Business Combinations under Common Control
Issues Paper

Objective

1 The purpose of the session is to seek EFRAG TEG and EFRAG CFSS views on:

(a) the some of the proposals included in the IASB's Discussion Paper DP/2020/2 *Business Combinations under Common Control*. The feedback received will be presented at the Accounting Standards Advisory Forum (ASAF) meeting in June. Agenda paper 06-02 provides background for the discussion; and

(b) the EFRAG's tentative views expressed in its draft comment letter on these proposals.

Agenda Papers

2 In addition to this issues paper, agenda paper 06-02 – ASAF agenda paper 01 BCUCC – has been provided for the session.

Background

3 Currently, IFRS Standards do not specify how to account for business combinations under common control (BCUCC) and without guidance entities develop their own accounting policies based on the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. As a result, transactions are reported inconsistently and comparability within and across entities is impaired.

4 To address this problem, the IASB published a discussion paper (DP) on BCUCC in November 2020. In its DP, the IASB explores possible reporting requirements for BCUCC transactions in the receiving company's financial statements to reduce diversity in practise and improve the transparency of reporting for such transactions. An overview of the proposals included in the IASB's DP are included in the IASB Snapshot.

5 In February 2021, EFRAG published a draft comment letter (DCL) on the DP. In its DCL, EFRAG broadly supports the approach proposed by the IASB and is posing several questions to constituents on specific areas such as selecting a measurement method and the application of the acquisition method and a book-value method to BCUCC. A summary of EFRAG's preliminary position on the IASB's DP in included in the EFRAG Fact sheet.

6 In April, EFRAG published an EFRAG Secretariat Briefing: *Business Transfers under Common Control*. The Briefing considers how transactions within the scope of the project will be reported under the proposed requirements of the DP and what would be the impact of the proposals, in particular, on questions raised about the application of IFRS Standards.

7 The following sections of this agenda paper contain a summary of:

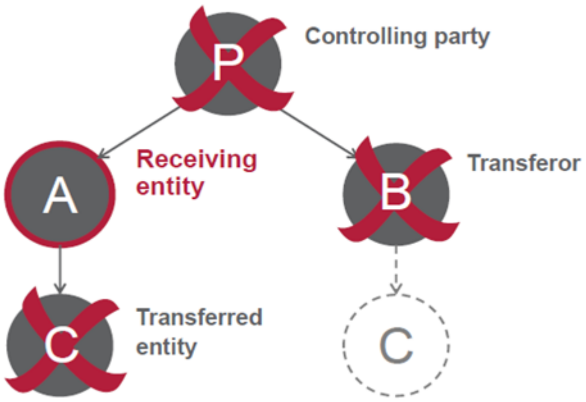
(a) the IASB's proposal on selecting a measurement method and how to apply the acquisition method and a book-value method to BCUCC; and

(b) the EFRAG's tentative views expressed in its DCL on these proposals.

Which measurement method to apply to BCUCC

IASB's proposals

8 The scope of the project includes transactions under common control in which the reporting entity (receiving entity A in the diagram below) obtains control of one or more businesses, regardless of whether IFRS 3 *Business Combinations* would identify the reporting entity as the acquirer.



9 The focus of the project is how to account for BCUCC transactions in the consolidated financial statements of the receiving entity and in some cases in its individual and separate financial statements, if the transferred business is not an incorporated entity.

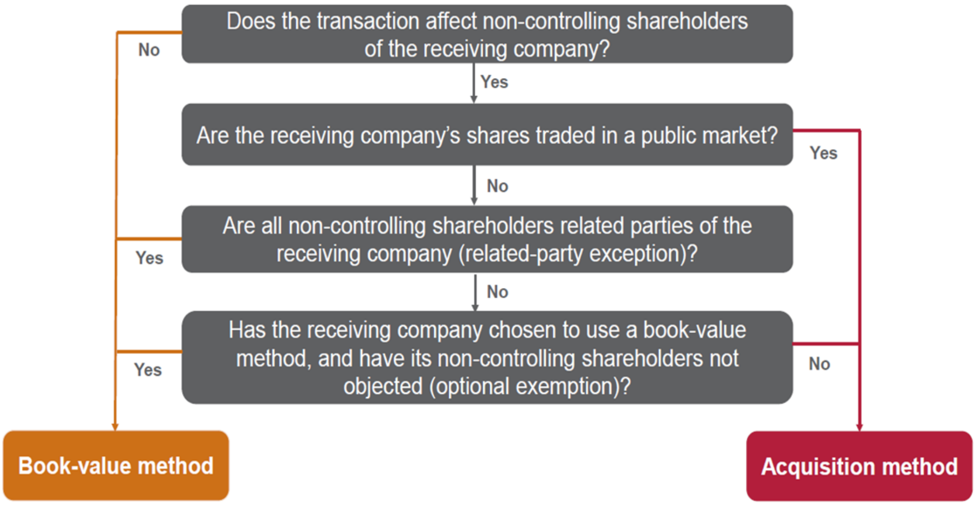
10 The BCUCC project considers the information needs of the primary users of the receiving entity's financial statements. The primary users' information needs can vary depending on their economic exposure to the receiving entity. The cost-benefit considerations can also be different for different primary users.

