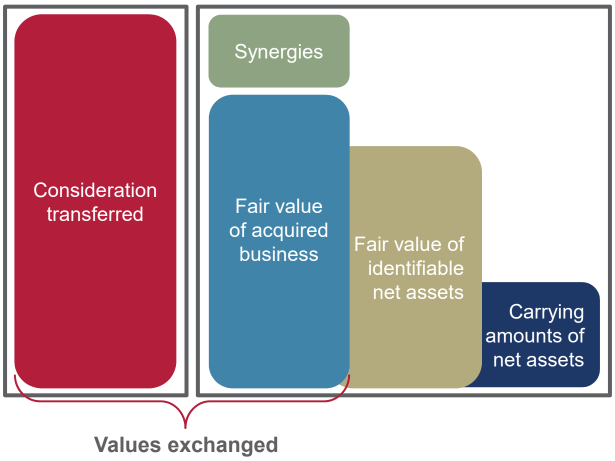
- Equal values are exchanged;
- Higher value is given up;
- Higher value is received.

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.

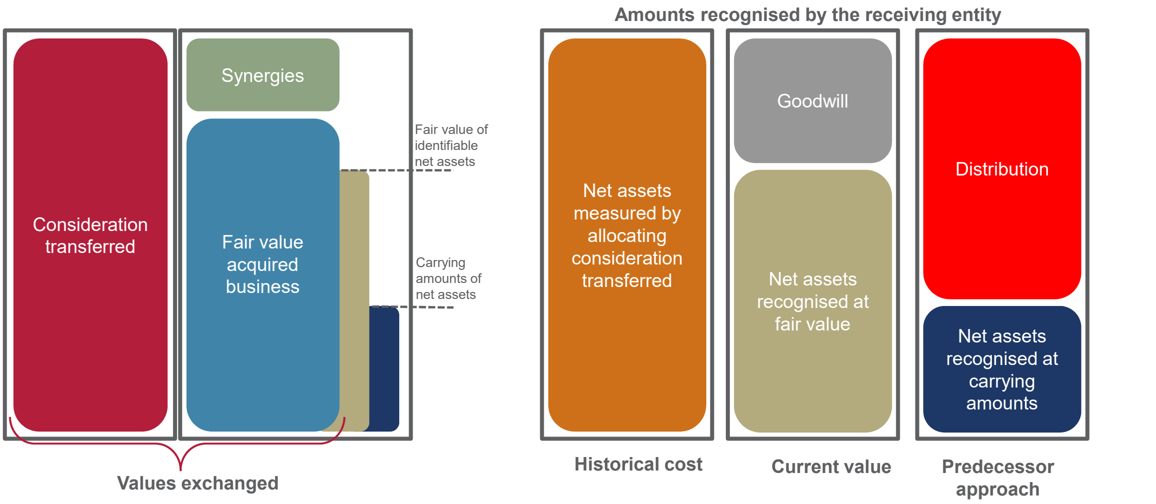
For simplicity, assume the consideration is paid in cash.



