Staff paper

Agenda reference: 30B

IASB® meeting

Date	**February 2024**
Project	**Second Comprehensive Review of the *IFRS for SMEs*® Accounting Standard**
Topic	**Proposed amendments to Section *19 Business Combinations and Goodwill***
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Purpose of this paper

1. The purpose of this paper is to ask the International Accounting Standards Board (IASB) to:

   (a) consider feedback on the proposals in the Exposure Draft *Third edition of the* IFRS for SMEs *Accounting Standard* (Exposure Draft) to align Section 19 *Business Combinations and Goodwill* of the *IFRS for SMEs* Accounting Standard (the Standard) with the acquisition method of accounting in IFRS 3 *Business Combinations*[1]; and

   (b) decide whether to proceed with its proposals in the Exposure Draft to amend Section 19 of the Standard.

2. In this paper, the term SMEs refers to entities that are eligible to apply the Standard.

[1] IFRS 3 refers to the IFRS 3 (2008) version, including subsequent amendments to IFRS 3.

Staff recommendation

3. The staff recommend the IASB proceeds with its proposed amendments to Section 19 of the Standard as in the Exposure Draft, including on, among other proposals:

   (a) introducing requirements for an acquisition achieved in stages (step acquisitions) as set out in IFRS 3.

   (b) not introducing the fair value option for measuring non-controlling interest in the acquiree.

   (c) not introducing application guidance, as set out in paragraphs B36 and B53 of IFRS 3, on reacquired rights regarding the settlement of pre-existing relationships.

4. The staff also recommend the IASB:

   (a) removes the non-mandatory appendix to Section 19 (Appendix B) and include those examples in separate educational material; and

   (b) considers suggestions for additional guidance and illustrative examples when updating the separate educational material.

Structure of this paper

5. The paper is structured as follows:

   (a) development of the proposals in the Exposure Draft (paragraphs 6–13 of this paper);

   (b) feedback on the proposals in the Exposure Draft (paragraphs 14–20 of this paper);

   (c) staff analysis (paragraphs 21–42 of this paper):

      (i) introducing requirements for step acquisitions (paragraphs 22–27 of this paper);

(ii) measurement of non-controlling (paragraphs 28–31 of this paper);

(iii) other feedback on the proposals (paragraphs 32–40 of this paper); and

(iv) conclusion (paragraphs 41–42 of this paper); and

(d) questions for the IASB.

Development of the proposals in the Exposure Draft

Background and current requirements

6. Section 19 of the Standard is based on IFRS 3 (2004). IFRS 3 (2004) used the purchase method of accounting for business combinations. In contrast, IFRS 3 (2008) is based on the acquisition method of accounting.[2]

7. In the Request for Information *Comprehensive Review of the* IFRS for SMEs *Standard* (2020 Request for Information), the IASB asked for views on whether (and how) to:

(a) introduce requirements for some (but not all) aspects of the acquisition method of accounting, and simplify them where possible, for example:

(i) introducing requirements for step acquisitions; and

(ii) requiring measurement of contingent consideration at fair value if it can be measured reliably without undue cost or effort; and

(b) align Section 19 of the Standard with the 2018 amendment to IFRS 3 on the definition of a business.[3]

[2] During the first comprehensive review of the Standard, the IASB prioritised providing SMEs with a stable platform over aligning the Standard with IFRS 3 (2008), including subsequent amendments to IFRS 3.

[3] For further details, refer to question S5 of Request for Information *Comprehensive Review of the* IFRS for SMEs Standard.

Feedback on the 2020 Request for Information and Proposals in the Exposure Draft

8. Overall, the feedback to the 2020 Request for Information and the advice from the SME Implementation Group (SMEIG) supported the IASB's approach in paragraphs 7(a)–7(b) of this paper.

9. Taking into consideration this feedback, the IASB proposed in the Exposure Draft:

   (a) aligning Section 19 of the Standard with the acquisition method of accounting in IFRS 3 by:

      (i) adding requirements and guidance for a new entity formed in a business combination.

      (ii) updating the references when recognising the identifiable assets acquired and liabilities assumed in a business combination to refer to the definitions of an asset and a liability in the revised Section 2 *Concepts and Pervasive Principles.*

      (iii) clarifying that an acquirer cannot recognise a contingency that is not a liability.

      (iv) requiring recognition of acquisition-related costs as an expense.

      (v) requiring measurement of contingent consideration at fair value if the fair value can be measured reliably without undue cost or effort.