11 Therefore, the DP proposes to apply different measurement methods to BCUCC depending on whether the transactions are similar to acquisitions within the scope of IFRS 3 or not. Under the proposed requirements, the receiving entity should apply:

(a) the acquisition method set out in IFRS 3 when its non-controlling shareholders (NCS) are affected by the transfer, subject to cost-benefit consideration; and

(b) a book-value method – in all other cases.

12 The IASB proposes the following decision tree to determine when to apply which measurement method:



Source: IASB

13 Under the proposed requirements, the IASB is proposing an **optional exemption** from the acquisition method, if the receiving company's shares are privately held, it should be permitted to use a book-value method if it has informed all of its NCS that it proposes to apply a book-value method and they have not objected.

14 In addition, the IASB is proposing a **related-party exception** to the acquisition method, if the receiving company's shares are privately held and all of its NCS are related parties of the company, then it should be required to apply a book-value method.

Initial feedback received by the IASB

15 So far, the IASB has received the following feedback on the proposals on selecting a measurement method to be applied to BCUCC;

(a) some stakeholders agree that neither method should apply in all cases, and largely agree with the IASB's preliminary views on when each method should apply;

(b) some stakeholders say that a book-value method should apply in all cases and some other stakeholders say that the acquisition method should apply to pre-IPO scenarios;

(c) some stakeholders suggested the use of other indicators when selecting the measurement method, for instance whether the consideration paid is at fair value;

(d) some stakeholders question whether a related-party exception is needed and whether the optional exemption for privately held companies is operational;

(e) some stakeholders wonder whether a public debt company should also trigger the application of the acquisition method in a BCUCC.

EFRAG Draft Comment Letter

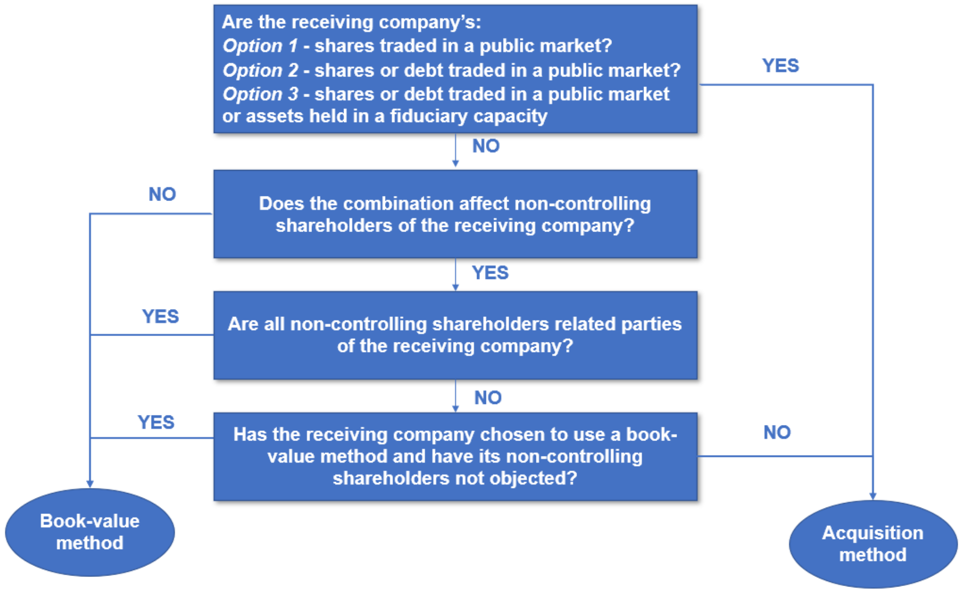
16 In its DCL, EFRAG agrees that a single measurement method is not appropriate for all BCUCC as they do not represent a homogeneous population of transactions. EFRAG supports the application of the acquisition method to BCUCC that affect the NCS of the receiving company, subject to cost-benefit trade-off and other practical considerations.

