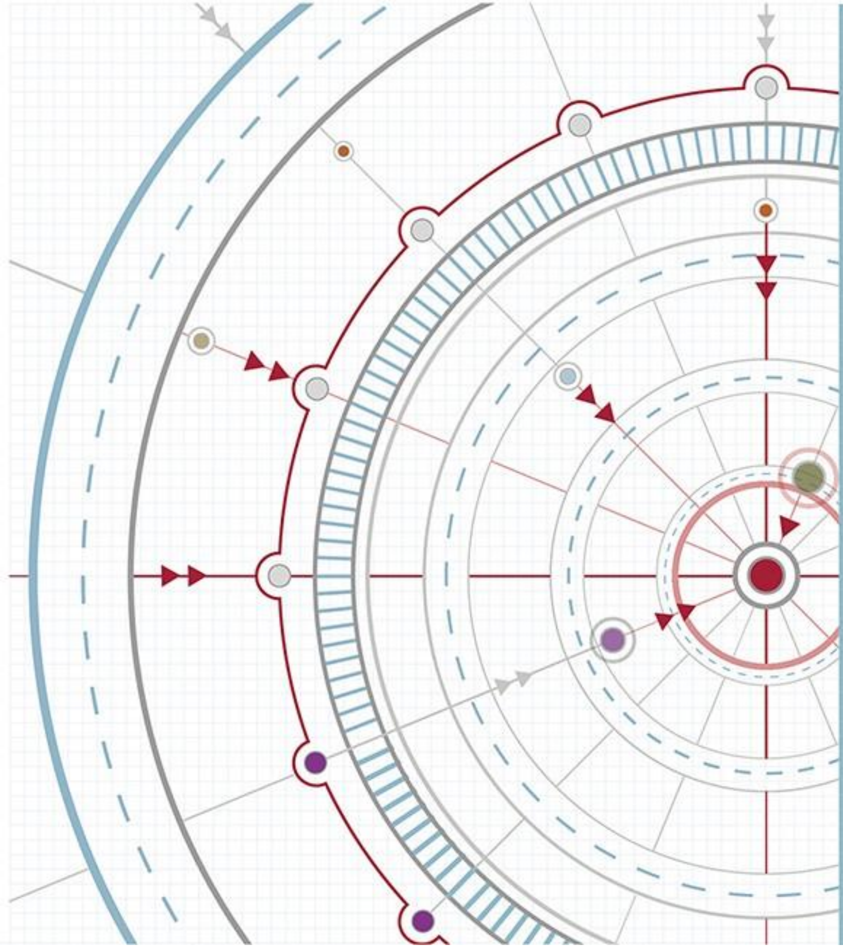

IASB Agenda ref 23

Business Combinations under Common Control

Update on the approaches being developed by the staff

IASB Meeting – April 2018

Disclaimer

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB® *Update*.

Project	**Business Combinations under Common Control (BCUCC)**		
Paper topic	Update on the approaches being developed by the staff		
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Purpose of the session

Update	The purpose of this session is provide an update to the Board on the approaches being developed by the staff for transactions within the scope of the BCUCC project.
Discussion	This session will give Board members an opportunity to provide feedback on the approaches being developed by the staff and to ask questions.

This session is educational and the staff do not ask the Board to make any decisions.

Content

- Where we are
- Fair values exchanged or different information?
- Building on the requirements in IFRS 3 and IAS 1
- Illustrating the alternative approaches
- Summarising the alternative approaches
- To be continued
- Appendix—Board's tentative decisions to date

For a specific subset of transactions within the scope of the BCUCC project

Where we are

Scope of the project finalised

focusses on transfers of **business*** under common control

includes **more** transactions than just **BCUCC**

addresses financial reporting by the **receiving entity**

considers **application questions**

* As defined in IFRS 3 *Business Combinations*.
A **webinar** on the scope of the project is available on the IFRS Foundation website.
Board's tentative decisions to date are reported in the **Appendix**.

Starting point in the analysis

Transactions within the scope of the BCUCC project

Where to start in developing proposals?

Acquisition method set in IFRS 3

Using the acquisition method as a starting point in the analysis:

- does NOT presuppose whether, when and how often the Board will propose to use that method; and
- does NOT imply that it will be treated as the default method.

Fair values exchanged or different information?

Health warning

- **The analysis in this slide deck:**
  - is based on a **simple scenario** where Entity A acquires Entity B and the two entities are under common control;
  - considers information needs of existing **non-controlling shareholders** in Entity A; and
  - focuses on the usefulness of information **before applying the cost constraint** on useful financial information.
- **At future meetings, we will discuss:**
  - **other transactions** within the scope of the project;
  - information needs of **other primary users** of the receiving entity's financial statements (for example, debts holders or prospective shareholders); and
  - **application of the cost constraint** (for example, in cases where non-controlling interest in Entity A is not significant).