      (vi) adding requirements for step acquisitions (see paragraphs 11 and 22–27 of this paper).

   (b) aligning the definition of a 'business' in the Standard with the amended definition of a 'business' issued in 2018, adding application guidance and illustrative examples.

10. For other aspects of the acquisition method of accounting, the IASB did not propose:

    (a) the application guidance, as set out in paragraphs B36 and B53 of IFRS 3, on reacquired rights regarding the settlement of pre-existing relationships, as it is unlikely to be relevant to SMEs (see paragraphs 32–35 of this paper).

    (b) the fair value option for measuring non-controlling interest, as elimination of this option is an appropriate simplification (see paragraphs 12–13 and 28–31 of this paper).

    (c) to amend the recognition criteria for intangible assets acquired in a business combination, balancing the costs and benefits of separate recognition of these items because goodwill recognised in a business combination is amortised.[4]

Introducing requirements for step acquisitions

11. Feedback on the 2020 Request for Information supported introducing requirements for step acquisitions, providing evidence that the topic is relevant. However, SMEIG members had mixed views on this matter. The IASB, therefore, proposed requirements for step acquisitions and asked for further information in the Invitation to Comment on the Exposure Draft.

Measurement of non-controlling interest

12. Some respondents to the 2020 Request for Information questioned the elimination of the option of measuring non-controlling interests at fair value. In developing the 2020 Request for Information, the IASB's initial view was that introducing that option would add complexity into the Standard.

[4] Paragraphs BC130–BC183 of the Basis for Conclusions on the Exposure Draft further explain the IASB's rationale for these proposals in paragraphs 9–10 of this paper.

13. In considering the feedback on the 2020 Request for Information, IASB members had mixed views on whether to introduce the option to measure non-controlling interests at fair value. The IASB did not propose the option in the Exposure Draft, retaining the requirement in Section 19 of the Standard that an acquirer measures any non-controlling interest in the acquiree at the non-controlling interest's proportionate share in the recognised amounts of the acquiree's identifiable net assets. However, as IASB members had mixed views, the IASB asked for further information in the Invitation to Comment on the Exposure Draft.

Feedback on the proposals in the Exposure Draft

Introducing requirements for step acquisitions

Question 7(i) of the Invitation to Comment
Do you agree with the proposal to introduce requirements for the accounting for step acquisitions? If your answer is yes, do you agree with the proposed requirements in the Exposure Draft? If you disagree with the proposal, please explain why and give your alternative suggestion.

Relevance

14. Almost all the respondents that provided comments:

    (a) agreed with introducing requirements for step acquisitions; and

    (b) said that these requirements will enhance comparability and consistency.

15. A few respondents had mixed views on whether step acquisitions are common among SMEs in their jurisdiction:

    (a) some indicated that step acquisitions are relatively uncommon for SMEs.

    (b) others indicated that step acquisitions are becoming common for SMEs.

Simplicity and faithful representation

16. Most respondents that provided comments agreed with the proposed requirements for step acquisitions in the Exposure Draft to remeasure any previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss in profit or loss.

17. However, a few respondents suggested simplifying the requirements (by introducing an undue cost or effort exemption) to allow an acquirer to measure its previously held interest at the acquisition date carrying amount, instead of remeasuring to fair value. In their view, SMEs typically acquire unlisted entities, and obtaining the acquisition-date fair value of any previously held equity interest in the acquiree is costly.

Measurement of non-controlling interest

Question 7(ii) of the Invitation to Comment
Do you agree that the IASB's proposals appropriately simplify the measurement of non-controlling interests by excluding the option to measure them at fair value? If your answer is no, please explain your reasons.

18. Most respondents that provided comments:

    (a) agreed with the proposal to simplify the measurement of non-controlling interests by not introducing the option to measure them at fair value; and

    (b) said that this simplification reduces the complexity of the Standard as the costs of measuring non-controlling interests at fair value may outweigh the benefits.

19. A few respondents:

    (a) suggested permitting the option to measure non-controlling interests at fair value, consistent with IFRS 3, which provides, if elected to use, a more faithful representation of goodwill and better-quality information to users; and

    (b) explained that SMEs can benefit from having the same options that are available in IFRS Accounting Standards.

Other feedback on the proposals

Question 7(iii) of the Invitation to Comment
Do you have any further comments or suggestions on the proposed amendments to Section 19? Please explain the reasons for your suggestions.