17 However, EFRAG is proposing a few modifications to the IASB's decision tree on when to apply each measurement method. In its DCL, EFRAG is consulting constituents on two possible modifications:

(a) Reverse Step 1 and Step 2 of the IASB's diagram included in paragraph 12; and

(b) Expand the scope of companies included in the proposed new Step 1.

18 The proposed modifications are illustrated in the diagram below.



19 EFRAG also supports the optional exemption and the related-party exception to the application of the acquisition method for privately-held companies with NCS. However, EFRAG is consulting constituents on whether the related-party exception should be optional rather than required.

Questions for EFRAG TEG/CFSS (for ASAF discussion)

20 What types of BCUCC are most common in your jurisdiction? What are common reasons for undertaking such combinations, for example preparing for an IPO or other reasons?

21 Do you agree that the acquisition method should apply to combinations that affect non-controlling shareholders, subject to the cost benefit trade-off, and that a book-value method should apply in all other cases?

22 For privately-held companies, do you agree with:

(a) the related-party exception to the acquisition method; and

(b) the optional exemption from the acquisition method?

Questions for EFRAG CFSS (EFRAG DCL questions)

23 Does EFRAG CFSS agree with EFRAG's suggestion in paragraph 17(a) above to reverse the order of Step 1 and Step 2 of the decision tree when selecting the measurement method for BCUCC?

24 When considering the options on how to modify the scope of the IASB's decision tree in paragraph 17(b) above for selecting the measurement method for BCUCC, which option do you prefer?

25 Does EFRAG CFSS agree that the related-party exception provided by the IASB should be rather 'permitted' under the proposals and not 'required'?

How to apply the acquisition method

IASB's proposals

26 The IASB proposes that the acquisition method as set out in IFRS 3 is applied to BCUCC transaction with one modification. The DP is proposing for the receiving entity to recognise the excess fair value of the identifiable acquired assets and liabilities over the consideration paid in a business combination as a **contribution to equity** and not as a bargain purchase gain in the statement of profit or loss.

27 With respect to providing disclosures for BCUCC to which the acquisition method is applied, the IASB is proposing:

(a) that the receiving company should be required to comply with the disclosure requirements in IFRS 3, including any improvements to those requirements resulting from the discussion paper *Business Combinations – Disclosures, Goodwill and Impairment*; and

(b) to provide application guidance on how to apply those disclosure requirements together with the disclosure requirements in IAS 24 *Related Party Disclosures* when applied to BCUCC, in particular information about the terms of the combination such as information about how the transaction price was determined.

Initial feedback received by the IASB

28 With respect to applying the acquisition method to BCUCC, stakeholders have expressed the following views:

(a) some stakeholders agree with the IASB's preliminary views to recognise 'underpayment' as a contribution to equity;

(b) some stakeholders suggest that an 'underpayment' should be recognised as a gain in the statement of profit or loss in some cases;

(c) while some stakeholders suggest that an 'underpayment' should be recognised as a gain in the statement of profit or loss in all cases.

EFRAG Draft Comment Letter

29 EFRAG agrees that the IASB should not develop a requirement for the receiving company to identify, measure and recognise a **distribution** from equity in a BCUCC transaction but rather recognise any 'overpayment' entirely as goodwill.

30 EFRAG has not formed a tentative view on the IASB proposal to recognise a **contribution** to equity when there is 'underpayment' in a BCUCC. EFRAG is consulting constituents on:

(a) Alternative 1 – support the IASB proposal to recognise contribution to equity for any excess fair value of identifiable acquired assets and liabilities over the consideration paid, not as a bargain purchase gain in the statement of profit or loss; or

(b) Alternative 2 – support consistency with the requirements in IFRS 3 and recognise the difference as a gain in the statement of profit or loss.

Questions for EFRAG TEG/CFSS (for ASAF discussion)

31 Does EFRAG TEG and EFRAG CFSS agree with the IASB's proposal not to require the receiving company to identify, measure and recognise a **distribution** from equity in a BCUCC?

32 Does EFRAG TEG and EFRAG CFSS agree with the IASB's proposal that any 'underpayment' in a BCUCC should be recognised as a **contribution** to equity, not as a gain on a 'bargain purchase'?

33 Does EFRAG TEG and EFRAG CFSS agree that the receiving company should apply all the disclosure requirements in IFRS 3 *Business Combinations* and also disclose additional information about how the transaction price was determined?