Health warning

Transactions within the scope of the BCUCC project

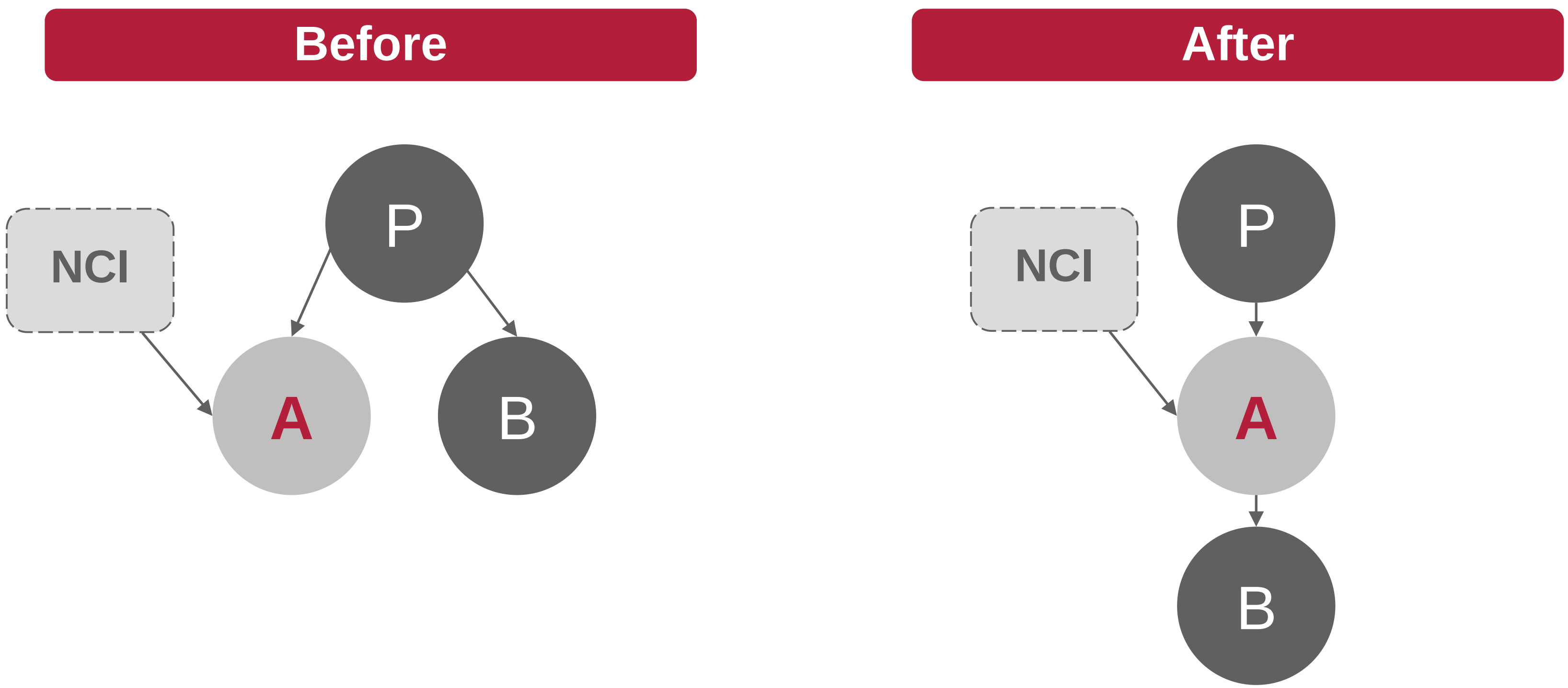
Primary users

Cost constraint

**The scenario considered in
the slide deck constitutes
a specific subset of transactions
within the scope of the BCUCC project**

Fact pattern

- Entity A and Entity B are businesses and are both controlled by Entity P;
- Entity B is wholly owned by Entity P but there are non-controlling shareholders (NCI) in Entity A;
- Entity A acquires Entity B from Entity P.



Questions to consider

Consider the transaction illustrated on slide 11 from the perspective of Entity A (receiving entity) and its NCI.

Question 1

What **information** about the transaction is **useful** for **NCI in Entity A**?

In particular, is information about the fair values exchanged or different information useful?

Question 2

Is there **anything special about BCUCC** that needs to be reflected in financial reporting and that does not happen in business combinations not under common control?

Question ❶—useful information (1/4)

- **NCI in Entity A rely on Entity A's general purpose financial statements as a source of information about the transaction.**
- **NCI in Entity A need information to help them assess:**
  - the prospects for future net cash inflows to Entity A; and
  - management's stewardship of Entity's A economic resources.
- **To make those assessments, NCI need information about:**
  - the impact of the transaction on Entity A's financial position and financial performance; and
  - how efficiently and effectively Entity A's management have discharged their responsibilities to use Entity A's economic resources.
- **What approach would provide NCI in Entity A with such information about the acquisition of Entity B?**

Question ❶—useful information (2/4)

- **Consider the following approaches:**

Historical cost of Entity B	Predecessor carrying amounts	Fair values exchanged (Staff's view)
Allocating the consideration transferred to Entity B's identifiable net assets would fail to reflect the fact that Entity A acquired a business (ie an integrated set of activities and assets that consists of inputs and processes applied to those inputs to create outputs).	Using the predecessor carrying amounts would fail to reflect the impact of the transaction on Entity A's financial position and financial performance, and on management's stewardship of Entity A's resources if items exchanged have similar carrying amounts but different fair values (or the other way round).	**Using the fair values exchanged would reflect the economics of the transaction meeting the objective of financial reporting.**

Question ❶—useful information (3/4)

- **Would the conclusion change depending on:**
  - the purpose of the transaction?
  - how the transaction was negotiated?
  - whether the transaction occurred on market terms?
  - the form of the consideration transferred?
  - …

Staff's view

NO

Staff's view

Information about the fair values exchanged would help NCI in Entity A understand **the economics** of the transaction **regardless of the characteristics of the transaction**.

Fair values exchanged

Question ❶—useful information (4/4)

How does the staff's analysis relate to IFRS 3?

- The staff's view is consistent with the conclusion the Board made in developing IFRS 3 that the **acquisition method** provides the **most useful information about an acquisition**.
- Reflecting the transaction at **the fair values exchanged** would be consistent with IFRS 3 requirements to measure both **Entity B's identifiable net assets and consideration transferred at fair value**.
- Although IFRS 3 requires measuring the consideration transferred at fair value, it **does not require measuring the fair value of the acquired business**. However, in a business combination that is not under common control the consideration transferred for the acquired business would normally approximate that business's fair value.

Question ❷—anything special about BCUCC?

- Unlike business combinations not under common control, BCUCC may include a **transaction with owners acting in their capacity as owners** (ie a contribution or a distribution). Applying IAS 1 *Presentation of Financial Statements*, such transactions are recognised in equity.

Acknowledging that there may be an equity transaction in a BCUCC and recognising any such transaction in equity …

… is consistent with the requirements in IFRS 3 para 51-52 (ie identifying any amounts that are not part of the exchange for the acquiree)

… is consistent with the accounting for some other transactions under common control (eg accounting for an interest-free intercompany loan)

… suggests that any 'bargain' component in a BCUCC constitutes a **contribution to equity rather than a gain** in profit or loss

Staff's conclusions

Consider the transaction illustrated on slide 11 from the perspective of Entity A (receiving entity) and its NCI.

Question 1

What information about the transaction is useful for NCI in Entity A?

Question 2

Is there anything special about BCUCC that needs to be reflected in financial reporting?