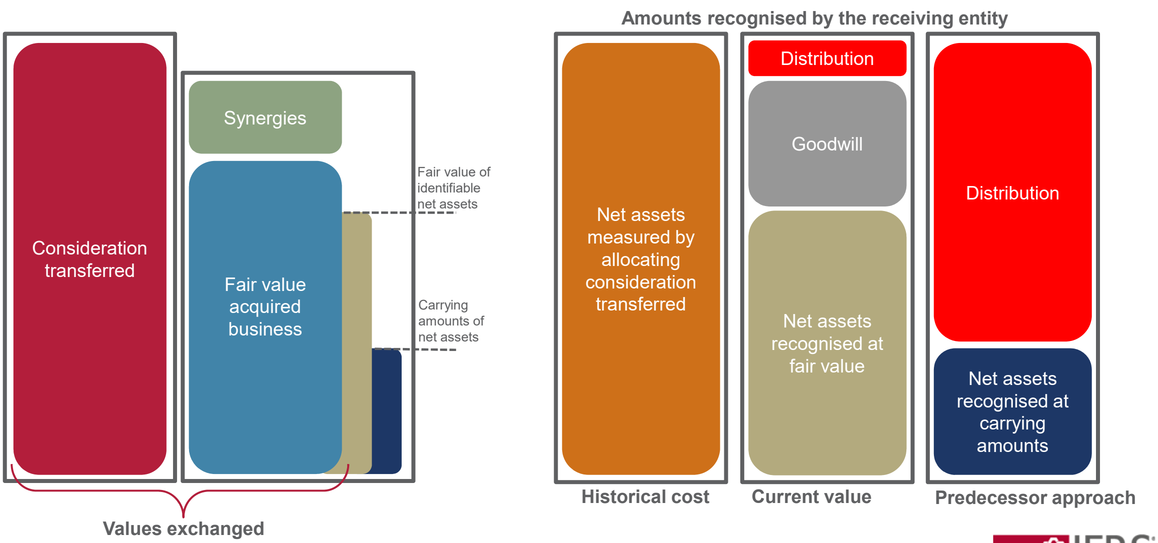
Health warning

- 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.

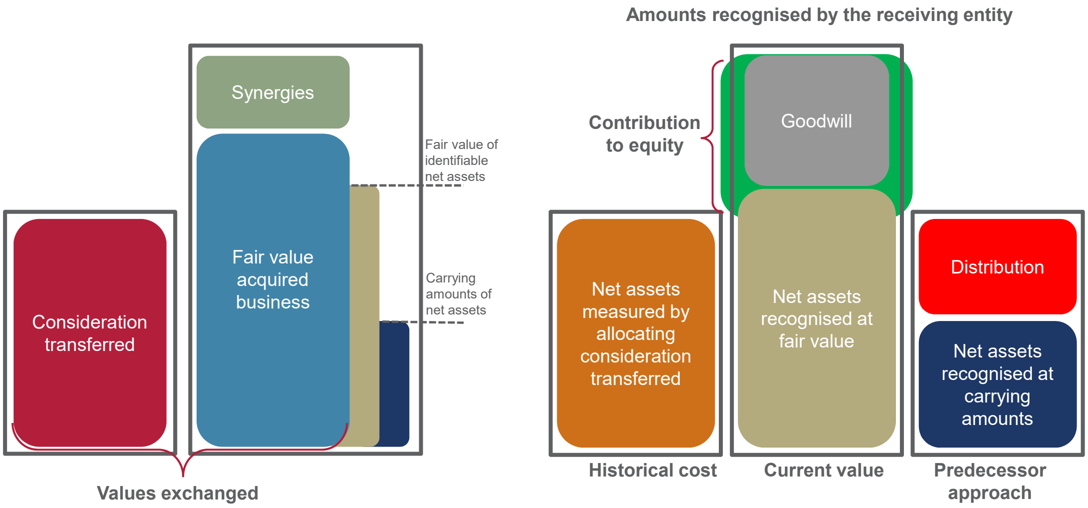
If equal values are exchanged



If a higher value is given up



If a higher value is received* (1/2)



* Fair value of identifiable net assets > consideration transferred
Carrying amount of net assets < consideration transferred

