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STAFF PAPER

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Project	Business Combinations under Common Control		
Paper topic	Predecessor approach—consideration and presentation in equity		

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Purpose of this paper

1. At the September 2019 meeting, the Board tentatively decided that a current value approach based on the acquisition method set out in IFRS 3 *Business Combinations* would be applied to transactions that affect non-controlling shareholders of the receiving entity—subject to an exception and an exemption[1]—and a predecessor approach would be applied to all other transactions within the scope of the project, including all transactions between wholly owned entities.

2. At the October 2019 meeting, the Board discussed how a predecessor approach should be applied and tentatively decided that:

    (a) a receiving entity would recognise and measure assets and liabilities transferred in a business combination under common control at the carrying amounts included in the financial statements of the transferred entity; and

    (b) pre-combination information in the primary financial statements would be provided only about the receiving entity.

[1] A current value approach would be applied to transactions that affect non-controlling shareholders of a receiving entity unless equity instruments of the receiving entity are not traded in a public market and (1) all non-controlling shareholders are the receiving entity's related parties (the exception) or (2) the receiving entity chooses to apply a predecessor approach and all its non-controlling shareholders have been informed about the receiving entity applying that approach and not objected (the exemption).

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3. This paper discusses the remaining aspects of how a predecessor approach should be applied, specifically:

    (a) how the consideration paid in a business combination under common control should be measured and how transaction costs should be reported; and

    (b) how any difference between the consideration paid and the carrying amounts of assets and liabilities received in a business combination under common control should be presented.

4. The staff expect that these topics will complete the Board's discussion of how a predecessor approach should be applied.

Structure of this paper

5. This paper is structured as follows:

    (a) staff recommendations (paragraphs 6-7);

    (b) overview of findings in the staff's research and outreach (paragraphs 8-22);

    (c) consideration paid and transaction costs (paragraphs 23–47); and

    (d) the difference between the consideration paid and the carrying amounts of the assets and liabilities received (paragraphs 48–56).

Staff recommendations

6. The staff recommend that a receiving entity in a business combination under common control reported applying a predecessor approach should:

    (a) measure consideration paid in assets at the fair value of those assets at the date of combination;

    (b) measure consideration paid by incurring liabilities to or assuming liabilities from the transferor at the carrying amounts of those liabilities determined using applicable IFRS Standards on the initial recognition of those liabilities at the date of combination;

(c) recognise transaction costs as an expense in the statement of profit or loss in the period in which they are incurred except as stated in paragraph 6(d);

(d) recognise the costs to issue debt or equity instruments in accordance with IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments*; and

(e) recognise as a change within equity any difference between the consideration paid and the carrying amounts of assets and liabilities received in the business combination under common control.

7. The staff recommend that the Board should not prescribe:

(a) how the receiving entity should measure consideration paid in own shares; and

(b) in which component, or components, of its equity the receiving entity should recognise any difference between the consideration paid and the carrying amounts of assets and liabilities received in the business combination under common control.

Overview of findings in the staff's research and outreach

Review of requirements and guidance on a predecessor approach

8. As discussed in October 2019 Agenda Paper 23A *Predecessor approach—carrying amounts* and Agenda Paper 23B *Predecessor approach—pre-combination information*, in developing recommendations on how a predecessor approach should be applied, the staff reviewed requirements and guidance on applying a predecessor approach[2] to business combinations under common control and group restructurings. The staff's review covered, but was not limited to, requirements and guidance issued by member jurisdictions of the Accounting Standards Advisory Forum, the Emerging Economies Group and G20. In total, the staff's review covered 25 jurisdictions as well

[2] A predecessor approach is sometimes referred to in other GAAPs as 'pooling of interests method' or 'merger accounting'.

IPSAS 40 *Public Sector Combinations* issued by the International Public Sector Accounting Standards Board.

