IFRS

STAFF PAPER

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IASB® meeting

Project	Business Combinations under Common Control
Paper topic	Review of academic literature
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Purpose

1. This paper provides an overview of academic papers we identified that are relevant to reporting business combinations under common control (BCUCC). All papers were identified from EBSCO, Social Science Research Network, Google Scholar and other databases of academic studies and include working and published papers.

2. This literature review is based on:

    (a) an updated summary of the academic literature relevant to BCUCCs conducted before publishing the Discussion paper (Agenda Paper 23B of the International Accounting Standards Board (IASB)'s February 2020 meeting); and

    (b) six additional academic papers—three academic commentaries (items 1, 2 and 3 in Appendix A) and three papers providing descriptive evidence (items 5, 6 and 7 in Appendix B).

3. An important caveat when interpreting findings is that researchers may have difficulty identifying BCUCCs because different entities use different terms to refer to such transactions. As a result, authors may unintentionally include in their sample transactions that are not BCUCCs or exclude transactions that are BCUCCs. This could affect the validity of the findings.

4. Staff commentary is included for some papers where we identified something notable. Staff commentary is not intended to be an exhaustive list of all possible observations because we review papers primarily to identify major findings and not to thoroughly critique each paper.

Structure of this paper

5. This paper includes:

   (a) key messages (paragraphs 6–11);

   (b) question for the IASB;

   (c) Appendix A—Academic commentaries;

   (d) Appendix B—Descriptive evidence; and

   (e) Appendix C—Empirical evidence[1].

Key messages

Academic commentaries

6. Researchers generally agree that the method used to account for BCUCCs should:

   (a) be determined on a transaction-by-transaction basis;

   (b) depend on:

      (i) the economic substance of the underlying transaction; and

      (ii) the type of users and users' information needs.

[1] Academic commentaries express researchers' opinions based on existing academic and non-academic literature on BCUCCs. Descriptive evidence provides information about the characteristics of entities involved in BCUCC and the accounting methods applied. Empirical evidence is based on quantitative data analyses that examine the reasons and consequences of entities' choices and looks for associations between variables,

Descriptive evidence

7. The research documents significant variation across entities in:

   (a) the methods used to account for BCUCCs; and

   (b) disclosure of information about BCUCCs.

8. Researchers document that the reasons entities undertake BCUCCs are for:

   (a) organisational motivations (for example restructuring); and

   (b) strategic motivations (for example synergies).

9. The authors of two studies, based on Chinese entities, argue that BCUCCs in China are reorganisations and not capital market transactions and the pooling of interests method is more appropriate to account for BCUCCs.

Empirical evidence

10. One study documents that entities apply discretion in choosing the method for BCUCCs—entities use the acquisition method to reduce accounting leverage.

11. One study, based on Chinese entities, examines the value relevance—association between stock prices and returns and earnings and equity values—of using the acquisition versus the book value method to account for BCUCCs. The researchers compare audited book value method amounts and 'as if' acquisition method amounts and conclude that the book value method is more value relevant.[2]

Question for the IASB
Does the IASB have any questions or comments on the academic literature summarised in this paper?

[2] See item 2 in Appendix C for more explanation.

Appendix A—Academic commentaries

Title, author(s) and scope	Overview of paper's conclusions and findings
1. Bradbury, M. (2021). 'Business combinations under common control: Further considerations', *Australian Accounting Review*, *Forthcoming.*	This commentary responds to Tarca (2021)'s paper explaining the IASB's preliminary views and Seah-Tan (2021)'s discussion of a preparer's perspective on those preliminary views.[3] The author discusses the IASB's preliminary views and says: (a) measurement should depend on the substance of the underlying transactions and not ownership (non-controlling shareholders). (b) using controlling entity's book values would provide more relevant and comparable information than using transferred entity's book values when applying a book-value method. (c) BCUCCs are related party transactions and regardless of the accounting method applied, disclosure is key to meet the needs of: (i) non-controlling shareholders in the transferring entity (and not just in the receiving entity); and (ii) creditors and lenders of both the transferring and receiving entities.
2. Onesti, T., Romano, M. and M. Taliento. (2015). 'Business combinations under common control: Concerns, criticisms and strides', *Financial Reporting,* 1, 107–126.	The authors assess possible accounting methods for BCUCCs and conclude that entities should choose the most suitable method on a transaction-by-transaction basis: (a) acquisition method—if IFRS 3 *Business Combinations* can be applied by analogy, and the benefits of applying the method outweigh the costs; (b) fresh-start accounting method;[4] or