Reflecting the transaction at fair values exchanged

Identifying and accounting for an equity transaction, *if any*

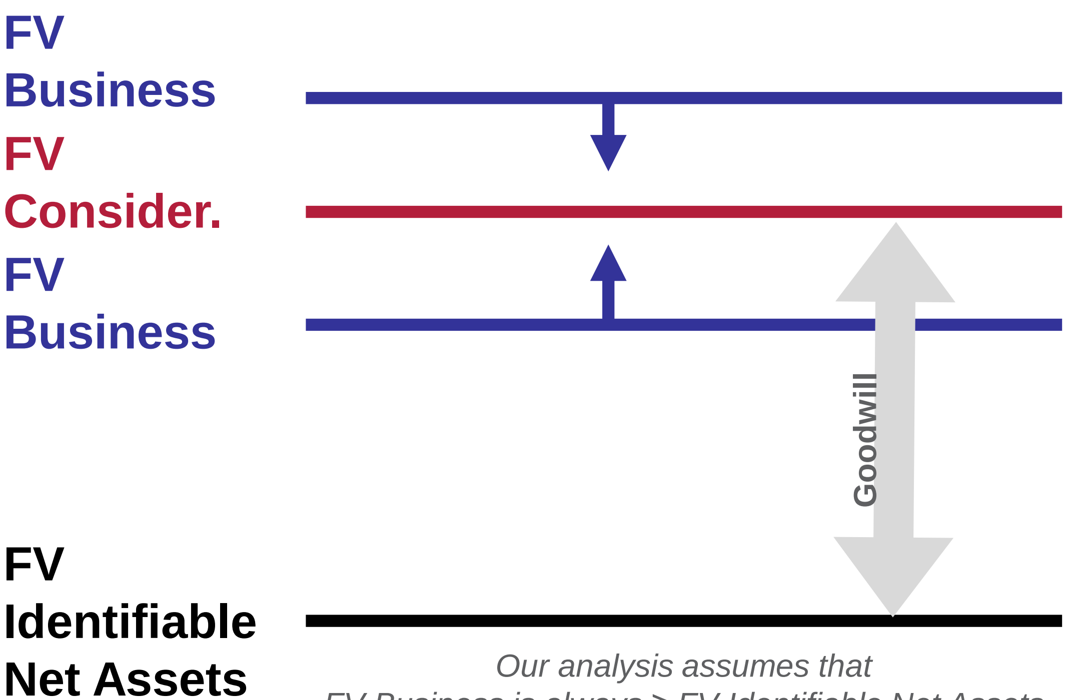
A combination of the acquisition method and IAS 1 requirements

Let's consider how the acquisition method and the requirements in IAS 1 might apply together…

Building on the requirements in IFRS 3 and IAS 1

Applying IFRS 3

Consider a business combination not under common control



Our analysis assumes that FV Business is always ≥ FV Identifiable Net Assets

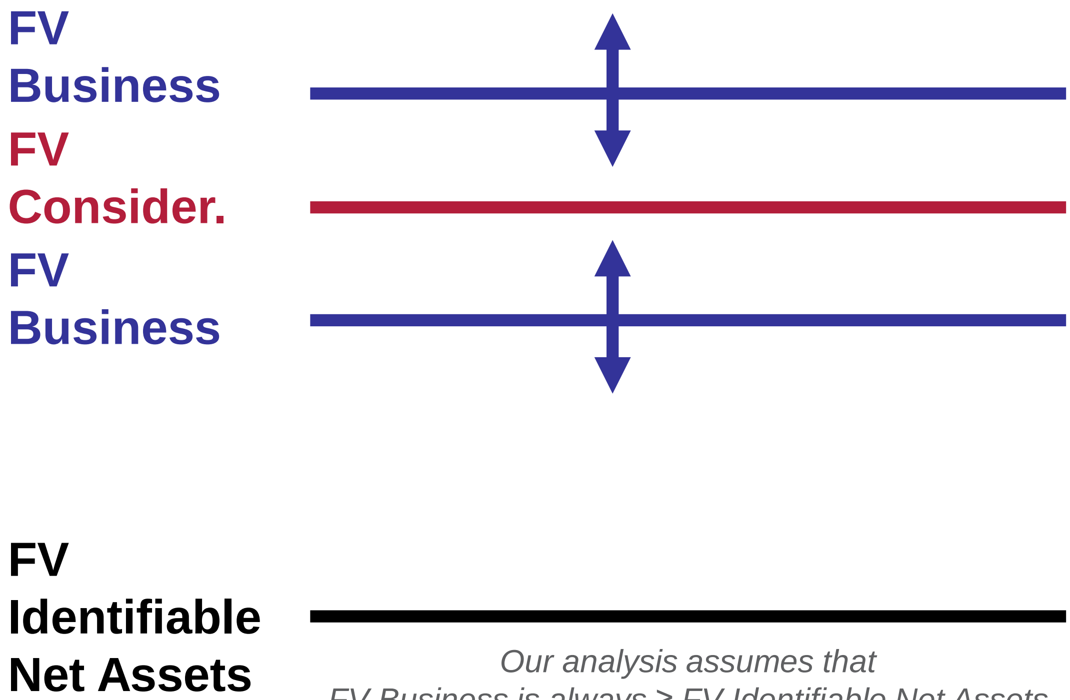
IFRS 3 does not require determining the fair value of the acquired business. However, in a business combination not under common control the consideration transferred would normally approximate the fair value of the acquired business.

Goodwill is the difference between the fair value of the consideration and the fair value of the acquired identifiable net assets.* Goodwill is subsequently tested for impairment and any loss is recognised in profit and loss.

* If less than 100% interest is acquired, measurement of goodwill takes into account the NCI in the acquiree.

Building on IFRS 3 and IAS 1

Consider a BCUCC



Our analysis assumes that FV Business is always ≥ FV Identifiable Net Assets

In a BCUCC, the fair values of the consideration transferred and the acquired business may or may not be approximately equal. The difference between them would constitute a contribution to equity or a distribution from equity.

Therefore, it is important to, both:

– avoid recognition of any **inflated goodwill** or any **artificial gain**; and

– recognise any **equity transaction**.

Building on IFRS 3 and IAS 1 (cont.)

In the light of the objectives stated in the previous slide the staff is currently developing two alternative approaches.