Consideration paid and transaction costs

9. Most of the GAAPs reviewed do not explicitly address measurement of consideration paid applying a predecessor approach. In some cases, national requirements or guidance set out a view that a predecessor approach is designed to reflect a *continuation* of benefits and risks associated with the combining businesses rather than an *acquisition* of those benefits and risks and do not provide guidance on how consideration paid should be measured; in other cases, the basis for the requirements and guidance is not explained. In both scenarios, the GAAPs reviewed tend to provide guidance on which predecessor carrying amounts should be used and what pre-combination information should be provided but do not tend to address measurement of consideration paid. In some cases, information about consideration paid is required to be provided in the notes. For example, Hong Kong Accounting Guideline 5 *Merger Accounting for Common Control Combinations* issued by the Hong Kong Institute of Certified Public Accountants requires disclosure of the composition of the consideration, and of fair value of the consideration other than shares issued.

10. Where requirements or guidance on measurement of consideration paid exist in national GAAPs, they vary and may depend on the form of consideration:

    (a) some GAAPs prescribe measuring consideration in the form of shares at nominal or par value of the issued shares and measuring other types of consideration at fair value (for example, FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* issued by the UK Financial Reporting Council);

    (b) some GAAPs require measuring consideration in the form of shares at nominal or par value of the issued shares and measuring other types of consideration at the carrying amounts (for example, Accounting Standard for Business Enterprises 20 *Business Combinations* issued by Ministry of Finance of the People's Republic of China);

    (c) in some jurisdictions, the measurement of shares issued to effect a business combination under common control is determined by reference to the

carrying amounts of assets and liabilities transferred in the combination (for example, Statement No. 21 *Revised Accounting Standard for Business Combinations* issued by the Accounting Standards Board of Japan).

11. The staff identified requirements or guidance on reporting transaction costs applying a predecessor approach in approximately a half of the reviewed GAAPs. When this topic is addressed, transaction costs directly attributable to a business combination under common control are required to be recognised as an expense in profit or loss. The staff identified such requirements or guidance in national GAAPs in Hong Kong, USA, UK, Japan, China, South Africa, Singapore, Malaysia, Turkey, Indonesia and in IPSAS 40. In a few cases, the costs of issuing debt or equity instruments to effect a business combination under common control are also addressed in national GAAPs. When this topic is addressed, such costs decrease the amount initially recognised for those instruments.

Difference between the consideration paid and the carrying amounts of assets and liabilities received

12. National GAAPs reviewed by the staff that address how a predecessor approach should be applied require the difference, if any, between the consideration paid and the carrying amounts of the assets and liabilities received in a business combination under common control to be recognised in equity. However, requirements or guidance on how this difference should be presented within equity vary and include the following:

    (a) the difference is required to be presented as a 'capital reserve', which is sometimes required to be presented separately from other reserves (for example, in FRS 102);

    (b) the difference is included within accumulated surplus or deficit or a similar component of equity (for example, in Accounting Standards Committee's Opinion on business combinations under common control[3]);

[3] Saudi Arabia's Accounting Standards Committee's Opinion on the *Accounting Treatment of Business Combinations in Which Entities Are under Common Control before the Combination or Are Connected to Each Other or to Other Parties That Control Some or All Combining Parties with a Related Party Relationship*.

(c) the difference is included within share premium or additional paid-in capital or a similar component of equity (for example, in PSAK 38 *Business Combination of Entities under Common Control* issued by the Indonesian Financial Accounting Standards Board); and

(d) the difference is required to be presented in equity but there are no specific requirements on where in equity the difference should be presented.

Guidance on a predecessor approach published by accounting firms

13. Guidance on applying a predecessor approach published by accounting firms reviewed by the staff states that an entity has an accounting policy choice in determining where within equity any difference between the consideration paid and the carrying amounts of assets and liabilities received in a business combination under common should be presented. Three of the four accounting firms' manuals reviewed by the staff discuss presenting any such difference within the receiving entity's 'capital account' referred to as 'merger reserve' or a 'similar' reserve or including any such difference within retained earnings. One accounting manual suggests that the choice on which component of equity to use may be influenced by the legal or regulatory requirements to which the reporting entity is subject.

