Business Combinations under Common Control Issues Paper

Objective

1 The objective of this paper is to provide an update to EFRAG Board and TEG members on the IASB Research Project *Business Combinations under Common Control* (BCUCC).

2 The project considers how to account for the acquisition of a business under common control in the financial statements of the receiving entity.

Background

3 BCUCC are currently excluded from the scope of IFRS 3 *Business Combinations*. Without specific guidance in IFRS Standards entities must apply the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to develop an accounting policy which would result in relevant information for users of financial statements.

4 In practice, there is diversity in the way entities account for BCUCC transactions. Some entities apply by analogy the acquisition method as set out in IFRS 3. Other entities use a predecessor method, by reference to national GAAPs, under which the assets and liabilities of the acquired business are measured at historical carrying amounts. Under the latter approach divergence also exists as to which historical carrying amounts are used (e.g. the amounts in the separate financial statements of the acquired entity or the amounts used when consolidating the entity). Consequently, it is difficult for users to compare the effects of BCUCC on entities' financial positions and financial performance.

5 In 2016, the IASB added the BCUCC project to its research agenda and decided that the scope of the project should include transactions under common control in which the reporting entity obtains control of one or more businesses, regardless of whether IFRS 3 would identify the reporting entity as the acquirer. The focus of the project is how to account for a BCUCC in the financial statements of the receiving entity.

6 The IASB is planning to issue a discussion paper (DP) on BCUCC in September 2020. The IASB's tentative decisions to be included in the DP are set out in the paragraphs below.

The IASB tentative decisions on the project

Approach for accounting for the transaction

7 In 2019, the IASB discussed and concluded that a single measurement approach for all business combinations under common control was not appropriate. This is because the IASB considered that BCUCC are not a homogenous population. Some of the transactions are similar to acquisitions within the scope of IFRS 3 (e.g. when

the transaction is initiated and negotiated by the receiving entity in order to benefit that entity), while some are not (e.g. a tax-driven restructuring undertaken by the receiving entity's parent entity in order to benefit the entire group). In addition, the IASB considered that the benefits of applying an acquisition approach would be different under different circumstances and, accordingly, the relationship between costs and benefits would be different under different circumstances.

8 Therefore, the IASB tentatively decided that to the extent BCUCC are similar to acquisitions, a current value approach based on the acquisition method should be applied unless the benefits of the information provided could not justify the cost. When a current value approach would not be applied, a predecessor approach should be applied.

9 BCUCC affecting the non-controlling shareholders of the receiving entity are typically subject to laws and regulations to protect the interests of those shareholders and are likely to be similar to the terms of transactions between independent parties. Therefore, the IASB assessed that applying the acquisition method as set out in IFRS 3 without any modification would provide the most useful information to primary users.

10 Consequently, the IASB tentatively decided to apply a current value approach based on the acquisition method as set out in IFRS 3 to all transactions that affect non-controlling shareholders of the receiving entity except when the receiving entity's equity instruments are not publicly traded and one of the following conditions applies:

(a) all non-controlling shareholders are related parties to the receiving entity; or

(b) the receiving entity chooses to apply a predecessor approach and all its non-controlling shareholders have been informed about and do not object it.

11 The IASB tentative decision on when to apply a current value approach and a predecessor approach is illustrated in Appendix 1.

The current value approach to be used

12 When a current value approach is used to account for BCUCC, the receiving entity should apply the acquisition method in IFRS 3 complimented by presenting a **contribution** to the receiving entity's equity when the acquired identifiable net assets exceed the consideration transferred instead of recognising that excess as a gain on a bargain purchase in the statement of profit or loss. Conversely, the IASB concluded that a symmetrical recognition of a **distribution** from the receiving entity's entity, when the consideration transferred in excess of the value received, would be infrequent as it would represent overpayment on the part of the receiving entity. In practice, it would not be possible to identify and reliably measure such an overpayment at the acquisition date and would result in additional costs and complexity in reporting and understanding information about BCUCC. Therefore, the IASB decided not to require recognition of a distribution and include the excess consideration in the initial measurement of goodwill.