20. A few respondents raised other suggestions on the proposed amendments to Section 19 of the Standard including:

    (a) *reacquired rights*—introduce application guidance related to reacquired rights as set out in IFRS 3. In the respondents' view, some SMEs operate on a franchise model. That feedback has been raised from two respondents from Africa.

    (b) *guidance*—that further application guidance and examples from IFRS 3 should be simplified and included in Section 19 of the Standard.

Staff analysis

21. It should be noted that the staff analysis in this paper has not discussed all IASB's proposals in the Exposure Draft regarding Section 19 of the Standard; see paragraphs 9–10 of this paper. Instead, it focused only on the aspects on which the staff obtained feedback. Therefore, the staff analysis is set out as follows:

    (a) introducing requirements for step acquisitions;

    (b) measurement of non-controlling interest; and

    (c) other feedback on the proposals.

Introducing requirements for step acquisitions

Relevance

22. The feedback in paragraphs 14–15 of this paper explains that almost all respondents supported introducing requirements for step acquisitions. Accordingly, the staff think that such feedback provides evidence that introducing requirements for step acquisition satisfies the relevance principle in the IASB's alignment approach.

Simplicity and faithful representation

23. The feedback in paragraph 16 of this paper explains that most respondents supported aligning requirements for step acquisition with those of IFRS 3 (as proposed in the Exposure Draft).

24. As noted in paragraph 17 of this paper, a few respondents suggested a simplification for an acquirer to measure its previously held interest at the acquisition date carrying amount, instead of remeasuring previously held interests to fair value. The staff do not think providing the simplification is necessary, nor would it be consistent with other requirements in the Standard because:

(a) Section 14 *Investments in Associates* of the Standard requires remeasurement of any previously held equity interest in the acquiree at its acquisition-date fair value. Paragraph 14.8(i)(i) of the Standard states that (emphasis added):

> …(i) *discontinuing the equity method*. An investor shall cease using the equity method from the date that significant influence ceases:
>
> (i) if the **associate becomes a subsidiary** or joint venture, the **investor shall remeasure its previously held equity interest to fair value** and recognise the resulting gain or loss, if any, in profit or loss…[5]

(b) in the Exposure Draft, the IASB proposed amendments to paragraph 9.18A(b)(ii) of the Standard (Section 9 *Consolidated and Separate Financial Statements*) to align with the requirements for step-disposals that result in loss of control. The IASB proposed alignment with paragraph 25(b) of IFRS 10 *Consolidated Financial Statements*—that is, an SME measures any retained interest at fair value when control is lost. Respondents have not disagreed with this proposal.[6]

25. In addition, the staff also think that not remeasuring previously held equity interest in the acquiree at its acquisition-date fair value could be perceived as inconsistent with the reporting entity concept. Furthermore, the IASB is proposing to align Section 2 of the Standard with the *2018 Conceptual Framework for Financial Reporting* which includes the reporting entity concept.

[5] In other words, currently, Section 19 does not provide *explicit* guidance on the accounting for step acquisitions.

[6] Refer to AP30B: Simplification of the control model in Section 9 Consolidated and Separate Financial Statements for further details of the IASB deliberations on Section 9.

26. Introducing requirements for step acquisition addresses a gap in the Standard and thereby should reduce divergence practice for SMEs. Also, given paragraph 14.8(i)(i) of the Standard, the staff think that SMEs are familiar with remeasuring previously held interest at acquisition-date fair value and, therefore, it is not expected to be costly to apply.

27. Therefore, the staff recommend the IASB proceeds with its proposals in the Exposure Draft to introduce requirements for step acquisitions as set out in IFRS 3.

Measurement of non-controlling interest

28. The feedback in paragraph 18 of this paper supports the proposal to simplify the measurement of non-controlling interests by not introducing the option to measure them at fair value.

29. A few respondents, as noted in paragraph 19 of this paper, said that permitting the option to measure non-controlling interests at fair value would be consistent with IFRS 3, and the same option should be available to SMEs.

30. Not introducing the option to measure non-controlling interests at fair value is consistent with how the IASB simplifies the Standard. The IASB aims to restrict accounting policy options in the Standard because including more complex options generally increases cost for both preparers and users of SMEs financial statements; increases complexity and also reduces comparability. Paragraphs BC208–BC209 of the Basis for Conclusions on the Standard explain the IASB's reasons for restricting accounting policy options.

