IFRS® Foundation

Business Combinations under Common Control

Emerging Economies Group Meeting

EEG Agenda Paper 4
May 2021

The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board or the IFRS Foundation.

Purpose of this paper

Background

- Discussion Paper *Business Combinations under Common Control* was published in November 2020
- Comment period closes 1 September 2021

Purpose of this paper

- To provide a recap of the Discussion Paper
- To seek EEG members' views on:
  - when the acquisition method and a book-value method should be used;
  - how those methods should be used
- Questions for EEG members are on slides 16, 20 and 24

Agenda

- Which method to apply
- How to apply the acquisition method
- How to apply a book-value method

Which method to apply

Setting the scene

Useful information for the primary users of the receiving company's financial statements

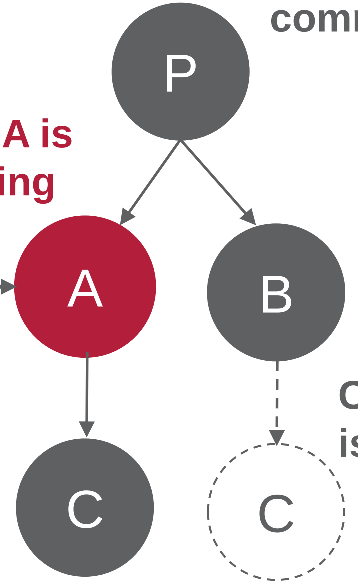
Subject to the cost–benefit trade-off

- Non-controlling shareholders
- Potential shareholders
- Lenders and other creditors

Primary users can have different information needs

Company P has common control

Company A is the receiving company



Company C is a business

What has the Board heard in developing its views?

Business combinations under common control…

Are always different from business combinations covered by IFRS 3	Are always similar to business combinations covered by IFRS 3	May or may not be similar to business combinations covered by IFRS 3
Do not have 'economic substance'	Always have 'economic substance'	May or may not have 'economic substance'
Always use a book-value method	Use the acquisition method, subject to the cost-benefit trade-off	Use the acquisition method in some cases and a book-value method in other cases

The IASB's preliminary views—at a glance

One size does not fit all

A single method in all cases?	Neither the acquisition method nor a book-value method should apply in all cases
How to 'draw the line'?	The acquisition method should apply when non-controlling shareholders are affected
What about the cost-benefit trade-off?	There is an exception to and an exemption from the acquisition method
When to apply a book-value method?	A book-value method should apply in all other cases

The exemption and the exception

What if non-controlling interest is ‘small’ or ‘not substantive’?

Receiving company’s shares are publicly traded	Receiving company’s shares are privately held	
Require the acquisition method	Permit a book-value method if non-controlling shareholders do not object	Require a book-value method if non-controlling shareholders are the company’s related parties
	The optional exemption from the acquisition method	**The related-party exception to the acquisition method**

How to determine which method to use?

Does the transaction affect non-controlling shareholders of the receiving company?

- No → Book-value method
- Yes ↓

Are the receiving company’s shares traded in a public market?

- Yes → Acquisition method
- No ↓

Are all non-controlling shareholders related parties of the receiving company (related-party exception)?

- Yes → Book-value method
- No ↓

Has the receiving company chosen to use a book-value method, and have its non-controlling shareholders not objected (optional exemption)?

- Yes → Book-value method
- No → Acquisition method

Book-value method

Acquisition method

Initial feedback

We hear the following questions and comments…

1) Initial feedback on which method to apply

2) Why use the acquisition method for some BCUCC?

3) What about the needs of the controlling party?

4) Did you consider measurement uncertainty?

1) Initial feedback on which method to apply

Some stakeholders agree that neither method should apply in all cases, and largely agree with the Board’s preliminary views on when each method should apply.

Some stakeholders agree with the overall suggested approach, but have questions or comments on particular aspects of the Board’s preliminary views.