Disclosures when the current value approach is used

13 When the acquisition method is used to account for BCUCC the receiving entity would apply all disclosure requirements in IFRS 3 and the disclosures suggested in the discussion paper *Business Combinations – Disclosures, Goodwill and Impairment*. Additionally, the IASB tentatively decided that it should provide guidance on applying the disclosure requirements of IFRS 3 and IAS 24 *Related Party Disclosures* for BCUCC.

The predecessor approach to be used

14 The IASB tentatively decided that when the **predecessor approach** is used to account for BCUCC the method should be applied by the receiving entity as follows:

(a) **assets and liabilities** received should be measured at the carrying amounts included in the financial statements of the transferred entity;

(b) **pre-combination information** in primary financial statements should be provided only about the receiving entity i.e. comparative figures should not be restated for all the combining entities;

(c) **consideration paid** in BCUCC:

(i) **consideration paid in the form of assets** should be measured at the carrying amounts of those assets at the date of the combination;

(ii) **consideration paid by incurring liabilities to or assuming liabilities from the transferor** should be measured at the carrying amounts of those liabilities, as determined in accordance with applicable IFRS Standards.

(d) recognise as a change in equity any **difference between the consideration paid and the carrying amounts of assets and liabilities received**. However, the IASB has tentatively decided not to specify in which component or components of equity the receiving entity would present the difference between the consideration paid and the carrying amounts of assets and liabilities received;

(e) recognise **transaction costs** as an expense in the statement of profit or loss in the period in which they are incurred. Respectively, to recognise costs related to the issue of debt or equity instruments in accordance with IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments*.

15 The IASB has tentatively decided not to prescribe how the receiving entity should measure the consideration paid in its own shares as it is usually subject to legal requirements which are different between jurisdictions.

Disclosures when the predecessor approach is used

16 The IASB has tentatively decided that the receiving entity should disclose the following information when the predecessor approach is used to account for BCUCC:

(a) apply the following disclosure requirements in IFRS 3 and in the discussion paper *Business Combinations – Disclosures, Goodwill and Impairment*:

(i) the disclosure objective of providing information to help users of financial statements to evaluate the nature, the financial effect and the expected benefits of a combination;

(ii) the name and the description of the transferred entity, the combination date, the percentage of voting equity interests transferred to the receiving entity, the primary reasons for the combination and a description of how the receiving entity obtained control;

(iii) the recognised amounts of each major class of assets and liabilities assumed, including information about recognised amounts of liabilities arising from financing activities and defined benefit pension liabilities;

(iv) the carrying amount of non-controlling interest;

(v) the requirement to provide aggregate information for individually immaterial combinations;

(vi) the disclosure requirements for combinations that occur after the end of the reporting period but before the financial statements are authorised for issue;

(vii) the amount and an explanation of any gain or loss that relates to assets and liabilities received if such disclosure is relevant to understanding the combined entity's financial statements; and

(viii) the requirement to disclose whatever additional information is necessary to meet the applicable disclosure objectives.

(b) disclose the amount recognised in equity for the difference between the consideration paid and the carrying amounts of assets and liabilities received, and the component of equity in which that difference is recognised.

17 In February 2020, the IASB concluded its deliberation on its research project BCUCC and decided to publish a discussion paper as a next consultation document. The discussion paper is expected to be published in September 2020 and the comment period is expected to be determined at the IASB meeting in July.

EFRAG TEG views so far

18 A majority of EFRAG TEG members were generally supportive of the IASB's proposals to apply a current value approach based on the acquisition method as set out in IFRS 3 to the particular subset of BCUCC, however, members expressed concerns regarding the practical application of the proposed exemption allowing the receiving entity to apply a predecessor approach when its equity instruments are not publicly traded and its non-controlling shareholders do not object applying that approach. Some members commented that a current value approach should be applied to all BCUCC.

19 EFRAG TEG members considered the IASB proposal to apply the acquisition method and recognise the excess fair value of the acquired identifiable net assets over the fair value of the consideration transferred as a **contribution** to the receiving entity's equity. Members expressed broad support for the proposed application of the acquisition method.

