IFRS

STAFF PAPER

September 2019

IASB® Meeting

Project	**Business Combinations under Common Control**		
Paper topic	When to apply which measurement approach		
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Purpose of the paper

1. In February 2018, the International Accounting Standards Board (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 Business Combinations under Common Control project. The Board noted that using the acquisition method as a starting point in the analysis 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.

2. In June 2018, the Board directed the staff to develop an approach based on the acquisition method for business combinations under common control that affect non-controlling shareholders of a receiving entity and to consider whether and how that method should be modified to provide the most useful information about such transactions. In December 2018, the Board discussed whether to apply a current value approach based on the acquisition method to all or only some such transactions. The Board was not asked to make decisions.

3. In April 2019, the Board tentatively decided that it need not pursue a single measurement approach for all transactions within the scope of the project. Specifically, the Board could pursue:

(a) a current value approach for all or some transactions that affect non-controlling shareholders of a receiving entity; and

(b) a different approach, such as a form of predecessor approach, for transactions that do not affect non-controlling shareholders.

4. This paper discusses whether and when a current value approach and a predecessor approach should be applied to transactions within the scope of the project and asks the Board for decisions.

Structure of the paper

5. This paper is structured as follows:

(a) summary of the staff recommendations (paragraphs 6–7);

(b) recap of the staff's approach (paragraphs 8–12);

(c) summary of input received (paragraphs 13–17);

(d) staff analysis and recommendations (paragraphs 18–44):

(i) whether to apply a single measurement approach for all transactions within the scope of the project (paragraphs 19–21);

(ii) when to apply a current value approach (paragraphs 22–37);

(iii) when to apply a predecessor approach (paragraphs 38–44); and

(e) Appendix A—A flowchart illustrating the staff recommendations.

Summary of the staff recommendations

6. The staff recommend that the forthcoming Discussion Paper on Business Combinations under Common Control (Discussion Paper)[1] does not propose that a single approach is applied to all transactions within the scope of the project. The staff recommend that the Discussion Paper sets out the following preliminary views:

[1] At a future meeting, the staff will ask the Board to confirm what the next due process document on the project should be.

(a) a current value approach based on the acquisition method should be required for transactions within the scope of the project that affect non-controlling shareholders of a receiving entity unless equity instruments of the receiving entity are not traded in a public market[2] and one of the following conditions applies:

(i) all non-controlling shareholders are related parties of the receiving entity as defined in IAS 24 *Related Party Disclosures*; or

(ii) the receiving entity qualifies for an exemption from applying a current value approach to a particular transaction (see paragraph 6(c));

(b) a predecessor approach should be required for all other transactions within the scope of the project; and

(c) a receiving entity whose equity instruments are not traded in a public market should be permitted, but not required, to apply a predecessor approach to a transaction that affects non-controlling shareholders if the non-controlling shareholders have been informed about, and do not object to, the receiving entity applying that approach.

7. Appendix A provides a flowchart illustrating the staff recommendations.

Recap of the staff's approach

8. In developing possible measurement approaches for transactions within the scope of the project, the staff have performed a range of research and outreach activities, including but not limited to:

(a) analysis of the requirements and guidance in existing IFRS Standards and in the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*);

[2] Public market is described in IFRS Standards as a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets (paragraph 4(a)(ii) of IFRS 10 *Consolidated Financial Statements*, paragraph 2(b)(i) of IFRS 8 *Operating Segments*, paragraph 2(b)(i) of IAS 33 *Earnings per Share*).

(b) research into requirements and guidance in various jurisdictions and into current reporting practice; and

(c) discussions with the Board's consultative bodies and other interested parties.

9. Agenda papers on particular topics provided detailed summaries of work performed by the staff in developing those agenda papers.

10. April 2019 Agenda Paper 23A *Update on the staff's approach* summarised the staff's approach to the analysis, explaining the staff's focus on:

(a) whether and how transactions within the scope of the project can be different from business combinations that are not under common control;

(b) what information would be useful to various primary users of the receiving entity's financial statements;

(c) whether the benefits of providing particular information would justify the costs of providing that information; and

(d) complexity and opportunities for accounting arbitrage that could arise under various approaches.