***Full fair value* approach**

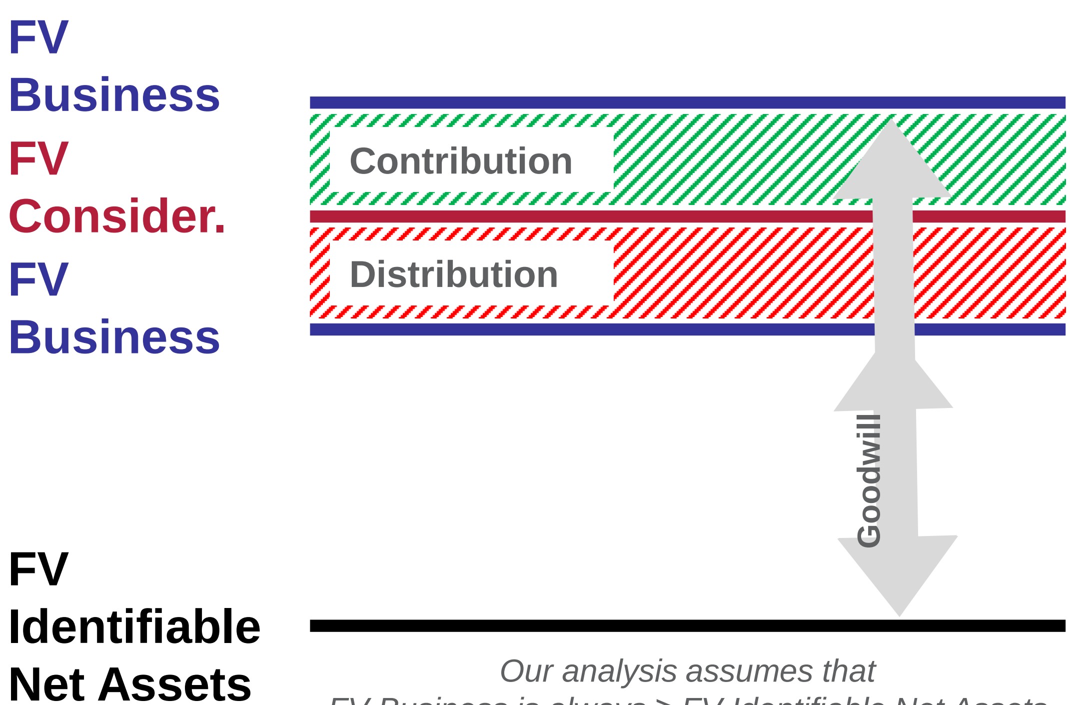
***Ceiling* approach**

These approaches:

- **are only being considered for a specific subset of transactions within the scope of the BCUCC project; and**
- **explore accounting from the perspective of the receiving entity (Entity A).**

Full fair value **approach**

Focus on identifying and recognising any equity transaction



Our analysis assumes that
FV Business is always ≥ FV Identifiable Net Assets

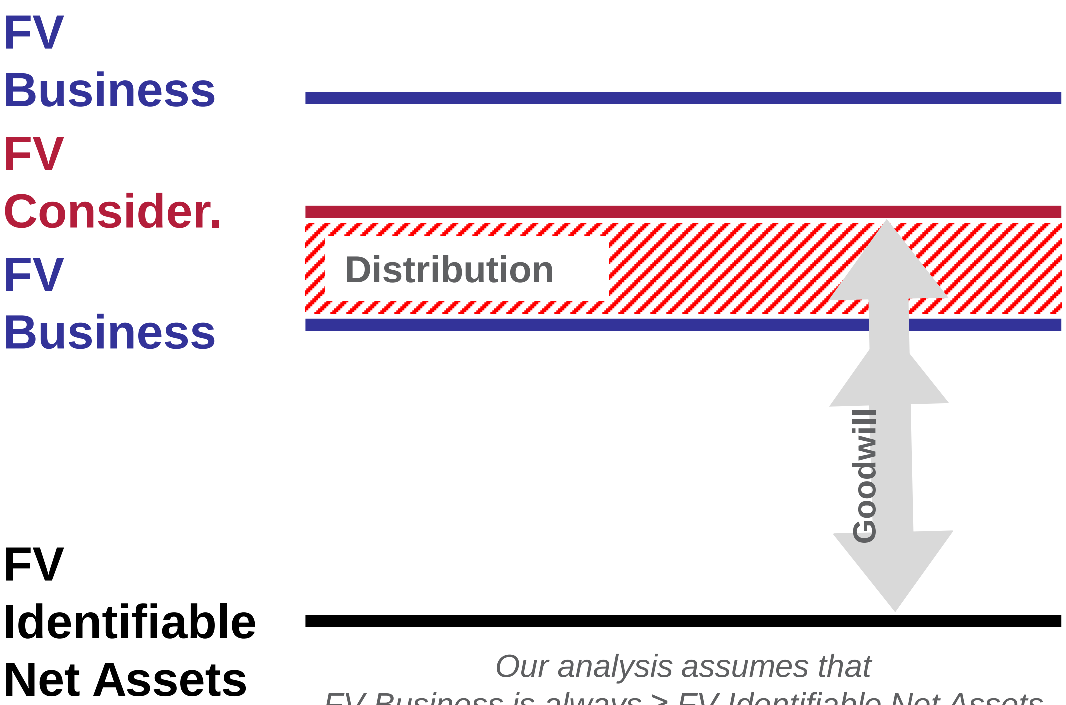
Full fair value approach would require determining the fair value of both the consideration transferred and the acquired business. Any difference between them is recognised as a contribution to equity or distribution from equity.

Goodwill is recognised as the difference between the fair value of the acquired business and the fair value of the acquired identifiable net assets.

Gain is never recognised.

Ceiling approach

Focus on avoiding recognising any inflated goodwill



Our analysis assumes that
FV Business is always ≥ FV Identifiable Net Assets

Ceiling approach involves assessing the fair value of the consideration transferred against the fair value of the acquired business.