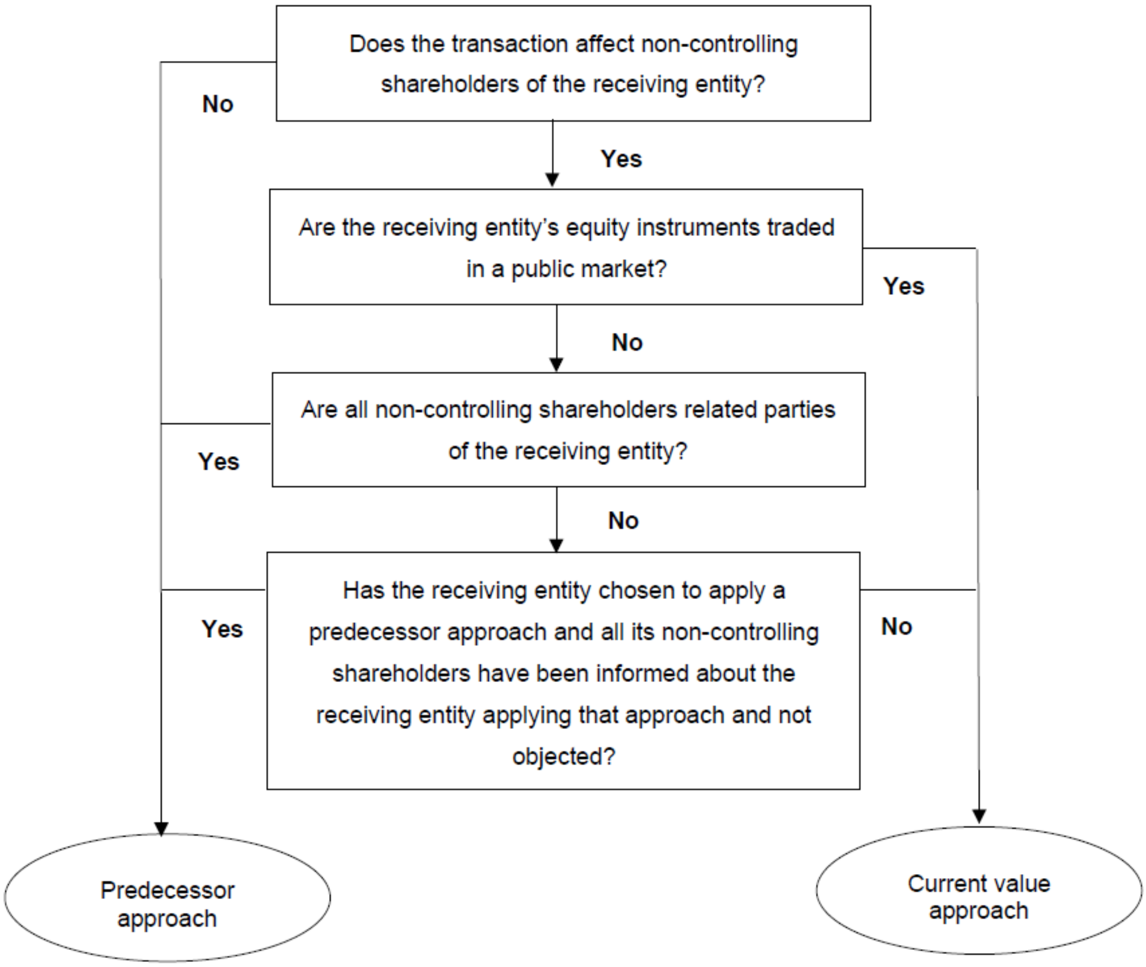
20 In April, EFRAG TEG discussed the IASB proposals for how to measure the consideration paid in BCUCC and where in equity the difference between the consideration paid and the carrying amounts of assets and liabilities received should be presented when the predecessor approach is applied. EFRAG TEG also considered how transaction costs should reported and what disclosures should be required under the predecessor approach. EFRAG TEG expressed broad support for those proposals.

21 EFRAG TEG expressed support for the disclosure requirements for BCUCC under both the acquisition and the predecessor approach.

Question for EFRAG Board and EFRAG TEG

22 Do EFRAG Board members have any questions or comments on the BCUCC project at this stage and to the preliminary views of EFRAG TEG?

Appendix 1: Illustration of the IASB's tentative decisions on when a current value approach and a predecessor approach would apply



Source: the IASB