14. The staff did not identify in the reviewed accounting firms' manuals any guidance on how to measure consideration paid or on how transaction costs should be reported applying a predecessor approach.

Research into current reporting practice

15. As discussed in September 2019 Agenda Paper 23A *When to apply which measurement approach*, the staff performed a desktop review of business combinations under common control reported applying IFRS Standards in annual reports filed between 1 January 2018–31 March 2019[4]. The staff's review identified

[4] In performing the desktop review, the staff used the financial search engine, *AlphaSense*. The search was limited to annual reports written in English and would identify the existence of business combinations under common control only if details of those transactions were disclosed in annual reports.

251 transactions reported applying a predecessor approach. In reviewing those transactions, the staff explored:

(a) which forms of consideration were used in practice (paragraph 16);

(b) how various types of consideration paid were measured (paragraphs 17);

(c) how transaction costs were reported (paragraph 18);

(d) in which component of equity any difference between the consideration paid and the carrying amounts of assets and liabilities received in a business combination under common control was presented (paragraphs 19); and

(e) whether there is a correlation between the component of equity in which that difference was presented and the form of consideration used in the transaction (paragraph 20).

16. The desktop review indicated that both cash and shares were common forms of consideration paid in the transactions reported applying a predecessor approach. Specifically, out of 251 such transactions reviewed:

(a) consideration was paid in cash in 96 cases;

(b) consideration was paid in shares in 42 cases; and

(c) a combination of cash, shares or liabilities was used in 19 cases.[5]

17. The staff further reviewed how consideration was measured in 61 transactions that were settled other than fully in cash (see paragraph 16(b)–(c)). In the transactions reviewed, the issued shares were measured at:

(a) nominal amount in 20 transactions (in China, Australia, Singapore, Hong Kong, India, Indonesia and Malaysia);

(b) fair value in 13 transactions (in Hong Kong, Australia, Sweden, Thailand and Malawi); and

[5] In the remaining 94 cases, the information provided in the financial statements was not sufficient to determine the form of consideration transferred.

(c) the carrying amounts of assets and liabilities received in four transactions (in Canada, Singapore and Jamaica).[6]

18. The staff identified 13 sets of financial statements that discussed treatment of transaction costs applying a predecessor approach. Almost all of them stated that transaction costs directly attributable to a business combination under common control were recognised in the statement of profit or loss and one entity stated that such costs were written off immediately in equity against reserves.

19. The staff's review indicated that when a predecessor approach is applied to a business combination under common control, any difference between the consideration paid and the carrying amounts of assets and liabilities received is always presented as a change within equity and in most cases within reserves. Specifically, out of 251 transactions reviewed, the difference was presented:

(a) within reserves in 185 cases, including as a special reserve (eg merger reserve, reorganisation reserve etc) in 98 cases and within general reserves in 87 cases;

(b) within retained earnings or a similar component of equity in 13 cases;

(c) as share premium, additional paid-in-capital or a similar component of equity in 31 cases;

(d) in the remaining 22 cases, the financial statements did not specify which component of equity the difference was included into, or the difference was allocated between several components of equity, or no difference arose.

20. The staff further explored whether there is a correlation between presentation in equity and the form of consideration. Specifically, the staff reviewed presentation of the difference between the consideration paid and the carrying amounts of assets and liabilities received in a business combination under common control for transactions settled solely in cash and transactions settled solely in shares. The staff's review did not identify any such correlation.

[6] In the remaining 24 cases, the information provided in the financial statements was not sufficient to determine how consideration was measured.

21. Finally, the staff's review also indicated that when national requirements and guidance exist, entities tent to apply those requirements and guidance in preparing their IFRS financial statements.