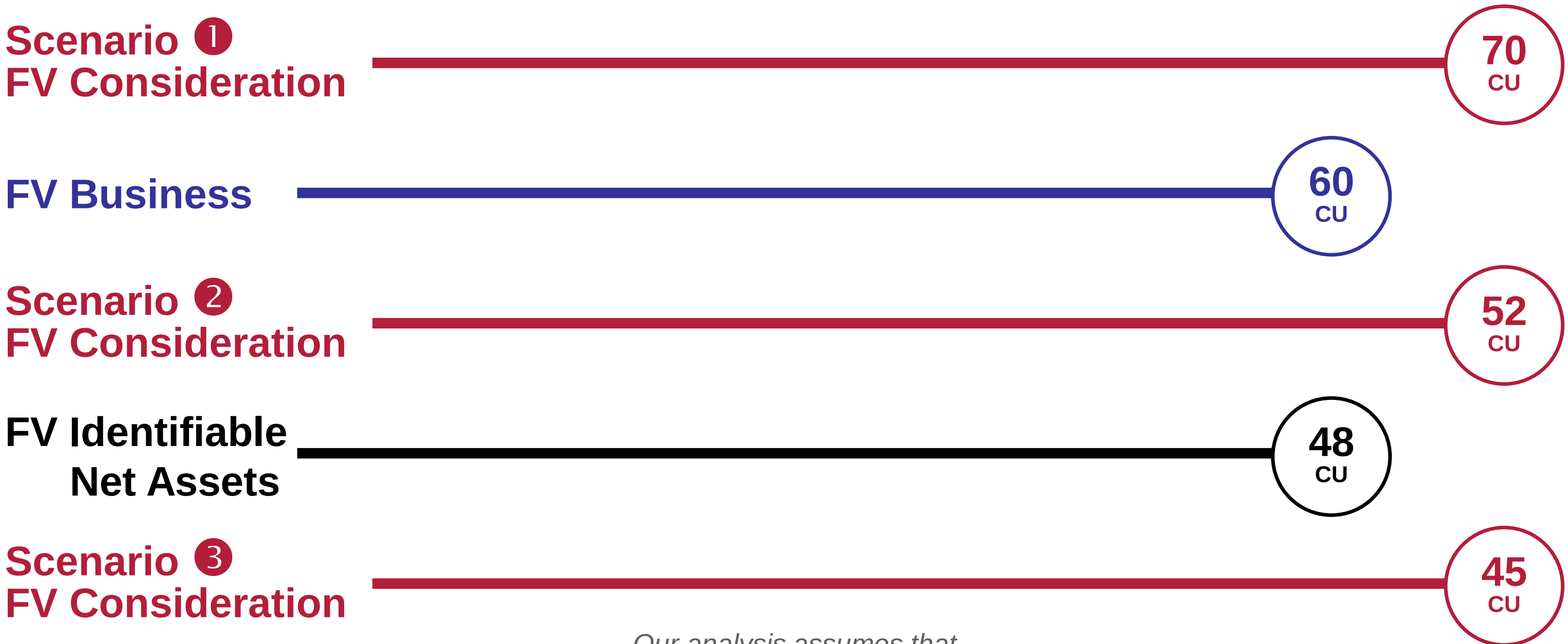
Goodwill is the excess of the consideration transferred over the fair value of the acquired identifiable net assets, ‘capped’ at the fair value of the acquired business.

Gain is never recognised.

Excess consideration over the fair value of the acquired business is recognised as a distribution from equity.

Illustrating the alternative approaches

Possible scenarios



Our analysis assumes that
FV Business is always ≥ FV Identifiable Net Assets

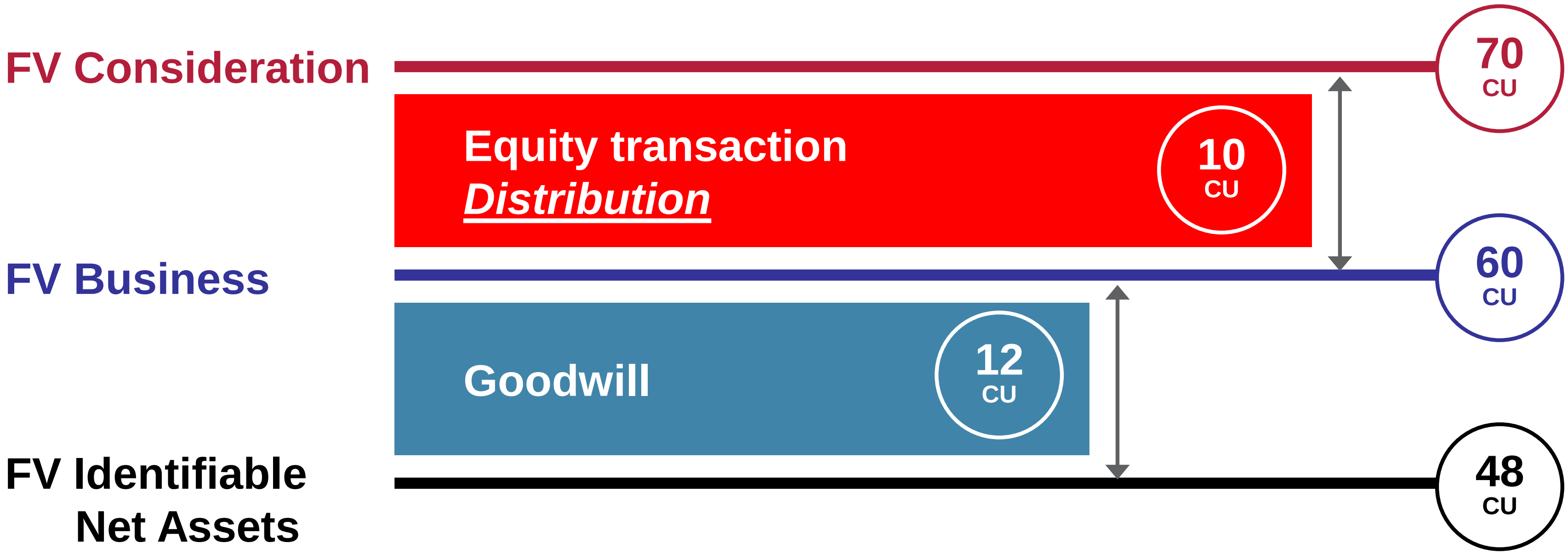
In these examples:

- the consideration transferred is cash;
- the amounts are denominated in ‘currency units’ (CU).

Scenario ❶

The fair value of the consideration transferred is <u>more</u> than the fair value of the acquired business.