31. Therefore, the staff recommend the IASB proceeds with its proposals in the Exposure Draft to not introduce the fair value option for measuring non-controlling interest in the acquiree.

Other feedback on the proposals

Reacquired rights

32. As part of a business combination, an acquirer may reacquire a right that it had previously granted to the acquiree to use one of its assets (ie a pre-existing relationship); for example, a right to use the acquirer's trade name under a franchise agreement. Paragraphs B36 and B53 of IFRS 3 provide application guidance that, for example, if the terms of such an agreement are favourable or unfavourable when compared with pricing for current market transactions for the same or similar items, the acquirer recognises, separately from the business combination, a gain or loss for the effective settlement of that pre-existing relationship. Section 19 of the Standard does not include this application guidance.

33. In the Exposure Draft, the IASB did not propose to introduce the application guidance from paragraphs B36 and B53 of IFRS 3. Based on advice from SMEIG members, these types of reacquired rights do not occur frequently for SMEs acquiring businesses. Accordingly, the IASB decided that the topic did not meet the relevance principle.

34. Two respondents from Africa suggested introducing application guidance related to reacquired rights as set out in IFRS 3 because some SMEs in their jurisdictions operate on a franchise model (see paragraph 20(a) of this paper). However, the staff note that the feedback did not indicate whether SMEs acquiring businesses, in those jurisdictions, would be likely (or occur frequently) to have the same fact pattern as in paragraph 32 of this paper; that is, an agreement with favourable or unfavourable terms which requires, separately from the business combination, recognising gain or loss for an effective settlement of pre-existing relationship.

35. Therefore, given the previous advice from SMEIG, the staff recommend the IASB proceeds with its proposals and does not introduce application guidance, as set out in paragraphs B36 and B53 of IFRS 3, on required rights regarding the settlement of pre-existing relationships.

Guidance

36. The feedback in paragraph 20(b) of this paper notes respondents' requests that further application guidance and examples from IFRS 3 should be simplified and included in Section 19 of the Standard.

37. At its September 2023 meeting, the IASB:

    (a) discussed the objective of providing educational material on the Standard; and

    (b) decided to either update the Standard educational modules that support the second edition of the Standard; or provide similar comprehensive educational material on the third edition.

38. The IASB also discussed factors to use as a guide when deciding which guidance to include in the third edition of the Standard and which to include in educational material, including the suggestion to move non-mandatory guidance from the Standard into separate educational material for consistency and to keep the Standard concise.

39. In the Exposure Draft, there are two appendices for Section 19:

    (a) Appendix A–*Application guidance*, which is considered as an integral part of Section 19 because it includes, for example, an optional concentration test as in paragraphs B7A–B7B of IFRS 3; a decision tree to assess whether an acquired process is substantive; and application guidance as in paragraphs B8–B12D of IFRS 3.

    (b) Appendix B–*Illustrative examples*, regarding the definition of a business, which is considered an accompanying, but is not part of, Section 19.

40. Considering the factors in paragraph 38 of this paper and that most respondents supported the proposed level of content in Section 19, the staff:

    (a) recommend removing the non-mandatory appendix to Section 19 (Appendix B) and include those examples in separate educational material; and

(b) do not recommend further application guidance and examples from IFRS 3 should be included in Section 19. However, the staff think the suggestions could be considered in developing educational material for Section 19.

Conclusion

41. Considering paragraphs 21–40 of this paper, the staff recommend the IASB proceeds with its proposed amendments to Section 19 of the Standard as in the Exposure Draft, including on, among other proposals:

(a) introducing requirements for step acquisitions as set out in IFRS 3.

(b) not introducing the fair value option for measuring non-controlling interest in the acquiree.

(c) not introducing application guidance, as set out in paragraphs B36 and B53 of IFRS 3, on reacquired rights regarding the settlement of pre-existing relationships.

42. The staff also recommend the IASB:

(a) removes the non-mandatory appendix to Section 19 (Appendix B) and include those examples in separate educational material; and

(b) considers suggestions for additional guidance and illustrative examples when updating the separate educational material.

Questions for the IASB

Questions for the IASB
1. Does the IASB agree with the staff recommendation in paragraph 3(a) of this paper? 2. Does the IASB agree with the staff recommendation in paragraph 3(b) of this paper? 3. Does the IASB agree with the staff recommendation in paragraph 3(c) of this paper? 4. Does the IASB agree with the staff recommendation in paragraph 4 of this paper?