11. In that paper, the staff argued that assuming the same composition of primary users of the reporting entity's financial statements, to the extent that transactions within the scope of the project are similar to other business combinations, they should be reported applying the acquisition method. However, a need for a different measurement approach or for additional disclosure in the notes may arise for transactions within the scope of the project if:

(a) those transactions are different from other business combinations; or

(b) the composition of primary users of information about those transactions differs from the composition of primary users of information about other business combinations. That difference in composition might result in a different conclusion about what information would meet the needs of the

maximum number of primary users[3] at a cost justified by the benefits of that information.

12. At the April 2019 meeting, the Board supported the staff's approach to the analysis.

Summary of input received

13. The staff discussed their analysis of whether and when a current value approach and a predecessor approach should be applied to transactions within the scope of the project with the Board's consultative groups, including the Accounting Standards Advisory Forum (ASAF), the Capital Markets Advisory Committee (CMAC) and the Global Preparers Forum, and with other interested parties. An overview of the staff's outreach activities was provided in paragraphs 14–19 of April 2019 Agenda Paper 23A.

14. Stakeholders expressed diverse views on the topics discussed. However, the following common themes emerged:

    (a) transactions that do *not* affect non-controlling shareholders of a receiving entity—most stakeholders generally supported applying a predecessor approach to such transactions, including when those transactions affect lenders and other creditors of the receiving entity or potential equity investors, for example, in an initial public offering (IPO). Most stakeholders who commented on the topic, including CMAC members who specialise in credit analysis, also agreed with the staff's conclusion that the outcome of credit analysis would not depend greatly on whether a current value approach or a predecessor approach is applied to business combinations under common control.

    (b) transactions that affect non-controlling shareholders of a receiving entity—many stakeholders generally supported applying a current value approach to such transactions, especially when non-controlling interest is 'substantive'. Those stakeholders agreed that a current value approach would provide useful information to those non-controlling shareholders

[3] Paragraph 1.8 of the *Conceptual Framework*.

or agreed that the presence of non-controlling shareholders is an indicator that the transaction may be an acquisition similar to a business combination not under common control.

15. Some stakeholders disagreed with applying a current value approach to transactions that affect non-controlling shareholders. They expressed the following views:

   (a) all business combinations under common control should be reported applying a single approach—a predecessor approach. This is because:

      (i) in selecting the appropriate accounting treatment, the Board should consider common information needs of all primary users of the financial statements rather than focus on the information needs of non-controlling shareholders;

      (ii) the substance of all business combinations under common control is different from other business combinations because the controlling party controls all combining entities or businesses both before and after the transaction;

      (iii) it would be difficult to make a distinction between ‘substantive’ and ‘non-substantive’ non-controlling interest in a meaningful way;

      (iv) identifying an acquirer in business combinations under common control in a way that results in useful information could be challenging;

      (v) applying different approaches to different business combinations under common control would decrease comparability and could create opportunities for accounting arbitrage;

      (vi) applying a current value approach to business combinations under common control would be more costly than applying a predecessor approach, would involve significant measurement uncertainty and result in recognition of goodwill that is not evidenced by a transaction price between independent parties;

      (vii) a predecessor approach would provide useful information about business combinations under common control to non-controlling shareholders of the receiving entity; and

(viii) a predecessor approach is commonly applied to business combinations under common control and is the required approach in some jurisdictions.

(b) some business combinations under common control are similar to business combinations that are not common control, whereas others are not. Therefore, different accounting treatments could be appropriate for different business combinations under common control. However, although the presence of non-controlling shareholders may be an indicator that a transaction is an acquisition similar to those not under common control, it is not suitable as a sole determinant in identifying those that are similar. Instead, the distinction should be based on the 'substance' of the transaction.

(c) a current value approach does not provide the most useful information about business combinations, including business combinations under common control.