***Full fair value* approach = *Ceiling* approach**



Scenario ❶—debits and credits

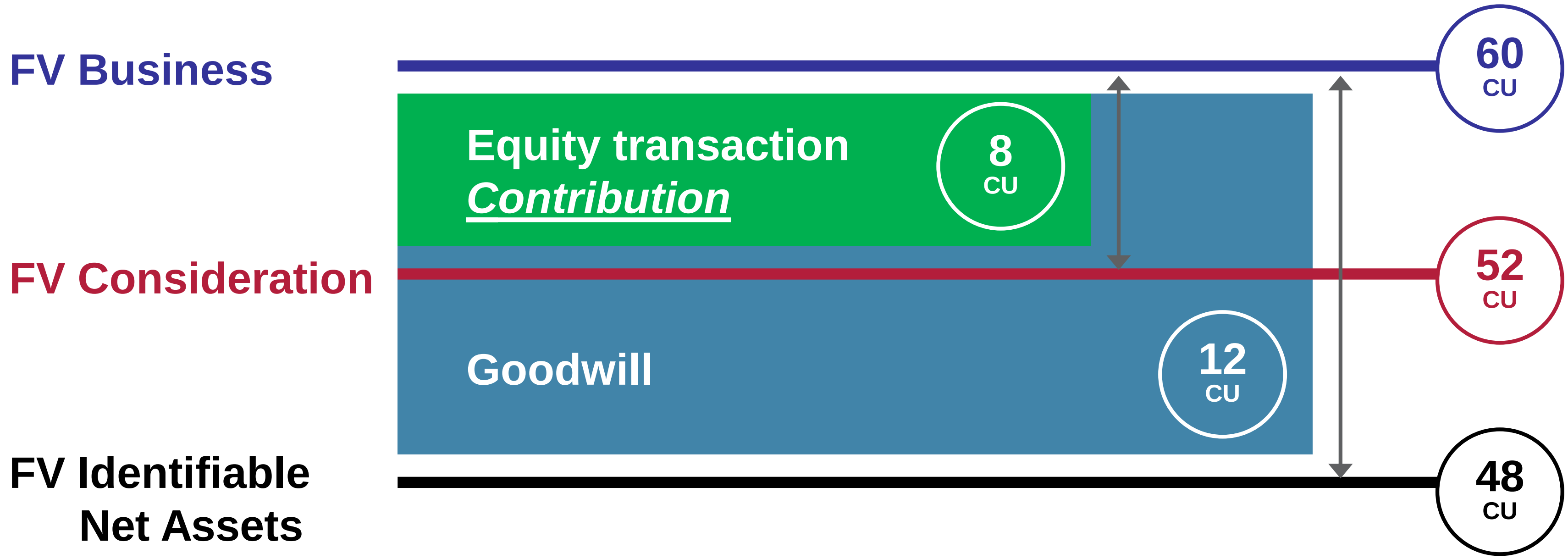
		Full fair value = Ceiling		IFRS 3	
Cr	Cash		70		70
Dr	Identifiable Net Assets	48		48	
Dr	Goodwill	12		22	⚠
Dr	Equity (***Distribution***)	10		-	
Dr	Impairment loss	-		⚠	

⚠ **Subject to impairment test!**

Scenario ❷

The fair value of the consideration transferred is <u>less</u> than the fair value of the acquired business but <u>more</u> than the fair value of the acquired identifiable net assets.

Full fair value approach



Scenario ❷

The fair value of the consideration transferred is <u>less</u> than the fair value of the acquired business but <u>more</u> than the fair value of the acquired identifiable net assets.

Ceiling approach

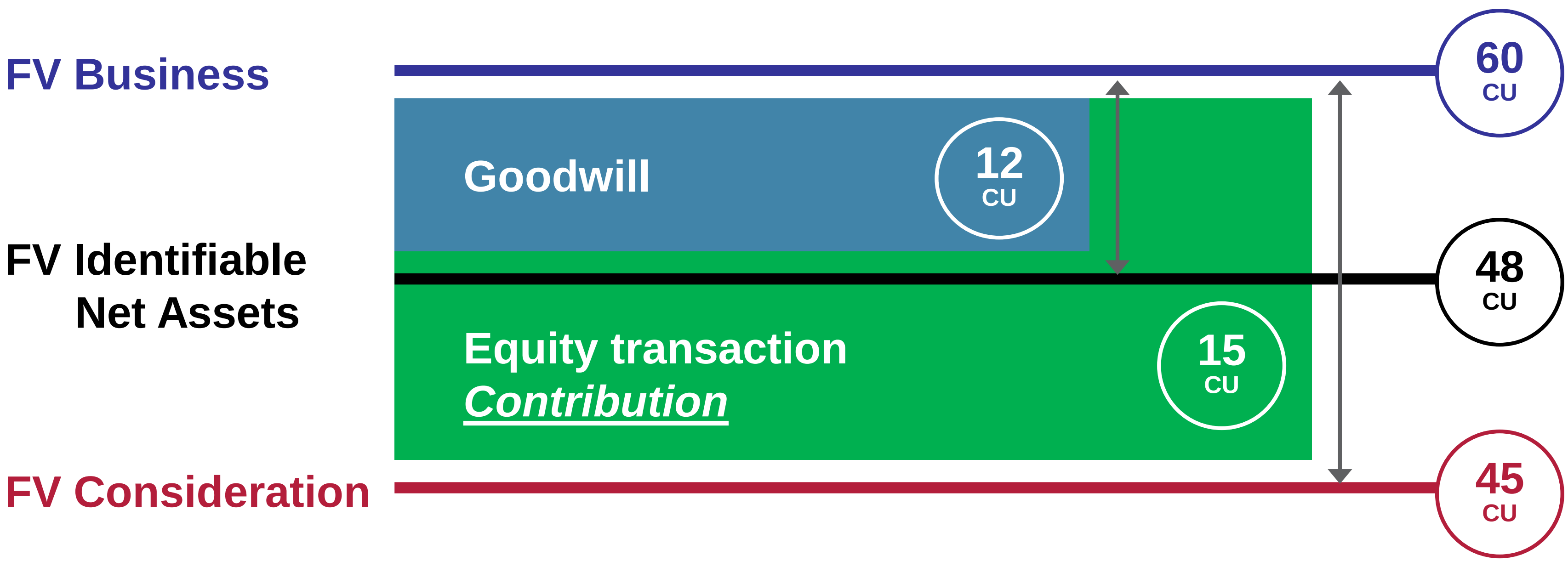
Scenario ❷—debits and credits

		Full fair value		Ceiling		IFRS 3	
Cr	Cash		52		52		52
Dr	Identifiable Net Assets	48		48		48	
Dr	Goodwill	12		4		4	
Cr	Equity (*Contribution*)		8		-		-

Scenario ❸

The fair value of the consideration transferred is <u>less</u> than the fair value of the acquired business and <u>less</u> than the fair value of the acquired identifiable net assets.

