Case study on BCUCC
Issues Paper

Objective

1 The purpose of the session is to seek EFRAG TEG and EFRAG User Panel's views on a case study illustrating the application of the proposals included in the IASB discussion paper DP/2020/2 *Business Combinations under Common Control* (DP).

Background

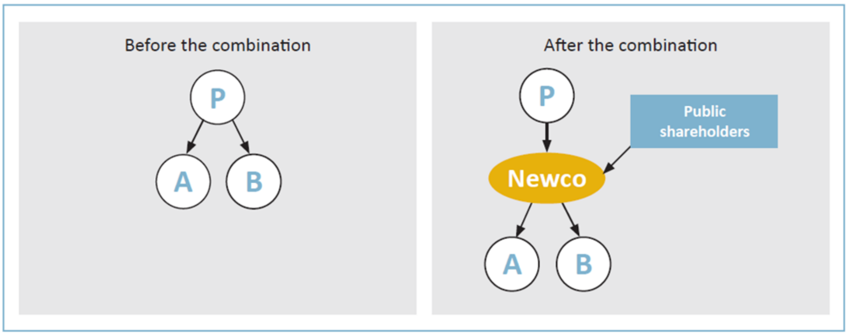
2 The IASB published its DP on business combinations under common control (BCUCC) in November 2020. In the DP, the IASB explores possible reporting requirements for BCUCC in the financial statements of the receiving entity in order to reduce diversity and improve transparency of reporting for such transaction. A factsheet on the IASB's project on BCUCC is included in agenda paper 10-02 (for background).

3 EFRAG published its draft comment letter (DCL) on the DP in February 2021. In the 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. Agenda paper 10-03 (for background) provides a summary of EFRAG's views in its DCL.

4 The section below contains a case study considering how the DP's proposals would apply to a particular restructuring transaction under common control. Based on the provided fact pattern, EFRAG Secretariat would like to obtain EFRAG TEG and EFRAG User Panel's views on the workings of the IASB's proposals.

Case study on BCUCC

5 Parent company P undertakes a group restructuring in preparation for an initial public offering (IPO) of two of its wholly-owned subsidiaries: entity A and entity B. To execute the transaction, the parent company P establishes an intermediate company Newco which will be the company subject to the IPO. Before the IPO, Newco is 100% owned by parent company P and does not have a business of its own. The fact pattern is illustrated in the diagram below.



6 Following the IPO, the parent company P:

(a) under *Scenario 1* - retains control over Newco by selling 30% of the shares of Newco and retaining the remaining 70% of the shares;

(b) under *Scenario 2* - loses control over Newco by selling 60% of the shares of Newco and retaining the remaining 40% of the shares.

7 Under *Scenario 1,* applying the proposals of the DP, Newco should use a **book-value method** to report the transaction. This is because before the IPO, Newco was 100% owned by the parent company P and as a result there were no existing non-controlling shareholders (NCS) affected by the transaction. This means that Newco will measure entity A and entity B's assets and liabilities received by using the book values (carrying amounts) in the financial statements of the transferred entities. Any difference between the consideration paid and the book value of the assets and liabilities received will be recognised in Newco's equity.

8 Similarly, under *Scenario 2*, Newco should apply a **book-value method** for the same reasons mentioned in paragraph 7 above. However, EFRAG Secretariat questions whether this accounting approach would provide the most relevant information for users of financial statements considering that under *Scenario 2* parent company P's control over Newco is lost.

9 Currently, IFRS 3 *Business Combinations* describes BCUCC as transfers of entities or businesses where all the combining entities or businesses are ultimately controlled by the same party or parties and control is not transitory. However, IFRS 3 does not provide guidance on what transitory control is.

10 In its DP, the IASB does not clarify the meaning of 'transitory control' when selecting a measurement method to account for BCUCC transactions. This is because depending on the outcome of the BCUCC project, the IASB could modify or remove the scope exclusion in IFRS 3 for BCUCC. However, at this stage of the project it is undetermined whether scenarios that involve loss of control by the controlling party (like in Scenario 2 above) would fall in the scope of IFRS 3 or in the scope of the proposals in the BCUCC project.

11 However, if under *Scenario 2*, parent company P's control over Newco is considered transitory and within the scope of IFRS 3, then Newco should apply the **acquisition method** as set out in IFRS 3. If Newco is identified as the acquirer, then Newco should measure the acquired assets and liabilities assumed of entity A and entity B at their acquisition-date fair values and recognise any difference between the fair value of the identifiable acquired assets and liabilities assumed any the consideration paid as goodwill or a gain from a bargain purchase in the statement of profit or loss. If the acquisition method under IFRS 3 is applied, Newco's prospective investors will be provided with fair value information and not book values as the DP proposes.

Disclosure of pre-combination information

12 The DP proposes that under both the acquisition method and a book-value method, Newco should include the acquired net assets of entity A and entity B prospectively from the combination date forward. Consequently, restating pre-combination information about Newco is not required.

13 Additionally, EFRAG Secretariat observes that IFRS 3 requires disclosure of 'pro forma' pre-combination information about all combining companies, prepared as if those companies had been combined as of the beginning of the annual reporting period.

Questions for EFRAG TEG-User Panel

14 Considering the fact pattern in paragraphs 5 and 6, what accounting method does EFRAG TEG-User Panel consider would provide more relevant information to users about the BCUCC:

(a) the acquisition method as set out in IFRS 3 *Business Combinations;* or

(b) a book-value method as described in the IASB's DP?

15 What are EFRAG TEG-User Panel's preferences when providing pre-combination information about BCUCC? Does EFRAG TEG-User Panel consider that pre-combination information about the transaction should be provided:

(a) prospectively from the combination date as proposed in the DP;

(b) retrospectively from the beginning of the annual reporting period; or

(c) retrospectively by restating the pre-combination information about all combining entities from the earlier comparative period presented?