16. Stakeholders, including those who did not support a distinction based on whether the transaction affects non-controlling shareholders of the receiving entity, expressed the following views on whether a current value approach should be applied to all or only some such transactions if the Board were to pursue such a distinction:

(a) most stakeholders supported applying a current value approach when the receiving entity's equity instruments are traded in a public market. They suggested that:

(i) listed entities are subject to robust capital market regulations and corporate governance requirements and therefore business combinations under common control involving such listed entities are likely to be akin to business combinations that are not under common control;

(ii) the benefits of providing current value information to non-controlling shareholders of listed receiving entities are likely to justify the costs of providing such information;

(iii) for transactions that affect non-controlling shareholders in privately held receiving entities, it would be difficult to distinguish a subset of those transactions for which a current

value approach would provide useful information at a cost justified by the benefits of such information.

(b) in contrast, some stakeholders argued that a current value approach should be applied not only to transactions that affect non-controlling shareholders in listed entities but also to all or at least some transactions that affect non-controlling shareholders in privately held entities. They stated that:

(i) information needs of non-controlling shareholders are the same regardless of whether the receiving entity's equity instruments are publicly traded;

(ii) in their jurisdictions, non-controlling shareholders enjoy regulatory 'protection' regardless of whether the receiving entity's equity instruments are publicly traded;

(iii) the opt-in/opt-out approach presented by the staff (see paragraph 33) would provide a solution that balances information needs of non-controlling shareholders in privately held entities and costs of providing current value information.

(c) some stakeholders suggested using a set of quantitative and/or qualitative indicators in determining when a current value approach should be applied to transactions that affect non-controlling shareholders, including the size of non-controlling interest and the change in non-controlling interest as a result of the transaction. In contrast, other stakeholders did not support using a quantitative threshold.

(d) some stakeholders suggested that a current value approach should not be applied if all non-controlling shareholders are the receiving entity's related parties.

17. Other comments made by stakeholders included:

(a) current value information is also useful for lenders and other creditors of the receiving entity, especially when the receiving entity's debt instruments are traded in a public market, and for potential equity investors, for example in an IPO;

(b) some primary users, for example some lenders and private equity investors, can have access to information other than via the receiving entity's financial statements;

(c) for assets and liabilities of a combined entity sold in an IPO following a restructuring under common control, using different measurement approaches would not provide useful information; instead, all assets and liabilities of all combining entities or businesses should be reflected at their predecessor carrying amounts or at their current values (that latter approach is sometimes referred to as 'fresh start' or 'new basis'[4]);

(d) a predecessor approach would provide useful information to potential equity investors, for example in an IPO, only if pre-combination trend information is provided for all combining entities or businesses;

(e) it is not clear when and why information needs of existing non-controlling shareholders would differ from those of potential equity investors[5].

Staff analysis and recommendations

18. As noted in paragraphs 2–3, the Board directed the staff to develop an approach based on the acquisition method for some business combinations under common control—those that affect non-controlling shareholders of a receiving entity. The Board also tentatively decided that it could pursue a different approach, such as a predecessor approach, for other transactions within the scope of the project.

Whether to apply a single measurement approach for all transactions within the scope of the project

19. For the reasons summarised in paragraph 15(a), some stakeholders argued for a single approach for all transactions within the scope of the project—a predecessor

[4] As discussed in September 2017 Agenda Paper 23 *Business Combinations under Common Control*, 'fresh start' accounting is not permitted under existing IFRS Standards and the staff's outreach indicated little support for that approach. Accordingly, the staff have not considered that approach further.

[5] Information needs of potential equity investors in the context of the transactions within the scope of the project were discussed in July 2019 Agenda Paper 23A *Potential equity investors in BCUCC*.

approach. In contrast, for the reasons summarised in paragraph 17, some other stakeholders argued that current value information is useful not only for non-controlling shareholders but also for other types of primary users of the receiving entity's financial statements.

20. In the light of considerations discussed in paragraph 10, the staff do not think that either a current value approach or a predecessor approach should be required for all transactions within the scope of the project. This is because:

    (a) transactions within the scope of the project do not form a single homogeneous population just because common control is present in all of them. Instead, as discussed in paragraphs 19–32 of June 2019 Agenda Paper 23A *Transactions that do not affect non-controlling shareholders*:

        (i) some transactions within the scope of the project result in change in ownership interests in the underlying net assets for the owners of the receiving entity and are similar to acquisitions in the scope of IFRS 3 (see Scenario 1 in June 2019 Agenda Paper 23A); and

        (ii) other transactions within the scope of the project do not result in change in ownership interests in the underlying net assets for the owners of the receiving entity and are different from acquisitions in the scope of IFRS 3 to varying degrees (see Scenarios 2–3 in June 2019 Agenda Paper 23A).