[3] Tarca, A. (2021). 'Business combinations under common control: Filling a Gap in IFRS Standards', *Australian Accounting Review, Forthcoming;*
Seah-Tan, S. (2021). 'Business combinations under common control: A controlling entity cost approach, *Australian Accounting Review, Forthcoming.*
[4] Entities applying a fresh-start accounting method would apply IFRS 3 recognition and measurement principles to all assets and liabilities of the newly formed group (including the receiving entity's assets and liabilities) at the acquisition date.

Title, author(s) and scope	Overview of paper's conclusions and findings
	(c) predecessor method.[5] In the authors' view, the application of recognition and measurement principles depends on the type of users and users' information needs.
3. Onesti, T., Romano, M. and M. Taliento. (2015). 'Acquisition-type or merger-type accounting? Further insights on transactions involving businesses governed by the same party(-ies)', *Financial Reporting,* 2, 117–137.	The researchers examine the accounting methods for BCUCCs considered by standard-setting or advisory bodies and classify these methods into two categories:[6] (a) 'acquisition-type' accounting methods which use fair value and include: (i) acquisition method; and (ii) fresh start accounting method; and (b) 'merger-type' accounting methods which use historical cost and include: (i) predecessor method; and (ii) pooling of interests method.[7] The researchers say the selected method should focus on users' needs and provide decision-useful information based on the BCUCC's economic substance. In the researchers' view: (a) a fair-value based method would be acceptable when a BCUCC has economic substance (for example, in presence of other equity investors such as non-controlling shareholders or investors in convertible bonds or publicly offered financial instruments). (b) a historical cost-based method would be suitable for reorganisations or restructurings that involve related parties and the prevailing interest is held by the ultimate parent entity.

[5] Applying the predecessor method, the receiving entity recognises the transferred entity's assets and liabilities at the values registered in the last consolidated balance sheet of the transferring entity (the fair values based on the original acquisition of the transferred entity by the transferring entity from a third party).

[6] The researchers examine official documents issued by the European Financial Reporting Advisory Group-Organismo Italiano-Contabilità, IASB, the Financial Accounting Standards Board (FASB) and the Korean Accounting Standards Board.

[7] The pooling of interests method aggregates the book values of assets and liabilities of the transferred entity and the receiving entity.

Appendix B—Descriptive evidence

Title, author(s) and scope	Overview of paper's conclusions and findings	Staff observations
1. Baker, C. R., Biondi, Y., and Q. Zhang. (2010). 'Disharmony in international accounting standards setting: The Chinese approach to accounting for business combinations', *Critical Perspectives on Accounting,* 21 (2), 107-117. Case study: TCL Group reorganization - TCL Group (state-owned parent) merger with TCL Communication Equipment Co (market-listed subsidiary) through an exchange of shares The study provides comparative financial analysis of the impact of the pooling method (as reported) versus the purchase method (based on authors' construction of 'as if' information).	The authors argue that the Chinese standard-setters' decision to allow the pooling of interests method of accounting for business combinations is based on consideration of political and economic factors. The authors also say business combinations in China are reorganisations among economic entities and not capital market transactions. In their analysis, the authors observe that the pooling method compared to 'as if' acquisition method (referred to as the purchase method) results in lower return on equity (11.39% vs 25.21%) and lower debt to equity ratio (273% vs 451%). The authors interpret this result as a significant negative effect of the acquisition method on the receiving entity's consolidated financial statements.	A limitation of the study is that the authors substitute undisclosed 'as if' acquisition data with their proxy for such data. They compute goodwill as the difference between the market and book value of the combined entity at the acquisition date, based on the listed shares only and without recognising any control premium. This approach raises questions about the accuracy of the data, which may limit the inferences and conclusions from the study.
2. Baker, C. R., Biondi, Y., and Q. Zhang. (2012). 'Should merger accounting be reconsidered? A discussion based on the Chinese approach to accounting for	The authors say differences between Accounting Standard for Business Enterprises 20 *Business Combinations* (issued by the Ministry of Finance of the People's Republic of China) and FASB 141/ IFRS 3 are driven by the Chinese accounting standard	The study provides useful details about business combinations in China, a significant number of which are under common control.