Input received in the initial outreach activities on the project

22. As discussed in September 2019 Agenda Paper 23A, at the initial stages of the project the staff discussed how a predecessor approach is applied in practice and how it should be applied with standard-setters and regulators from various jurisdictions. At that time, the staff expressed a view that the Board should not prescribe in which component of equity any difference between the consideration paid and the carrying amounts of assets and liabilities received should be presented, and should not prescribe how consideration in the form of own shares should be measured because both topics would be likely to be addressed by national requirements and regulations. At those meetings:

    (a) most of the standard setters supported the staff's view. Some noted that presentation as a change in equity is a legal question and that the relevant requirements differ between jurisdictions. Some suggested that the Board should consider requiring that entities adopt consistent presentation of a change in equity as an element of the entity's accounting policy for business combination under common control.

    (b) most participants at a European Enforcers Coordination Session agreed with the staff's view. Many stated that presentation of equity is a legal matter. However, most also expressed the view that it would be least appropriate to present any such difference within share capital. One participant asked the Board to provide direction on this topic.

Consideration paid and transaction costs

23. Based on the research and outreach performed, the staff identified the following questions for the Board to consider in developing proposals for how a predecessor approach should be applied:

(a) whether to specify how consideration paid in the form of own shares should be measured (paragraphs 24–26); and

(b) how consideration paid in assets and consideration paid by incurring liabilities to or assuming liabilities from the transferor should be measured, specifically:

(i) whether consideration paid in the form of assets should be measured at the fair value or at the carrying amounts of those assets at the date of combination (paragraphs 27–37);

(ii) whether consideration paid by incurring liabilities to or assuming liabilities from the transferor should be measured at fair value or at the carrying amounts of those liabilities determined using applicable IFRS Standards on initial recognition of those liabilities at the date of combination (paragraphs 38–42); and

(iii) how transaction costs should be reported (paragraphs 43–47).

Consideration paid in the form of own shares

24. The staff do not think that the Board should specify how consideration paid in the form of own shares should be measured. Applying the acquisition method set out in IFRS 3, consideration is measured at fair value, including consideration in the form of own shares. That method is built on the premise that consideration paid reflects fair value of the acquired business and possibly includes a premium in exchange for synergies expected by the acquirer. In those circumstances, measuring both consideration paid and acquired identifiable net assets at fair value would result in recognising goodwill that reflects:

(a) the value of goodwill that was internally generated by the acquired business before the acquisition; and

(b) any premium paid for the expected synergies.

25. However, applying a predecessor approach, assets and liabilities received in a business combination under common control would be recognised by the receiving entity at their predecessor carrying amounts and, provided that the Board agrees with

the staff recommendation in paragraph 55, any difference between the consideration paid and the carrying amounts of those assets and liabilities would be recognised in the receiving entity's equity. In that case, measurement of the consideration paid in the form of own shares would affect presentation within the receiving entity's equity but would not affect the total carrying amount of the entity's equity or any assets, liabilities, income or expenses recognised by the receiving entity. This is illustrated in Example 1.

Example 1: Measurement of consideration paid in own shares

Parent A wholly owns and controls Entity B and Entity C. Entity B issues 1,000 shares to Parent A to acquire Entity C. Par value of the shares of Entity B is CU2 per share. At the date of the combination, the fair value of shares of Entity B is CU2.2 per share. The carrying amount of the assets and liabilities of Entity C at the date of the combination is CU2,500. Entity B could reflect the combination as follows:

	Alternative 1–shares issued are measured at par value		**Alternative 2–shares issued are measured at fair value**	
	Debit	*Credit*	*Debit*	*Credit*
Net assets received	CU2,500		CU2,500	
Equity: share capital		CU2,000		CU2,000
Equity: share premium		—		200[(a)]
Equity: difference arising applying a predecessor approach [(b)]		500		300

(a) Difference between the fair value and the par value of the shares issued.

(b) Difference between the consideration paid (the par value or the fair value of the shares issued applying Alternative 1 and Alternative 2 respectively) and the carrying amounts of the assets and liabilities received.

As illustrated in the example applying Alternative 1 and Alternative 2, measurement of the consideration paid in the form of own shares would affect presentation within the receiving entity's equity but would not affect the total carrying amount of its equity.