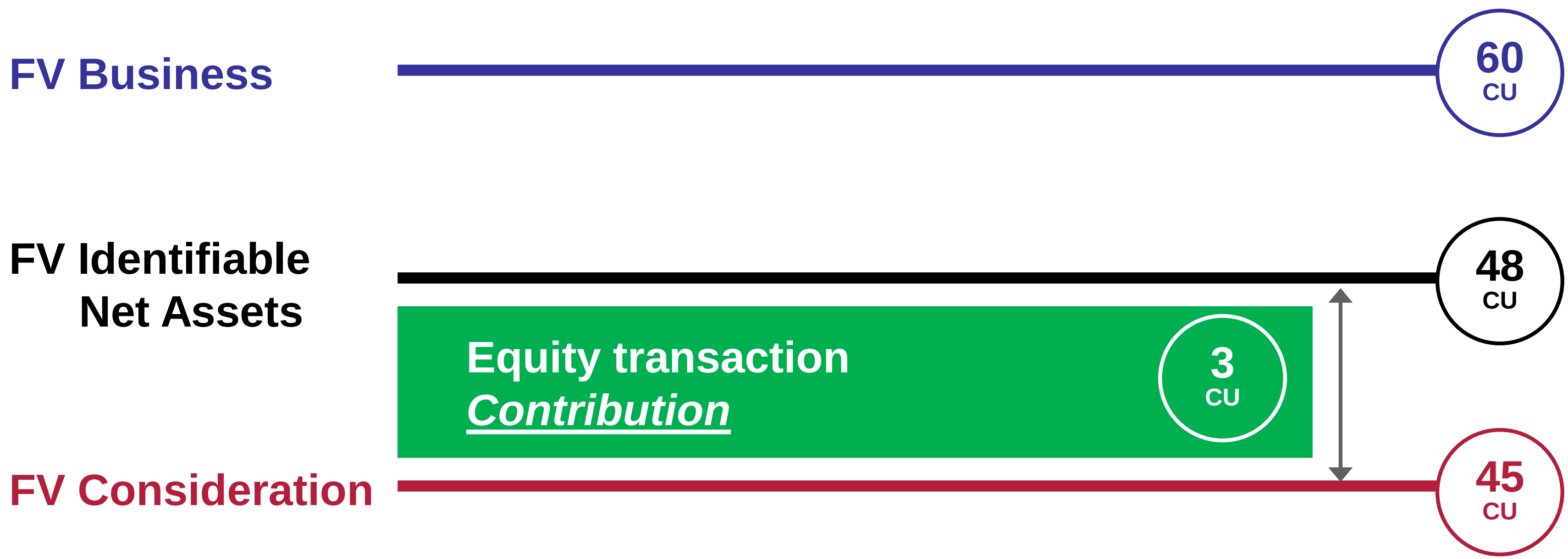
***Full fair value* approach**



Scenario ❸

The fair value of the consideration transferred is less than the fair value of the acquired business and less than the fair value of the acquired identifiable net assets.

***Ceiling* approach**



Scenario ❸—debits and credits

		Full fair value		Ceiling		IFRS 3	
Cr	**Cash**		**45**		**45**		**45**
Dr	**Identifiable Net Assets**	**48**		**48**		**48**	
Dr	**Goodwill**	**12**		**-**		**-**	
Cr	**Equity (*Contribution*)**		**15**		**3**		**-**
Cr	**Gain on a bargain purchase**	**-**	**-**	**-**	**-**		**3**

Summarising the alternative approaches

Full fair value approach—summary (1/3)

- Requires the receiving entity to measure the fair value of the acquired business and to compare it with the fair value of the consideration transferred in all scenarios.
- Fair value of the acquired business affects **recognition** of equity transactions.

FV Consideration > FV Business	**FV Consideration < FV Business**
The receiving entity recognises:	The receiving entity recognises:
Distribution	**Contribution**
FV Consideration – FV Business	**FV Business – FV Consideration**
Goodwill	**Goodwill**
FV Business – FV Identifiable Net Assets	**FV Business – FV Identifiable Net Assets**

Full fair value approach—summary (2/3)

- ***Full fair value*** approach aims to reflect the economics of the transaction.
- However, it involves **significant measurement uncertainty** as it requires, in all scenarios, **recognition** of amounts that depend on a **single estimate** of the fair value of the acquired business.
- In addition, it is also **operationally complex** for transactions **not priced at fair value** as it requires determining the fair value of the acquired business.

Full fair value **approach—summary (3/3)**

- Under the ***Full fair value*** approach:
  - **goodwill** is always calculated as the difference between the fair value of the acquired business and the fair value of the acquired identifiable net assets;
  - any difference between the fair value of the acquired business and the fair value of the consideration transferred is recognised as **an equity transaction**:
    - a contribution to equity (FV Business > FV Consideration); or
    - a distribution from equity (FV Consideration > FV Business);
  - a **gain** on a bargain purchase is **never recognised**.

Ceiling approach—summary (1/3)

- The fair value of the acquired business **only affects recognition** of goodwill or an equity transaction **when the fair value of the consideration transferred is more than the fair value of the acquired business**.

FV Consideration > FV I. Net Assets

The fair value of the consideration transferred is assessed against the fair value of the acquired business.

FV C. > FV B.

Distribution

FV Consideration – FV Business

Goodwill

FV Business – FV I. Net Assets

FV C. < FV B.