    (b) the conclusion in a particular scenario about what information would meet common information needs of the maximum number of primary users at a cost justified by the benefits of that information would depend on the composition of primary users in that scenario. For example, that conclusion could be different for transactions that affect non-controlling shareholders and transactions between wholly owned entities.

    (c) making a distinction between different transactions within the scope of the project would not decrease comparability. A lack of comparability already exists today both between business combinations and business combinations under common control and between different business combinations under common control. Instead, making an appropriate distinction between different types of business combinations under

common control would foster comparability by requiring similar information about like transactions and different information about dissimilar transactions.

(d) making a distinction between different transactions within the scope of the project would not necessarily increase complexity or opportunities for accounting arbitrage. This is because a distinction already exists today between business combinations and business combinations under common control. Making a distinction between transactions within the scope of the project would merely shift the existing distinction to a different point.[6] Furthermore, replacing the existing distinction with a new distinction could help reduce opportunities for accounting arbitrage depending on how that new distinction is made.

21. Accordingly, the staff recommend that the forthcoming Discussion Paper does not propose that a single approach is applied to all transactions within the scope of the project.

Question 1 for the Board
Does the Board agree that the forthcoming Discussion Paper should not propose that a single approach is applied to all transactions within the scope of the project?

When to apply a current value approach

A current value approach for transactions that affect non-controlling shareholders

22. As noted in paragraph 14(b), many stakeholders generally supported applying a current value approach to transactions that affect non-controlling shareholders of a receiving entity, especially when non-controlling interest is ‘substantive’. Those stakeholders agreed that a current value approach would provide useful information to those non-controlling shareholders or agreed that the presence of non-controlling

[6] That would be the case unless the Board decides to modify the acquisition method for business combinations under common control.

shareholders is an indicator that the transaction may be an acquisition similar to a business combination not under common control.

23. In contrast, as noted in paragraph 15(b), some stakeholders agreed that different measurement approaches might be appropriate for different transactions within the scope of the project but did not base such a distinction on whether the transaction affects non-controlling shareholders of the receiving entity. Instead, they suggested that different accounting treatments could be appropriate for different business combinations under common control depending on the 'substance' of those transactions.

24. As discussed in paragraph 20 of April 2019 Agenda Paper 23A, the staff think that a test based on the presence or absence of commercial substance will not provide a useful basis for distinguishing different types of business combination under common control. The staff acknowledge that, from the perspective of the controlling party, some business combinations under common control may have little commercial substance. In contrast, from the perspective of the receiving entity and the primary users of its financial statements, all business combinations under common control have commercial substance. Before the transaction, the receiving entity did not control the acquired business; after the transaction it does.

25. At the same time, as discussed in June 2019 Agenda Paper 23A and summarised in paragraph 20(a), the staff think that the presence or absence of non-controlling shareholders is an important factor to consider in assessing whether a transaction is similar to an acquisition in the scope of IFRS 3. When non-controlling shareholders are present, the transaction results in an acquisition of ownership interest in the underlying net assets of the transferred entity or business by those shareholders. If there are no non-controlling shareholders, there is no acquisition of ownership interest in underlying net assets by the owners of the combining entities or businesses; ownership interest of the controlling party in all combining entities or businesses continues unchanged. Thus, identifying 'an acquiring entity' in a way that would provide useful information may not be possible.

26. Accordingly, the staff think the Board should proceed with a current value approach based on the acquisition method for transactions that affect non-controlling shareholders of the receiving entity. Such an approach would provide the most useful

information to non-controlling shareholders about transactions that result in the acquisition by those shareholders of the ownership interest in the underlying net assets.

All or some transactions that affect non-controlling shareholders?