26. The Board does not generally prescribe the form of presentation within a reporting entity's equity or measurement of issued shares because these matters are often affected by national requirements and regulations. Accordingly, the staff do not

recommend that the Board prescribes measurement of own shares transferred as consideration in a business combination under common control. As stated in paragraph 22, that view was generally supported by feedback in the initial outreach on the project.

Consideration paid in the form of assets

27. As noted in paragraph 25, provided that the Board agrees with the staff recommendation in paragraph 55, measurement of consideration paid in the form of own shares would affect only presentation within the receiving entity's equity and would not affect the carrying amounts of the entity's assets, liabilities or equity or its recognised income or expenses.

28. In contrast, measuring consideration paid in the form of assets other than cash at fair value or at their carrying amounts at the date of combination would affect any gain or loss recognised by the receiving entity on derecognition of those assets:

    (a) if consideration is measured at the carrying amounts of those assets, no gain or loss on disposal would be recognised; and

    (b) if consideration is measured at fair value, a gain or loss on disposal would be recognised.

29. In addition, provided that the Board agrees with the staff recommendation in paragraph 55, measuring consideration paid in the form of assets at fair value or at their carrying amounts would also affect presentation within the receiving entity's equity but would not affect the total carrying amount of the entity's equity, as illustrated in Example 2.

Example 2: Measurement of consideration in the form of assets

Parent A wholly owns and controls Entity B and Entity C. Entity B acquires Entity C in exchange for an item of Entity B's property. At the date of combination, the carrying amount of that property is CU2,000 and its fair value is CU2,200. Carrying amount of the assets and liabilities of Entity C at the date of the combination is CU2,500. Entity B would reflect the combination as follows:

	Alternative 1–consideration is measured at the carrying amount of the transferred asset		Alternative 2–consideration is measured at the fair value of the transferred asset	
	Debit	*Credit*	*Debit*	*Credit*
Net assets received	CU2,500		CU2,500	
Asset transferred		CU2,000		CU2,000
Profit or loss / retained earnings		—		200[(a)]
Equity: difference arising applying a predecessor approach [(b)]		500		300

(a) Difference between the fair value and the carrying amount of the asset transferred.

(b) Difference between the consideration paid (the carrying amount or the fair value of the transferred asset applying Alternative 1 and Alternative 2 respectively) and the carrying amounts of the assets and liabilities received.

As illustrated in the example applying Alternative 1 and Alternative 2, measurement of the consideration paid in the form of assets would affect any gain or loss on disposal recognised in the statement of profit or loss and would affect presentation within the receiving entity's equity but would not affect the total carrying amount of its equity.

30. The staff think that if the Board were to require measuring consideration in the form of assets at their carrying amounts rather than at their fair value, that would result in accounting outcomes that would differ between the following circumstances:

    (a) an entity transfers an asset other than cash as consideration in a business combination under common control; and

    (b) the entity sells the asset at fair value and uses the cash proceeds received as consideration in a business combination under common control.

31. The staff do not think that such an outcome would be appropriate or would provide useful information to users of the receiving entity financial statements. Generally, the staff do not see conceptual basis for *not* recognising an economic gain or loss on disposal of an asset. Paragraph 5.27 of the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*) states that accounting requirements for

derecognition aim to faithfully represent the change in the entity's assets and liabilities. Paragraph 5.28(a) of the *Conceptual Framework* further states that this aim of faithful representation is achieved by, among other things, recognising any income or expenses resulting from derecognition of an asset or liability.

32. The staff reviewed the requirements of existing IFRS Standards and noted that a gain or loss on disposal of assets is typically required to be recognised—and such an outcome would be achieved if the consideration paid in the form of assets in a business combination under common control is measured at fair value of those assets and would not be achieved if such consideration is measured at the carrying amounts of those assets.

33. The staff identified two instances where a gain or loss on disposal of assets is not recognised applying existing requirements in IFRS:

    (a) applying IAS 16 *Property, Plant and Equipment*, if an item of property, plant and equipment is transferred in exchange for another item of property, plant and equipment and at least one of the following conditions is met:

        (i) the exchange lacks commercial substance; or

        (ii) fair value of neither the asset received nor the asset given up is reliably measurable; and

    (b) applying the *IFRS for SMEs*® Standard, distribution of non-cash assets to an entity's owners is measured at the carrying amounts of the assets being distributed if the fair value of those assets cannot be measured reliably without undue cost or effort.