Goodwill

FV Consideration – FV I. Net Assets

FV Consideration < FV I. Net Assets

An entity recognises:

Contribution

FV I. Net Assets – FV Consideration

Ceiling approach—summary (2/3)

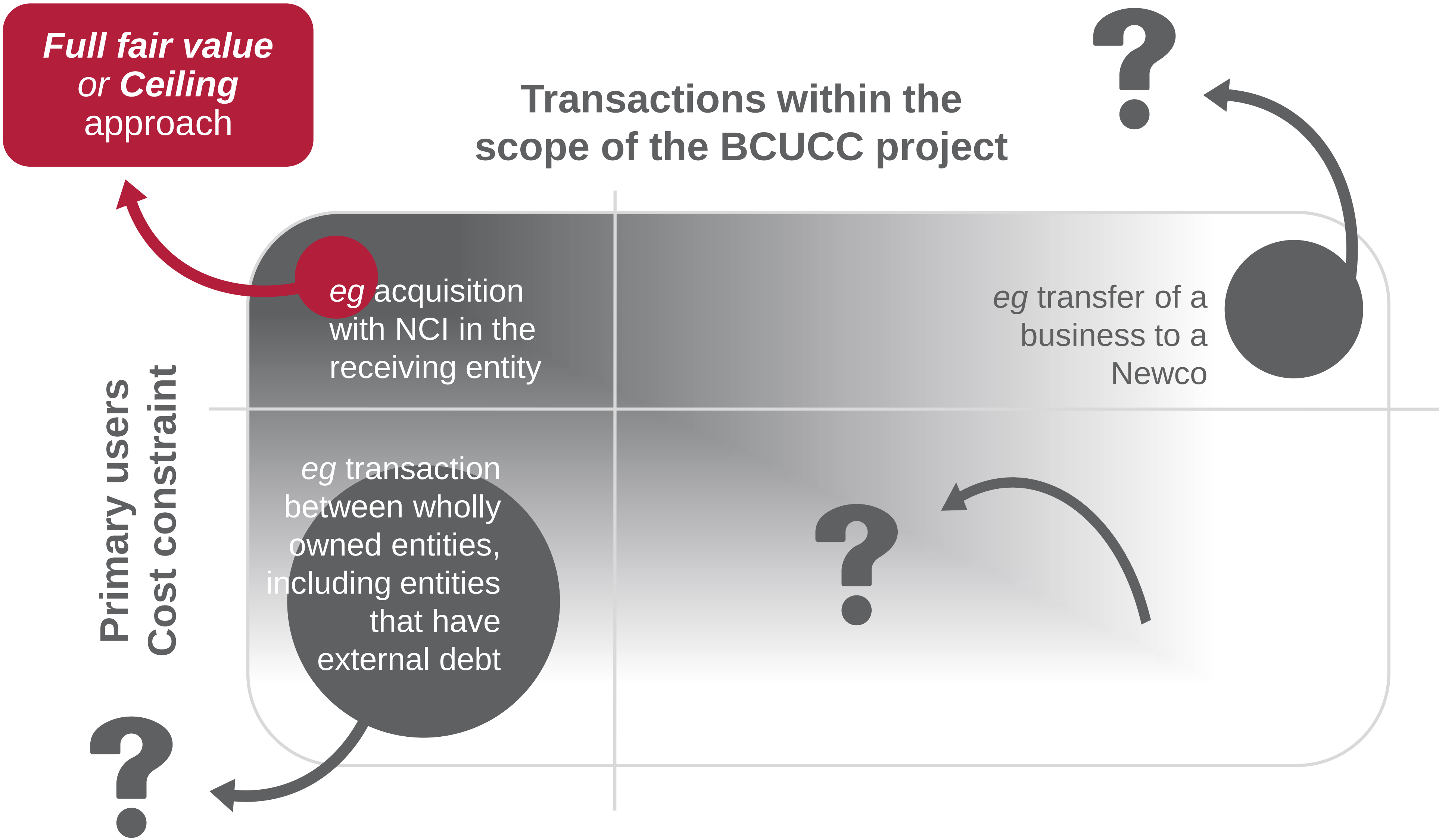
- ***Ceiling*** approach would not always fully reflect the economics of the transaction.
- However, it involves **less measurement uncertainty** than the *Full fair value* approach as the fair value of the acquired business only serves as the ceiling for recognising goodwill and the floor for recognising a distribution from equity when the fair value of the consideration transferred is more than the fair value of the acquired business.
- This approach involves **similar operational complexity** as the *Full fair value* approach for **transactions not priced at fair value** as it requires determining the fair value of the acquired business (except when the fair value of the consideration transferred is less than the fair value of the acquired identifiable net assets).

Ceiling approach—summary (3/3)

- Under the ***Ceiling*** approach:
  - consistent with IFRS 3, **goodwill** is calculated as the excess of the fair value of the consideration transferred over the fair value of the acquired identifiable net assets, **unless** the fair value of the acquired business is below the fair value of the consideration transferred. In the latter case, goodwill is capped at the fair value of the acquired business;
  - **equity transactions** are not always recognised. When an equity transaction is recognised, it is presented as:
    - a distribution from equity (when FV Consideration > FV Business); or
    - a contribution to equity (when FV Consideration < FV Identifiable Net Assets).
  - a **gain** in a bargain purchase is **never recognised**.

To be continued

To be continued



Feedback and discussion

- **Do Board members have any questions and/or comments?**

Thank you

Appendix

Board's tentative decisions to date

Appendix—Board's tentative decisions to date

Jun 2014
Setting the scope

The Board tentatively decided that the BCUCC project should consider:

- business combinations under common control that are currently excluded from the scope of IFRS 3 *Business Combinations*;
- group restructurings; and
- the need to clarify the description of business combinations under common control, including the meaning of 'common control'.

Appendix—Board's tentative decisions to date

Oct 2017

Clarifying the scope

Group restructuring

The Board clarified that the scope of the BCUCC project includes transactions under common control in which a reporting entity obtains control of one or more businesses, regardless of whether IFRS 3 *Business Combinations* would identify the reporting entity as the acquirer if IFRS 3 were applied to the transaction.

Appendix—Board's tentative decisions to date

Dec 2017

Clarifying the scope

Application questions

The Board tentatively decided that the scope of the project also includes transactions involving transfers of one or more businesses where all of the combining parties are ultimately controlled by the same controlling party or parties, and the transactions are:

- preceded by an external acquisition and/or followed by an external sale of one or more of the combining parties; or
- conditional on a future sale such as in an IPO.

Appendix—Board's tentative decisions to date

Feb 2018

Starting point in the analysis

The Board tentatively decided to use the acquisition method set out in IFRS 3 *Business Combinations* as the starting point in its analysis of transactions within the scope of the project. Using that starting point will not determine whether the Board will ultimately propose applying the acquisition method to all, or even to many, transactions within the scope of the project.