Title, author(s) and scope	Overview of paper's conclusions and findings	Staff observations
business combinations', Unpublished working paper. Case study: Further analysis of the TCL Group reorganisation - TCL Group (state-owned parent) merger with TCL Communication Equipment Co (market-listed subsidiary) through an exchange of shares.	setting body's different view of business combinations, which is based on the prevalence of reorganisations among entities under common control. The authors propose two issues that need to be considered in developing a new framework aimed at harmonising and enhancing both the Chinese approach and the FASB and the IASB's approach: (a) distinguish business combinations with related parties from business combinations with unrelated parties; and (b) distinguish business combinations with continuity from business combinations with discontinuity in the operations of the combining entities. The authors argue that in the case of related entities, a variant of the pooling method may be the preferred option. In the case of unrelated entities, checking for continuity in the operations of the combining entities is an important second step. Continuity may make the pooling of interests method preferable, while a discontinuity of one of the combining entities may make the purchase method the preferred option.	This paper uses the same case study as the one used by Baker et al. (2010)—see item 1. Therefore, there is a significant overlap in the conclusions of the two studies.
3. Biancone, P. (2013). 'Business combinations under common control (BCUCC): the Italian experience', *GSTF Business Review (GBR)*, 2 (3), 51-60.	The authors examine entities' related disclosures for 2011. Of the 48 Italian stock exchange entities, a third disclosed the reason for the transaction. Organisational motivations, such as restructuring, prevailed over strategic motivations, such as exploiting synergies. About 30% of the 48 entities disclosed the accounting	The study provides evidence on the frequency and type of BCUCCs, based on Italian entities' related disclosures. A limitation of the study is that the authors do not explain how they identify the related

<table>
<tr><th>Title, author(s) and scope</th><th>Overview of paper's conclusions and findings</th><th>Staff observations</th></tr>
<tr><td>Sample: Entities listed on Italian stock exchange (n = 128) and entities listed on FTSE MIB index (Italian and foreign entities) (n = 23), sample period 2009–2012 with focus on disclosures in 2011.

For that year, 38% of the sample of Italian stock exchange entities (48 entities) and 56% of the FTSE MIB entities (13 entities) were involved in at least one BCUCC.</td><td>treatment for BCUCCs which in the authors' view indicates low relevance of information about the accounting treatment.

From the FTSE MIB sample of 13 companies involved in at least one BCUCC in 2011, 40% disclosed reasons for the transaction and about six per cent disclosed the accounting method used.</td><td>disclosures–whether through reading the full report or through word search. Therefore, it is difficult to conclude how thorough their analysis is and how robust their findings are.

The authors do not examine financial data reported by the sampled entities, which would be useful for standard-setters in assessing the financial effects of the accounting methods used.</td></tr>
<tr><td>4. Janowicz, M. (2017). 'Business combinations under common control in International Financial Reporting Standards–is authoritative accounting guidance needed?', Zeszyty Teoretyczne Rachunkowości, (93), 97-112.

Sample: Entities listed on the Warsaw Stock Exchange and the alternative trading market (New Connect) that reported using IFRS Standards (n = 162), sample period 2005–2015. [8]</td><td>The research notes significant variation across entities in the methods used to account for BCUCCs and disclosure of information about BCUCCs. The author documents that of the sampled entities:
(a) 18% used the acquisition method;
(b) 37% used the pooling of interests method;
(c) 25% used the predecessor method; and
(d) 20% did not disclose information about the method used.

The author argues that a lack of explicit guidance on accounting for these transactions may decrease comparability of financial statements and lead to</td><td>The study's identification of BCUCCs through analysis of entities' reports provides some assurance that the business combinations examined are identified by the entity as a BCUCC.

A limitation of the study is that it does not provide information on the characteristics of entities that choose different methods of accounting for such transactions or of the circumstances when different methods are used. Therefore, apart from concluding that there is wide variation in the methods used, it is impossible to draw inferences about</td></tr>
</table>

[8] Entities in Poland are required by the Accounting Act of 1994 (Poland) to use national accounting regulations which allow the use of the pooling of interests method if the entity chooses to not apply IFRS Standards to account for a BCUCC.