34. However, the staff do not think that the logic for those requirements in IAS 16 and *IFRS for SMEs* Standard applies to measuring the consideration paid in the form of assets in a business combination under common control.

35. Furthermore, the staff think that the requirements of IFRIC 17 *Distributions of Non-cash Assets to Owners* should also be considered. IFRIC 17 requires an entity to measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. When the entity settles the liability, it recognises

the difference between the carrying amount of the assets distributed and the carrying amount of the liability in the statement of profit or loss.

36. Accordingly, for the reasons discussed in paragraphs 28–35, the staff recommend that the Board should require the consideration paid in the form of assets to be measured at fair value of those assets at the date of combination.

37. The staff acknowledge that such a requirement would create more burden for entities than measuring the consideration paid in the form of assets at the carrying amounts of those assets. However, the staff note that based on their desktop review of transactions that form of consideration is rare—as discussed in paragraph 16, the staff have not identified any transactions where consideration took that form. Accordingly, the staff think that requiring consideration paid in the form of assets to be measured at fair value would appropriately consider both the benefits of the resulting information and the costs of providing such information.

Consideration paid by incurring liabilities to or assuming liabilities from the transferor

38. A receiving entity might provide part or all of the consideration for a business combination under common control by incurring new liabilities, or by assuming existing liabilities of the transferring entity. Examples of liabilities that can be incurred or assumed by the receiving entity in exchange for a business transferred in a business combination under common control include, but are not limited to, financial liabilities, performance obligations, pensions, provisions.

39. As noted in paragraph 28, measuring consideration paid in the form of assets other than cash at fair value or at their carrying amounts at the date of combination would affect any gain or loss recognised by the receiving entity on derecognition of those assets. In contrast, measuring consideration paid by incurring liabilities to or assuming liabilities from a transferor at fair value or at the carrying amounts of those liabilities determined using applicable IFRS Standards on initial recognition of those liabilities at the date of combination would not have any such effect.

40. Furthermore, as discussed in paragraph 24, measuring consideration at fair value applying the acquisition method is expected to result in recognition of goodwill that

reflects goodwill internally generated by the acquired business before the acquisition and any premium for the expected synergies. Applying a predecessor approach, no goodwill is recognised in a business combination under common control. Instead, if the Board agrees with the staff recommendation in paragraph 55, measurement of consideration paid in the form of incurring liabilities to or assuming liabilities from the transferor would affect the carrying amount of the receiving entity's equity.

41. The staff do not see any rationale for measuring consideration paid in a business combination under common control applying a predecessor approach by incurring liabilities to or assuming liabilities from the transferor at other than their carrying amounts determined using applicable IFRS Standards on initial recognition of those liabilities, at the date of combination. Furthermore, the staff think that using IFRS Standards that apply on initial recognition of liabilities would provide the most useful information about those liabilities in such transactions—and those Standards would continue to apply to subsequent measurement of those liabilities.

42. Accordingly, on the basis of the analysis in paragraphs 39–41, the staff recommend that the Board requires measuring consideration paid by incurring liabilities to or assuming liabilities from the transferor at their carrying amounts determined using applicable IFRS Standards on initial recognition of those liabilities at the date of combination.

Transaction costs

43. Applying the *Conceptual Framework*, transaction costs are added in the initial measurement of an asset, and deducted in the initial measurement of a liability if that asset or liability is measured at historical cost; if the asset or liability is measured at current value, transaction costs are typically recognised as an expense when incurred (except when the asset or liability is measured at current cost, which is not a commonly used measurement basis in IFRS Standards).