Question for EFRAG CFSS (EFRAG DCL question)

34 Which of the alternatives in paragraph30 does EFRAG CFSS consider will provide the most useful information?

How to apply a book-value method

IASB's proposals

35 In its DP, the IASB proposes that the receiving entity applies a book-value method to BCUCC as follows:

(a) **assets and liabilities received** - should be measured at the transferred company's book values;

(b) **consideration paid**:

(i) consideration paid in assets - should be measured at the receiving company's book values 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 amount determined on initial recognition of those liabilities at the combination date applying IFRS Standards;

(c) **recognise within equity** any difference between the consideration paid and the book value of assets and liabilities received. However, the IASB does not prescribe in which component or components of equity this difference should be presented;

(d) **transaction costs** - recognise as an expense in the statement of profit or loss in the period in which they are incurred, except for costs related to the issue of debt or equity instruments which should be accounted for in accordance with IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments*;

(e) **pre-combination information** – the receiving company should include in its financial statements the assets, liabilities, income and expenses of the transferred company prospectively from the combination date, without restating pre-combination information.

36 The IASB does 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 differ between jurisdictions.

Initial feedback received by the IASB

37 When measuring assets and liabilities received in a BCUCC, the initial feedback received by the IASB shows that:

(a) some stakeholders agree that assets and liabilities received should be measured at the transferred company's book values;

(b) some stakeholders suggest that the transferred company's book values should be used unless the controlling party's book values provide more useful information;

(c) some stakeholders suggest that assets and liabilities received should always be measured at the controlling party's book values.

38 With respect to providing pre-combination information, the feedback received shows that:

(a) some stakeholders agree with a prospective approach;

(b) some stakeholders agree with a prospective approach but suggest that combined pre-combination information should be provided in the notes;

(c) some stakeholders support a retrospective approach, at least in some cases (e.g. IPO – regulators may already require this information);

EFRAG Draft Comment Letter

39 In its DCL, EFRAG has expressed the following tentative views on the IASB's proposals on how to apply a book-value method:

(a) measuring **assets and liabilities received** – EFRAG considers that both the use of the carrying amounts in the consolidated financial statements of the transferred company's controlling party and the use of the carrying amounts in the financial statements of the transferred company can provide decision-useful information for users. EFRAG is consulting constituents on their preferences;

(b) **consideration paid** – EFRAG agrees with the IASB's proposals on how to measure the consideration paid in a BCUCC. However, EFRAG suggests that the IASB considers allowing the use of fair value measurement, particularly in light of the IFRIC 17 *Distributions of Non-cash Assets to Owners*, where a company has to measure a liability to distribute non-cash assets as a dividend at the fair value of the net assets to be distributed;

(c) **reporting the difference** – EFRAG agrees to recognise within equity any difference between the consideration paid and the book value of the assets and liabilities received;

(d) **transaction costs** – EFRAG agrees with the DP's proposals for transaction costs;

(e) **pre-combination information** - EFRAG agrees that the receiving company should include in its financial statements the assets, liabilities, income and expenses of the transferred company prospectively from the combination date, without restarting pre-combination information. EFRAG is consulting constituents on whether the IASB's proposals conflict with the current practice or with current reporting requirements in some jurisdictions.

Questions for EFRAG TEG/CFSS (for ASAF discussion)

40 Does EFRAG TEG and EFRAG CFSS agree that the receiving company should measure assets and liabilities received at the book values reported by the transferred company?

41 Does EFRAG TEG and EFRAG CFSS agree that the receiving company should include the transferred company in its financial statements from the combination date, without restating pre-combination information?

42 Does EFRAG TEG and EFRAG CFSS agree that the IASB should not require disclosure of pre-combination information for the combining companies as though they had already been combined. If not, what particular information would be useful?

43 Does EFRAG TEG and EFRAG CFSS have other comments on a book-value method? In particular, in your view, what other aspects of a book-value method should the IASB consider in the next stage of the project?

Questions for EFRAG CFSS (EFRAG DCL questions)

44	Does EFRAG CFSS agree that the receiving company should measure assets and liabilities received at the book values reported by the transferred company?
45	What approach is currently being applied in the financial statements in your jurisdiction: Carrying amounts of the transferred company or carrying amounts in the consolidated financial statements of the transferred company's controlling party?
46	In your jurisdiction, do you currently require restatement of pre-combination information (comparatives)? If so, as from the beginning of the reporting period or as if the combining companies have always been combined?