Title, author(s) and scope	Overview of paper's conclusions and findings	Staff observations
The author examines business combinations involving listed entities and identifies around 90% of them to be BCUCCs. The BCUCCs are mainly concentrated in the later part of the sample period, namely in the years 2009–2015 (except 2010).	possible manipulation of information provided especially when full disclosure on the accounting method used is not provided. The author concludes that guidance on accounting for BCUCCs is necessary and argues for allowing both the predecessor method and acquisition method, depending on the substance of the transaction. The author also emphasises the importance of requiring a uniform set of disclosures.	entities' incentives to choose one method over the other. Even though the author examines in detail the financial statements of the entities in the sample, they do not attempt to quantify the effects of alternative methods on entities' financial statements, which would be informative.
5. Janowicz, M. (2018). 'The quality of information about business combinations under common control (BCUCC) disclosed under International Financial Reporting Standards (IFRS)', *Finanse, Rynki Finansowe,* 94 (1), 99-107. Sample: Publicly listed Polish entities involved in BCUCCs that reported using IFRS Standards in 2016 (n = 30 BCUCCs, 28 entity observations).	The researcher examines the scope of disclosure in parent and consolidated financial statements of receiving entities involved in BCUCCs. The author identifies a number of minimum disclosure items and assesses entities' disclosure in both sets of financial statements of these items: (a) entities involved in the BCUCC; (b) reason for the BCUCC; (c) nature of the transaction (description of the relation between the two entities); (d) method used to account for the BCUCC and details about the method; and (e) financial statement effects of the BCUCC. The findings are that: (a) disclosure varied between the parent and consolidated financial statements of the receiving	Based on the descriptive evidence, the author questions the usefulness and comparability of information on BCUCCs. However, as the author acknowledges, it is difficult to tell whether certain items are not disclosed because they are immaterial.

Title, author(s) and scope	Overview of paper's conclusions and findings	Staff observations
	entity and across the examined disclosure items; and (b) entities disclosed less information in consolidated financial statements than in parent entity financial statements. The descriptive statistics show that of the sampled entities: (a) ten percent used the acquisition method; (b) 37% used the pooling of interests method; (c) 40% used 'other' methods[9]; and (d) 13% did not disclose information about the method used.	
6. Janowicz, M. (2021). 'Business combinations under common control (BCUCC) – What kind of disclosure is enough? The Polish experience', *European Research Studies Journal,* 24 (2B), 1004-1013. Sample: Entities listed on the Warsaw Stock Exchange and the alternative trading market (New Connect) that are involved in legal mergers (n = 238	The researcher focuses on entities that did not apply acquisition method to account for BCUCCs and documents: (a) variation in the method used by sampled entities to account for BCUCCs: (i) 44% used pooling of interests method; (ii) 25% used predecessor method; (iii)six percent used a method combining the carrying amounts of assets, liabilities, and equity after adjusting for intercompany	The motivation for the study is to examine whether entities that apply national accounting requirements (pooling of interests method) provide comparable disclosures to those applying IFRS Standards (acquisition method). The purpose of the study is to inform the IASB' redeliberations of the Discussion Paper. The author, however, excludes entities applying the acquisition method from the sample which does not allow for a direct

[9] An example of 'other' methods used was adding only the elements of the statements of financial position.

Title, author(s) and scope	Overview of paper's conclusions and findings	Staff observations
BCUCCs, 204 entity observations), sample period 2009–2019.	transactions and differences in accounting policies between the acquirer and the acquiree; and (iv) the remaining 25% did not disclose information on the method used; and (b) entities using the pooling of interests method (allowed by the Polish Accounting Act) disclosed more information than other entities that used professional judgement in accounting for BCUCC. The researcher assesses the scope of entities' disclosure against the minimum set of disclosure items identified in Janowicz (2018)—see item 5.	comparison between acquisition and pooling of interests method disclosures. The author does not examine whether differences in the disclosure of information about BCUCCs relate to the size of the combining entities and their type of business activities and attributes differences in disclosure to the entity's choice of method. This could lead to biased inferences about the association between the level of disclosure and the choice of method.
7. Perćevic, H. and M. Ercegović. (2021). 'Possible approaches for accounting for business combinations under common control – Evidence from, Croatian consolidated groups', Proceedings of FEB Zagreb International Odyssey Conference of Economics and Business. Sample: Publicly listed entities that prepare IFRS consolidated financial statements in Croatia (n=160), sample period: 2017 and 2019.	The authors examine the accounting methods used for BCUCCs. The findings are that: (a) nine percent (21%) of the sampled entities disclosed information about the method used in 2017 (2019). (b) all entities that disclosed the method applied a book value method. Of these: (i) 57% (53%) applied predecessor method in 2017 (2019); (ii) 29% (29%) applied pooling of interests method in 2017 (2019); and (iii) 14% (18%) applied consolidated entity's book value method in 2017 (2019).	The study does not examine the reasons for the increase in the number of entities disclosing information in 2019 compared to 2017.