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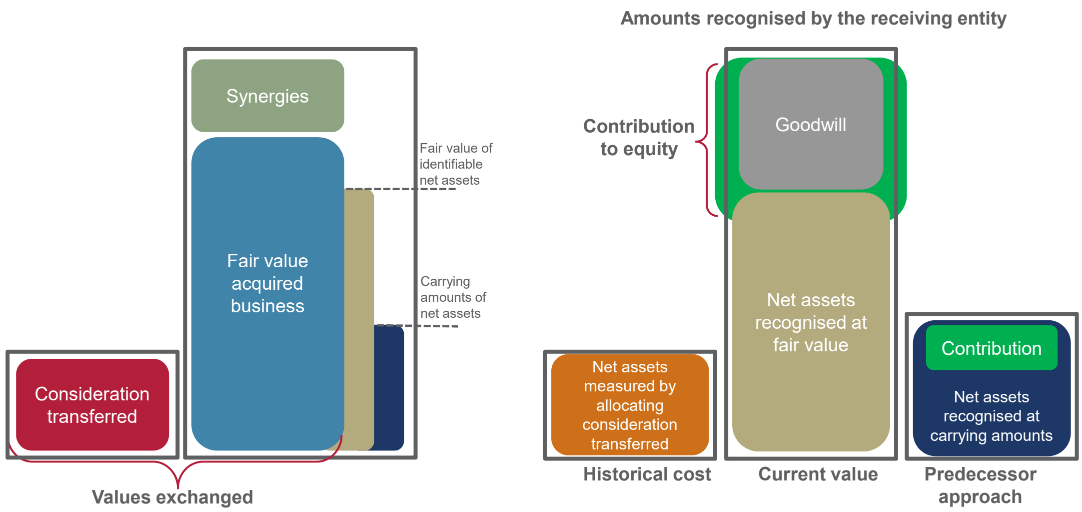
If a higher value is received* (2/2)



* Fair value of identifiable net assets > consideration transferred
Carrying amount of net assets > consideration transferred

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Question 1

In your view, which measurement basis would provide the most **useful** information to **existing non-controlling shareholders** of the receiving entity?

(a) Historical cost
(b) Current value
(c) Predecessor carrying amounts

Question 2

In your view, which measurement basis would provide the most **useful** information to **existing lenders and creditors** of the receiving entity?

(a) Historical cost
(b) Current value
(c) Predecessor carrying amounts

Question 3

Q

In your view, which measurement basis would provide the most **useful** information to **the controlling party** of the receiving entity?

(a) Historical cost
(b) Current value
(c) Predecessor carrying amounts

Question 4

Q

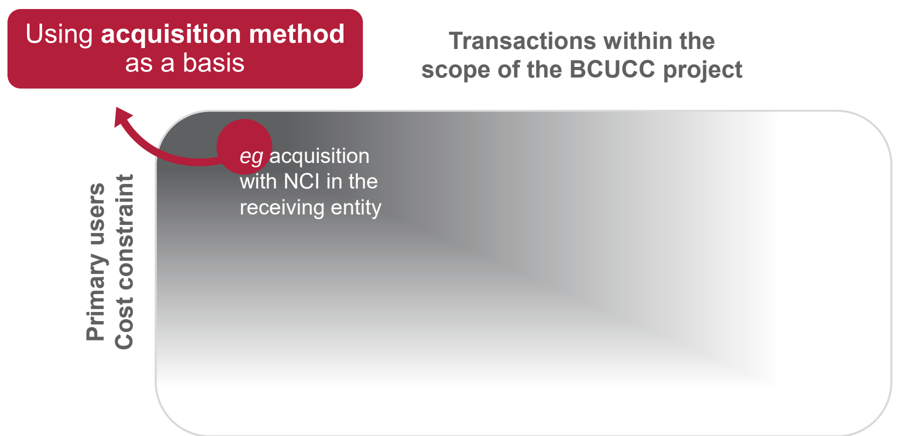
In your view, which measurement basis would provide the most **useful** information to **prospective capital providers** of the receiving entity?

(a) Historical cost
(b) Current value
(c) Predecessor carrying amounts

Ways forward for transactions affecting NCI

Approaches being developed

The Board discussed potential approaches for transactions that affect NCI.



A current value approach for BCUCC involving NCI

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Acquisition method

+

Additional disclosures

+

Recognise a contribution if it is a bargain purchase (not gain)

+

Recognise a distribution if there is an excess consideration (not goodwill)

- ***Ceiling* approach**
- ***Revised ceiling* approach**

The Board decided to pursue an approach that uses the **acquisition method** as the basis and to consider whether and how that approach may need to be modified for BCUCC.