44. Applying the acquisition method, acquisition-related costs that the acquirer incurs to effect a business combination are recognised as an expense as incurred, except that the costs to issue debt or equity instruments are recognised in accordance with IAS 32 and IFRS 9. In developing IFRS 3, the Board and the US Financial Accounting

Standards Board (boards) concluded that acquisition-related costs are not part of the exchange between the buyer and the seller for the business. Rather, they are separate transactions in which the buyer pays for the services received. In addition, the boards also observed that those costs do not represent assets of the acquirer because the benefits are consumed as services are received.

45. As discussed in paragraph 11, a similar approach is adopted in those national GAAPs reviewed by the staff that prescribe treatment of transaction costs applying a predecessor approach. Transaction costs directly attributable to the business combination under common control are generally expensed, and costs of issuing debt and equity instruments are included in the initial measurement of those instruments. Furthermore, as discussed in paragraph 18, the staff's desktop review of the current practice also indicated that transactions costs are typically recognised in profit or loss.

46. Based on the considerations discussed in paragraphs 43–45, the staff think that applying a predecessor approach transaction costs should be recognised as an expense in the statement of profit or loss in the period in which they are incurred—except that costs to issue debt and equity instruments should be recognised in accordance with IAS 32 and IFRS 9. The staff think that the guidance in the *Conceptual Framework* on reporting transaction costs arguably does not apply to analysing a predecessor approach—this is because the *Conceptual Framework* does not envisage measurement of assets and liabilities at their predecessor carrying amounts. However, the staff think that the boards' rationale for determining requirements for acquisition-related costs applying the acquisition method summarised in paragraph 44 can equally apply to reporting business combinations under common control applying a predecessor approach.

47. Accordingly, the staff recommend that transaction costs applying a predecessor approach are recognised as an expense in the statement of profit or loss in the period in which they are incurred, except that costs to issue debt and equity instruments are recognised in accordance with IAS 32 and IFRS 9. As noted above, such an approach would also be consistent with the requirements of national GAAPs reviewed by the staff and the prevailing reporting practice.

The difference between the consideration paid and the carrying amounts of the assets and liabilities received

48. As discussed in paragraphs 12 and 19, the staff's review of national GAAPs and of current reporting practice indicated that applying a predecessor approach the difference between the consideration paid and the carrying amounts of assets and liabilities received in a business combination under common control is recognised in equity, although presentation of that difference within equity varies. In the rest of this section, we use the term 'difference' as a concise label for that amount.

49. Applying IFRS Standards, changes in equity arise from one of two sources: transactions with owners acting in their capacity as owners or comprehensive income. Arguably, economically the difference that may arise[7] applying a predecessor approach does not arise from either of those phenomena, or at least not the entire difference—although a portion of that difference could in some cases represent a contribution from or a distribution to the receiving entity's owners and a portion of that difference could represent income or expense.

50. The question therefore arises how this difference should be recognised and in particular whether for recognition purposes this difference should be split into components each depicting different economic phenomena.

51. Economically, the difference could include the following components:

    (a) any difference between the carrying amounts of assets and liabilities received and their fair values—essentially, any unrecognised appreciation of net assets of the transferred entity that reflects economic benefits that those assets are capable of generating. It could be argued that this component of the difference meets the definition of an asset from the point of view of the receiving entity. Indeed, applying the acquisition method

[7] A difference between the consideration paid and the carrying amounts of assets and liabilities received would arise if the transaction is conducted at other than the carrying amounts of those assets and liabilities. The staff think that transactions within the proposed scope of a predecessor approach (eg transactions involving wholly owned private entities) may sometimes be conducted at those carrying amounts—rather than at fair value, which would often be required by laws and regulations for transactions that affect non-controlling shareholders. For transactions conducted at carrying amounts, no difference would arise.

those amounts would be included in the measurement of the identifiable assets and liabilities acquired.

(b) any difference between the fair values of assets and liabilities received and the fair value of the transferred business as a whole—essentially, any goodwill internally generated by that business that reflects economic benefits that the transferred business as a whole is capable of generating. Again, applying the acquisition method, that amount would be included in the measurement of goodwill that is recognised as an asset.