27. The question arises whether a current value approach should be applied to all transactions that affect non-controlling shareholders of the receiving entity or to only some such transactions, and if only to some, how to make that distinction. That question was analysed in December 2018 Agenda Paper 23 *Approach for transactions that affect non-controlling interest*. In paragraphs 13–21 of that Agenda Paper, the staff argued that a current value approach should be required for some, but not all, such transactions. This is because:

    (a) requiring a current value approach for all such transactions would fail to take into account that considering the cost constraint would have different outcomes in different scenarios. Although information needs of non-controlling shareholders do not depend on the size or nature of non-controlling interest in the receiving entity, the outcome of considering the cost constraint would arguably be different when non-controlling interest comprises a few employee stock options issued to the key management personnel than when it comprises a dispersed public holding of a significant stake in the receiving entity. In contrast, requiring a current value approach for only some such transactions would enable the Board to take into account the cost constraint in a more targeted way.

    (b) different non-controlling shareholders would rely on the receiving entity's financial statements for meeting their information needs to a different extent. For example, the access to information about the reporting entity may be more limited for a member of public than for a member of the entity's key management personnel or a private equity investor holding a significant stake in the entity. Requiring a current value approach for only some transactions that affect non-controlling shareholders would enable the Board to take those different levels of access into account.

(c) requiring a current value approach for only some such transactions would reduce opportunities for accounting arbitrage. This is because it would arguably be easier for an entity to go from a 'no non-controlling shareholders' scenario to a 'some non-controlling shareholders' scenario for example, by issuing a few employee stock options, than it would be to go from a 'no non-controlling shareholders' scenario to, for example, a 'public non-controlling shareholders' scenario.

Which transactions that affect non-controlling shareholders?

28. In December 2018 Agenda Paper 23, the staff identified and analysed the following alternatives for determining when a current value approach should be applied to transactions that affect non-controlling shareholders:

(a) a qualitative distinction, for example based on:

(i) whether the receiving entity's equity instruments are traded in a public market (paragraphs 25–28 of December 2018 Agenda Paper 23); or

(ii) the type of non-controlling shareholders, for example, based on whether they are related parties of the receiving entity (paragraphs 29–34 of December 2018 Agenda Paper 23);

(b) a quantitative distinction based on the percentage of non-controlling interest in the receiving entity (paragraphs 36–42 of December 2018 Agenda Paper 23); and

(c) a distinction based on a combination of qualitative and quantitative factors (paragraphs 44–45 of December 2018 Agenda Paper 23).

29. In that paper, the staff concluded that it is viable to explore a distinction based on whether the receiving entity's equity instruments are traded in a public market. The staff argued that such a distinction would:

(a) provide the most useful information to non-controlling shareholders in public entities[7]. Providing the best information in those cases is

[7] In this paper, we use the term 'public entities' to refer to entities whose equity instruments are traded in a public market.

consistent with the focus of regulatory requirements that tend to subject public interest entities to particular scrutiny.

(b) rule out most, if not all, scenarios when non-controlling interest is insignificant. Hence, such a distinction would reflect the quantitative perspective without creating a 'bright line'. This is because many public markets have minimum listing requirements (as discussed in paragraph 40 of December 2018 Agenda Paper 23). As a result, such a distinction would, in effect, take into account the cost constraint by requiring a current value approach only if non-controlling interest is publicly held and hence of sufficient size that minimum listing requirements are met.

(c) be based on the existing requirements in IFRS Standards and be easy for entities to apply and users of financial statements to understand.

(d) be least open to opportunities for accounting arbitrage. This is because going public is a complex and costly process. Hence, entities are unlikely to undertake that process with the sole objective of creating a publicly held non-controlling interest as a way of achieving a particular accounting treatment for an anticipated transaction.

30. The staff did not advocate a distinction based on quantitative factors. The staff argued that such a distinction would lack a conceptual basis and would be open to opportunities for accounting arbitrage. However, that staff suggested that the Board could explore a combination of qualitative and quantitative factors if the Board wanted current value information to be provided to non-controlling shareholders in privately held entities in some cases.

Transactions that affect non-controlling shareholders in privately held entities

31. As discussed in paragraph 16, most stakeholders supported applying a current value approach when the receiving entity's equity instruments are traded in a public market. However, some of those stakeholders argued that a current value approach would provide the most useful information to non-controlling shareholders in all cases and therefore that approach should be extended to some or all transactions that affect non-controlling shareholders in privately held entities. The staff considered whether and how the Board could extend a current value approach to transactions that affect non-controlling shareholders in privately held entities.