Ceiling approach

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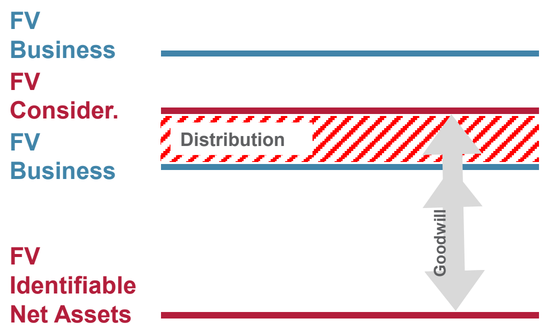


Assess fair value of the consideration transferred against the fair value of the acquired business.

Goodwill is the excess of the consideration transferred over the fair value of the acquired identifiable net assets, 'capped' at the fair value of the acquired business.

Excess consideration over the fair value of the acquired business is recognised as a distribution from equity.

Gain is never recognised. Bargain purchase is recognised as contribution to equity.

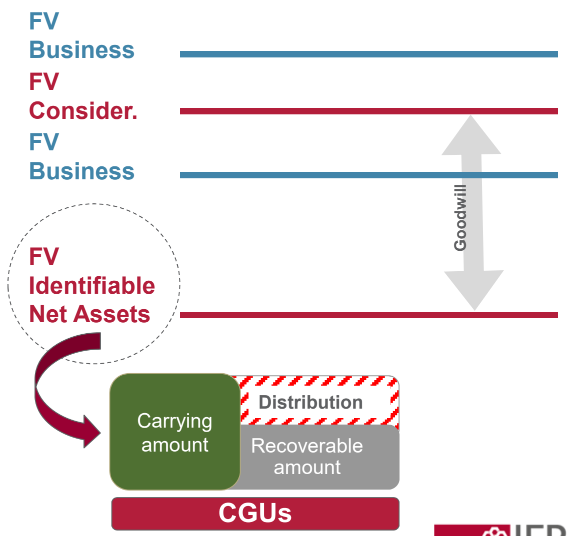
Revised Ceiling approach

Apply the mechanics of IAS 36
re: *impairment of goodwill*
Provisional goodwill is allocated to CGU(s) and tested to confirm the provisional amount and identify any distribution from equity

Any excess of the carrying amount over the recoverable amount of the CGU(s) is recognised as a **distribution from equity**

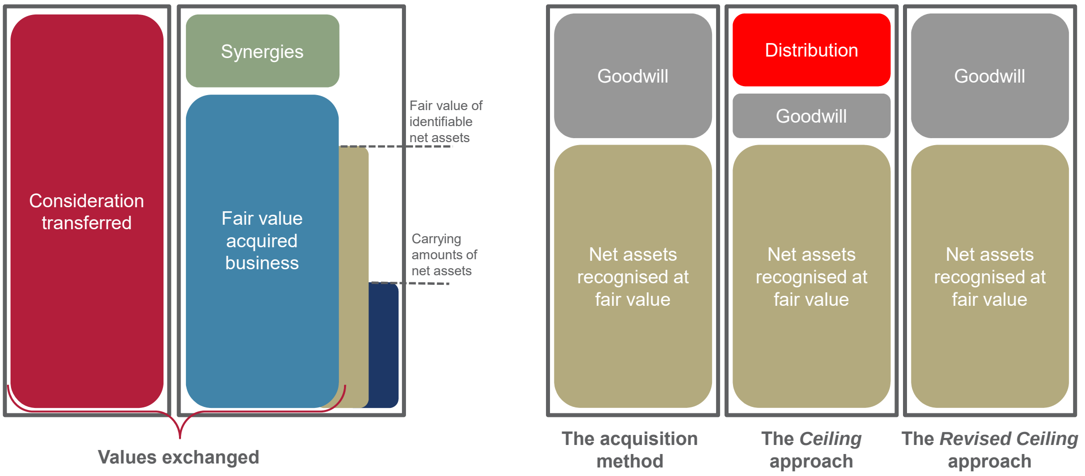
- Goodwill is calculated as the excess of the fair value of the consideration over the fair value of the acquired identifiable net assets but is capped
- **Gain** is never **recognised**