Appendix C—Empirical evidence

Title, author(s) and scope	Overview of paper's conclusions and findings	Staff observations
1. Bonacchi, M., Marra, A., and R. Shalev. (2015). 'Fair value accounting and firm indebtedness–evidence from business combinations under common control', Unpublished working paper. Sample: Listed entities from 18 European countries, (n = 230 (147 using acquisition method and 83 using predecessor method)), sample period 2005–2012.	The researchers conclude that entities choose to use a fair value method (ie the acquisition method) to reduce accounting leverage. To corroborate the above conclusion, the authors examine whether entities make use of the lower accounting leverage to issue more public debt in the four quarters following the BCUCC. They find that entities using the acquisition method, but not those using the predecessor method, are more likely to issue new public debt in the period following the transaction relative to comparable entities that did not undertake a BCUCC.	A limitation of the study is that the transactions examined (n = 230) are only a small fraction of BCUCCs involving European listed entities in the period 2005–2012 (n = 3,882). Therefore, the study's sample may not be fully representative of the whole population. The descriptive statistics show that some transactions had non-controlling interest (39% are accounted for at fair value, 32.5% are accounted for using the predecessor method). It would be informative to know more about the reasons why entities choose one method over the other in the presence of non-controlling interest.
2. Chen, S., Han, W. and Q. Zhang (2021). 'Predecessor versus acquisition: Evidence of business combinations under common control from China', *Emerging Markets Finance and Trade,* 57 (8), 2356-2369.	The researchers estimate the value relevance of the predecessor method versus the acquisition method for BCUCCs in China. In the empirical analyses the authors use numbers that are recognised and audited, based on the predecessor method, and estimate 'as if' acquisition method numbers based on disclosures in the notes to the financial statements. The findings are that:	The study provides evidence on the value relevance of the predecessor and acquisition methods, using a relevant research setting and a reasonable time frame. However, the evidence is not conclusive. It suffers from some methodological limitations. A limitation of studies relying on comparison of numbers recognised in audited financial statements and 'as if' numbers constructed by the authors from

Title, author(s) and scope	Overview of paper's conclusions and findings	Staff observations
Sample: Entities in China observations (n = 212), sample period 2010–2018.	(a) predecessor method earnings explain more of the variation in returns than acquisition method earnings; (b) the association between returns and earnings *changes* is stronger for the predecessor method but there is no difference in the association between returns and earnings *levels* across the two methods; (c) the value relevance of predecessor method earnings and equity values is not statistically different from the value relevance of 'as if' acquisition method earnings and equity values; (d) the association between prices and earnings is stronger for the predecessor method but there is no difference in the association between prices and equity values across the two methods; (e) the predecessor method is more value relevant than the 'as if' acquisition method only for the sub-sample of entities with a higher ratio of fair value to book value of equity;[10] and	disclosures in the financial statements is that the studies cannot provide grounds for standard setting. Researchers cannot observe 'as if' prices/returns that would be obtained if the alternative method were used. In addition, using association studies to examine the usefulness of alternative accounting policies can only shed light on whether the market behaves as if it both (1) believes and (2) attaches some weight to information provided to it (Ronen, 2001) [11].

[10] The motivation for this test is that investors in China might be concerned about the reliability of fair value information compared to that in mature markets. In the researchers' view, the greater the difference between the fair value and the book value of the assets acquired is, the more likely the fair value estimates contain errors and biases. Based on this, the researchers predict that the value relevance of earnings is higher for the predecessor method when the fair value to book value of equity ratio is higher.

[11] Ronen, J. (2001). On R&D capitalization and value relevance: a commentary. *Journal of Accounting and Public Policy*, 20 (3), 241-254.

Title, author(s) and scope	Overview of paper’s conclusions and findings	Staff observations
	(f) the predecessor method earnings have stronger predictive ability for future earnings and future cash flows than the ‘as if’ acquisition method earnings.	