32. The staff agree with the view that a current value approach would provide the most useful information for both public and private non-controlling shareholders of the receiving entity. However, as discussed in paragraph 27, the staff are of the view that requiring a current value approach for all transactions that affect non-controlling shareholders would fail to take into account the cost constraint. Furthermore, for the reasons discussed in paragraph 30, the staff do not recommend a distinction based on quantitative factors. The question therefore arises how to address the cost constraint for transactions that affect non-controlling shareholders in privately held entities.

33. Based on suggestions made at the December 2018 ASAF meeting, the staff developed an approach that is similar to the exemption in IFRS 10 *Consolidated Financial Statements* from presenting consolidated financial statements. In this paper, we refer to that approach as an 'opt-in/opt-out approach'[8]. Under this approach, a privately held receiving entity would be required to apply a current value approach to a transaction that affects non-controlling shareholders unless the entity has informed all the non-controlling shareholders about the entity applying a predecessor approach and none of them have objected.

34. The staff discussed the opt-in/opt-out approach at the July 2019 ASAF meeting. Most ASAF members did not support that approach. They argued that such an approach would lack a conceptual basis and result in reduced comparability and consistency if transactions are accounted for differently in different periods depending on the choices made by non-controlling shareholders over time. In addition, those ASAF members expressed concerns about operational challenges and costs of such an approach. Other ASAF members expressed a view that the opt-in/opt-out approach would provide a solution that balances information needs of non-controlling shareholders in privately held entities and costs of providing current value information.

35. The staff agree with the latter view. The staff note that:

    (a) ASAF members who did not support the opt-in/opt-out approach advocated either applying a current value approach to all transactions that

[8] This approach gives a receiving entity an opportunity to opt *out* of applying a current value approach to a transaction that affects non-controlling shareholders in particular circumstances but then gives those non-controlling shareholders an opportunity to opt *in* for a current value approach.

affect non-controlling shareholders or limiting that approach to transactions that affect non-controlling shareholders in public entities. However, the staff think that if the Board wanted current value information to be provided to non-controlling shareholders in privately held entities while taking into account the cost constraint, the opt-in/opt-out approach would deliver that outcome.

(b) the opt-in/opt-out approach is not designed as a required approach. Rather, it is designed to provide a relief. Accordingly, an entity would be free to choose not to apply the opt-in/opt-out approach if the entity considered that operational challenges and costs of applying that approach in particular circumstances outweigh the benefits of that approach. In addition, the staff note that the opt-in/opt-out approach would only be available for privately held receiving entities. The staff think that operational challenges and costs related to applying that approach would typically be less significant for privately held entities than for a public entity (for example, 'tracking' non-controlling shareholders for a privately held entity would typically be easier than for a public entity where the shares frequently change hands).

(c) a transaction that affected non-controlling shareholders in a particular period would not be treated differently from period to period depending on choices made by non-controlling shareholders over time. Rather, the transaction would be accounted consistently from period to period depending on the choice made by non-controlling shareholders affected by that transaction. However, reflecting the operation of the cost constraint, another transaction may be accounted for differently depending on whether the entity decides to pursue the opt-in/opt-out approach and on the choice made by non-controlling shareholders for that transaction. In addition, there would be nothing to stop privately held entities with a stable ownership structure seeking a continuing opt-out that would apply to all future transactions without having to keep informing non-controlling shareholders again separately each time.

36. The staff have considered whether any other factors should be taken into account in determining the accounting treatment for transactions that affect non-controlling

shareholders in privately held entities. The staff think that if all those non-controlling shareholders are related parties of the entity, that entity should not be permitted to apply a current value approach. As noted in paragraph 16(d), some stakeholders also expressed such a view. As discussed in paragraph 27(b), related parties may not rely on the entity's financial statements for meeting their information needs to the same extent as, for example, a member of public or an unrelated private shareholder. Accordingly, the staff think that excluding private entities held by related parties from the requirement to apply a current value approach would further help to take into account the cost constraint. In addition, it would also help to minimise opportunities for accounting arbitrage.