IFRS 3 | **IAS 36**

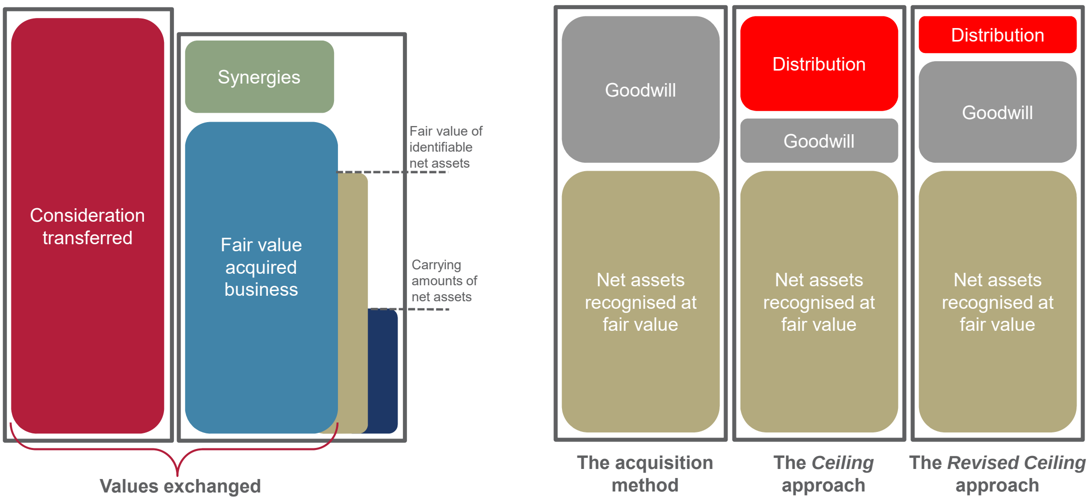


Exploring current value approaches

Equal values exchanged

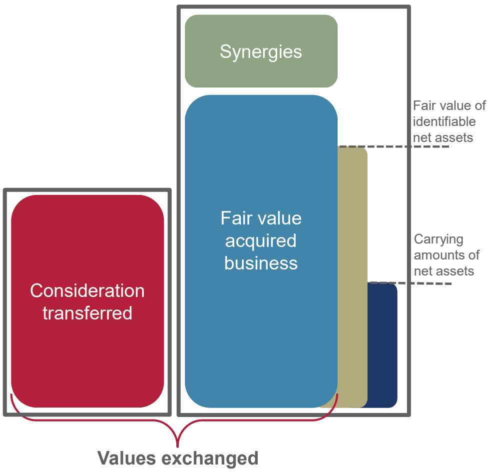


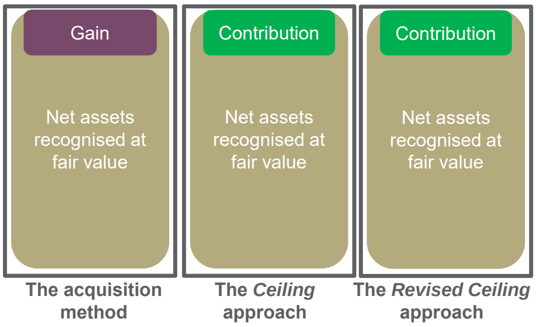
Higher value given up



Higher value received – Case 1

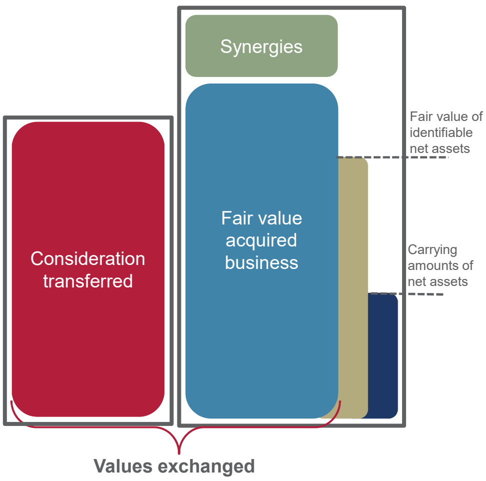
The fair value of the consideration transferred is below the fair value of the acquired business and acquired identifiable net assets.

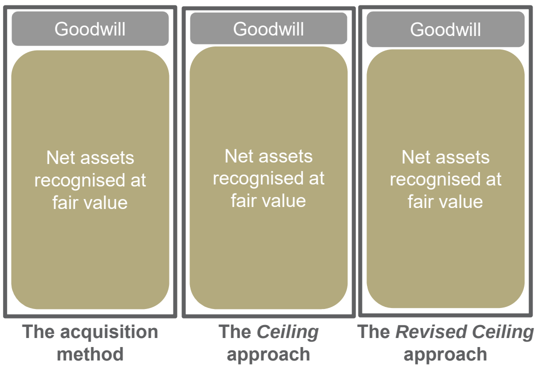




Higher value received – Case 2

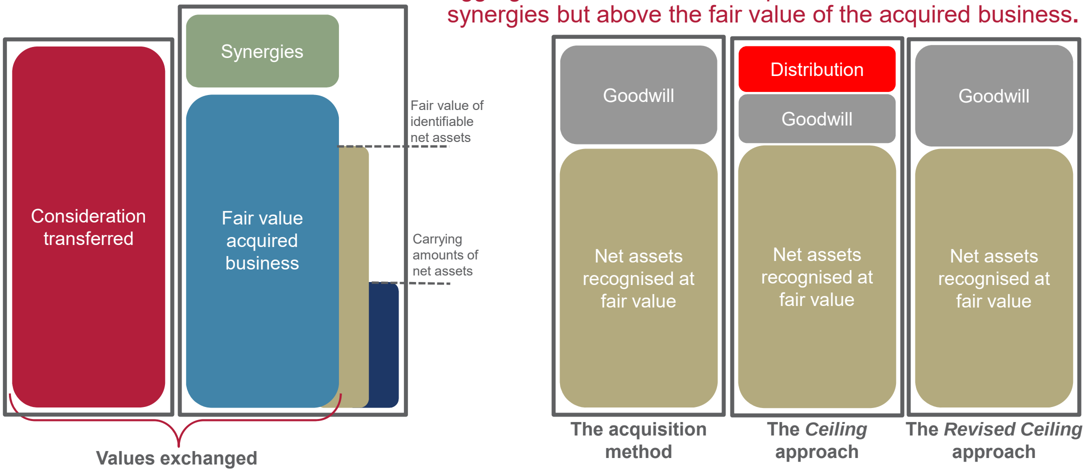
The fair value of the consideration transferred is below the fair value of the acquired business but above the fair value of the acquired identifiable net assets.





Higher value received – Case 3

The fair value of the consideration transferred is below the aggregate fair value of the acquired business and combination synergies but above the fair value of the acquired business.



Question 7

In your view, should a current value approach be applied whenever **NCI** are present with the receiving entity?

(a) Yes—in all cases.
(b) Yes—in some but not all cases (eg depending on the nature and size of the NCI).
(c) No—a different measurement approach should be applied.
(d) No—other reason/s.

Question 8

Q

What **potential modifications** to the acquisition method do you think would result in the most useful information about a business combination under common control involving NCI?

Select all that applies.

(a) No modification. Apply acquisition method as set out in IFRS 3.
(b) Require additional disclosures.
(c) Recognise contribution if there is a 'bargain purchase'.
(d) Introduce a 'cap' on recognition of goodwill.

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