(c) any difference between the fair value of the transferred business and the total amount at which the consideration paid would be measured in accordance with the staff recommendations in paragraphs 26, 36, 42 and 47—essentially, applying existing requirements in IFRS Standards for derecognising assets and for recognising liabilities and own shares. This component of the total difference could in theory comprise the following sub-components:

(i) if the transaction is conducted at fair value, a payment for expected synergies that would arguably arise in relation to a phenomenon that constitutes an asset for the receiving entity;

(ii) if the transaction is not conducted at fair value, a distribution to or a contribution from owners acting in their capacity as owners; and

(iii) the effects of measuring the consideration paid in accordance with the staff recommendations in paragraphs 26, 36, 42 and 47 applying existing requirements in IFRS Standards—rather than measuring it at fair value as is required for acquisitions in the scope of IFRS 3.

52. The staff think that when a predecessor method is used, segregating the total difference into some or all of the components described in paragraphs 51 would not be desirable and may not even be possible. This is because doing so would:

(a) essentially eliminate the distinctions between the acquisition method and a predecessor approach and create costs and complexity for preparers, which would contradict one of the Board's arguments for proposing a predecessor

approach in specified circumstances—to consider the cost constraint described in the *Conceptual Framework*;

(b) involve a significant degree of measurement uncertainty, in particular attempting to measure the fair value of the transferred business but also attempting to measure the fair value of individual assets and liabilities received in a transaction within the proposed scope of a predecessor approach (eg a transaction involving wholly owned private entities); and

(c) create significant additional complexity for users of financial statements and thus may not provide the most useful information, especially given the measurement uncertainty involved.

53. Accordingly, based on the analysis in paragraphs 51–52, the staff do not think that the difference should be segregated into components.

54. Applying the *Conceptual Framework*, from the point of view of the receiving entity, the difference *in its entirety* does not appear to represent any element of the financial statements defined in the *Conceptual Framework* nor does it reflect any measurement basis discussed in the *Conceptual Framework*. From the point of view of the combined entity, the difference represents a change in the combined entity's assets and liabilities. That change does not, at least not in its entirety, result from transactions with owners acting in their capacity as owners. Furthermore, it does not constitute an item of income or expense that could be recognised in other comprehensive income—this is because this change does not arise from a periodic remeasurement.[8] Finally, recognising the change in the combined entity's assets and liabilities in its entirety in the statement of profit or loss would not appear to provide relevant information or provide faithful representation of the transaction.

55. The staff note that applying a predecessor approach, the prevailing current practice is to recognise any difference between the consideration paid and the carrying amounts of assets and liabilities received in a business combination under common control in equity. Accordingly, considering that practice, as well as the analysis in paragraphs

[8] Paragraph 7.17 of the *Conceptual Framework*

49–54, notably the cost-benefit considerations discussed in paragraph 52, the staff recommend that the difference would be recognised in the receiving entity's equity.

56. Furthermore, for the reasons stated in paragraph 26, the staff do not recommend that the Board prescribes in which component, or components, of equity that difference should be presented.

Questions for the Board

Question 1
Does the Board agree with the staff recommendation to require a receiving entity in a business combination under common control reported applying a predecessor approach to: (a) measure consideration paid in assets at the fair value of those assets at the date of combination; (b) measure consideration paid by incurring liabilities to or assuming liabilities from the transferor at the carrying amounts of those liabilities determined using applicable IFRS Standards on the initial recognition of those liabilities at the date of combination; and (c) recognise transaction costs as an expense in the statement of profit or loss in the period in which they are incurred and recognise the costs to issue debt or equity instruments in accordance with IAS 32 and IFRS 9?

Question 2
Does the Board agree with the staff recommendation not to prescribe how a receiving entity in a business combination under common control reported applying a predecessor approach should measure consideration paid in own shares?

Question 3

Does the Board agree with the staff recommendation to require a receiving entity in a business combination under common control reported applying a predecessor approach to recognise as a change within equity any difference between the consideration paid and the carrying amounts of assets and liabilities received but not prescribe in which component, or components, of the receiving entity's equity that difference should be presented?