Bringing it all together

37. The staff recommend that the forthcoming Discussion Paper sets out a preliminary view that a current value approach based on the acquisition method should be required for transactions within the scope of the project that affect non-controlling shareholders of a receiving entity unless equity instruments of the receiving entity are not traded in a public market and all non-controlling shareholders of the receiving entity:

    (a) are related parties of the receiving entity as defined in IAS 24; or

    (b) have been informed about, and do not object to, the receiving entity applying a predecessor approach.

Question 2 for the Board
Does the Board agree with the staff recommendation in paragraph 37?

When to apply a predecessor approach

38. As noted in paragraph 3, the Board has tentatively decided that it *could* pursue a predecessor approach for transactions within the scope of the project other than those for which a current value approach is proposed. However, the Board has not made a decision on whether it *should* propose a predecessor approach for those remaining transactions.

39. If the Board agrees with the staff recommendation in paragraph 37, that remaining population of transactions would comprise:

    (a) transactions that do not affect non-controlling shareholders of a receiving entity (but may affect lenders and other creditors of the receiving entity or potential equity investors);

    (b) transactions that affect non-controlling shareholders of a privately held receiving entity when all those shareholders are the entity's related parties; and

    (c) transactions that affect non-controlling shareholders of a privately held receiving entity who have all been informed about, and do not object to, the receiving entity applying a predecessor approach.

40. The staff think that a predecessor approach is appropriate in all those circumstances. As discussed in April 2019 Agenda Paper 23B *Update on lenders and other creditors in BCUCC*, the outcome of credit analysis would not depend greatly on whether a current value approach or a predecessor approach is applied to a business combination under common control. As noted in paragraph 14(a), most stakeholders, including CMAC members who specialise in credit analysis, agreed with that conclusion and supported applying a predecessor approach for transactions that affect lenders and other creditors of a receiving entity but do not affect non-controlling shareholders.

41. Information needs of potential equity investors about transactions that do not affect non-controlling shareholders were discussed in March 2019 Agenda Paper 23A *Overview of the staff's approach* and July 2019 Agenda Paper 23A *Potential equity investors in BCUCC*. In those papers, that staff argued that a predecessor approach rather than a current value approach based on the acquisition method would provide useful information to potential equity investors about such transactions, including, but not limited to, transactions undertaken in preparation for an IPO (see paragraph 22 of July 2019 Agenda Paper 23A). This is because such transactions do not result in an acquisition of ownership interest in the underlying net assets by the owners of the combining entities or businesses and hence are not acquisitions. In addition, the staff noted that when external shareholders first invest in a previously wholly owned entity, they receive predecessor historical trend information about that entity. The

staff argued that the same information would be useful and should be provided regardless of whether the external investment is preceded by internal restructuring.

42. Finally, as discussed in paragraph 27(a), the staff think that a predecessor approach is appropriate for transactions that affect non-controlling shareholders when the benefits of applying a current value approach do not justify the costs of applying that approach. That would be the case when equity instruments of the receiving entity are not traded in a public market and all non-controlling shareholders of the receiving entity:

    (a) are related parties of the receiving entity as defined in IAS 24; or

    (b) have been informed about, and do not object to, the receiving entity applying a predecessor approach.

43. Accordingly, the staff recommend that the forthcoming Discussion Paper proposes a predecessor approach for all remaining transactions within the scope of the project for which a current value approach is not proposed.

44. Hence a predecessor approach would be:

    (a) *required* for transactions that:

        (i) do not affect non-controlling shareholders of a receiving entity; and

        (ii) affect non-controlling shareholders of a receiving entity but all those shareholders are the entity's related parties; and

    (b) *permitted*, but not required, for transactions that affect non-controlling shareholders of a receiving entity if:

        (i) the entity's equity instruments are not traded in a public market; and

        (ii) all non-controlling shareholders of the receiving entity have been informed about, and do not object to, the receiving entity applying a predecessor approach.

Question 3 for the Board
Does the Board agree with the staff recommendation in paragraph 43?

Appendix A—A flowchart illustrating the staff recommendations