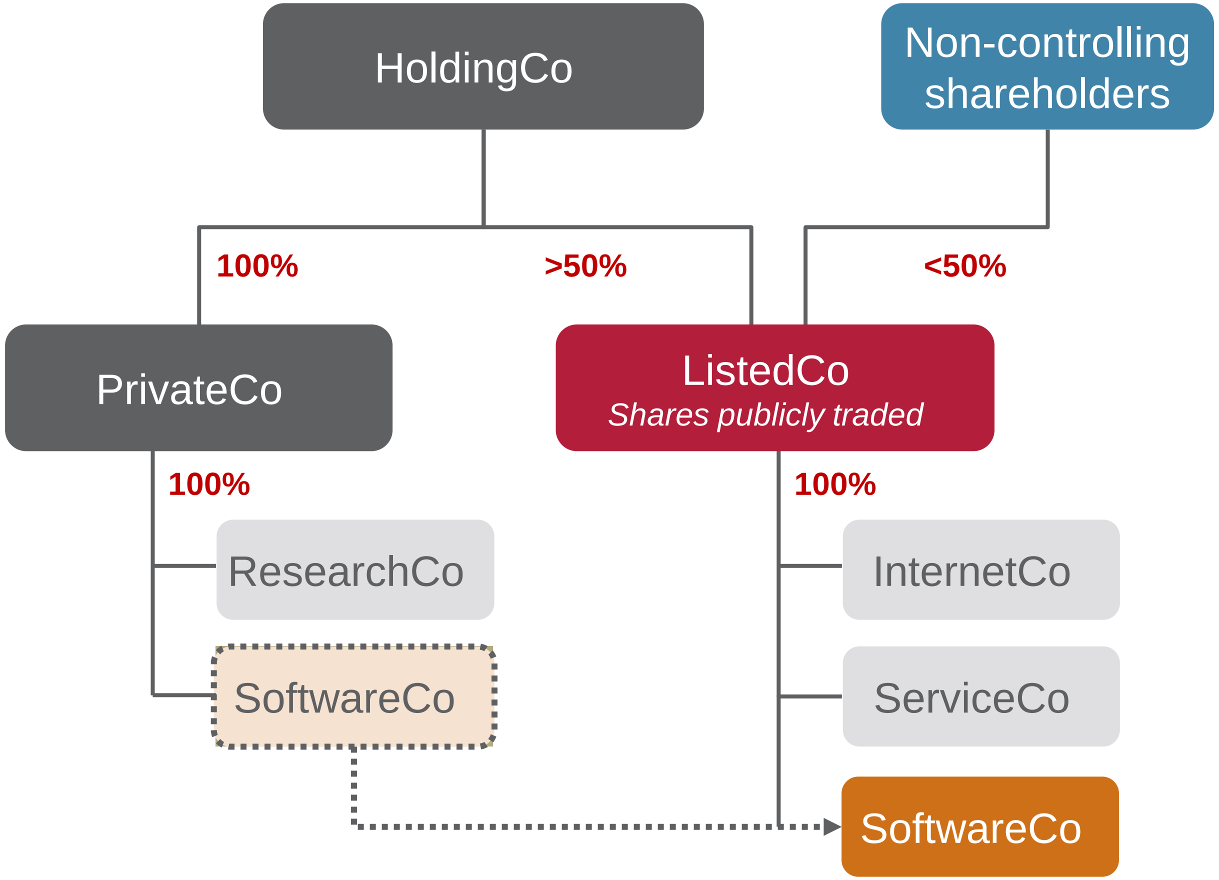
Some stakeholders think that a book-value method should apply in all cases and some other stakeholders think that the acquisition method should apply pre-IPO.

2) Why use the acquisition method for some BCUCC?

Consider the following fact pattern…

- SoftwareCo has significant internally-generated intangible assets.
- HoldingCo wishes to seek funding against its successful SoftwareCo, and decides to move SoftwareCo into the ListedCo group.
- ListedCo buys SoftwareCo from PrivateCo for cash at fair value.

The Board’s view is that ListedCo should use the acquisition method.



2) Why use the acquisition method for some BCUCC?
Information provided by each method

	Acquisition method	Book-value method
Cash consideration paid	**CU 500**	**CU 500**
Software	CU 380	CU 20
Brand name	CU 50	-
Other net assets	CU 40	CU 40
Goodwill	CU 30	-
Net assets recognised	**CU 500**	**CU 60**
Difference (recognised in equity)	n/a	CU 440

Acquisition method: Provides information about fair values of identifiable net assets acquired, including:

- brand name (previously unrecognised);
- software (previously measured at book value).

Book-value method: Does not provide information about fair values of identifiable net assets acquired and instead reports a reduction in equity.

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3) What about the needs of the controlling party?

HoldingCo does not need to rely on ListedCo's financial statements for information about SoftwareCo. The use of the acquisition method by ListedCo does not affect the amounts reported by the HoldingCo.

	SoftwareCo separate financial statements	**ListedCo consolidated financial statements**	**HoldingCo consolidated financial statements**
SoftwareCo's identifiable net assets	Book value	Fair value	Book value
Software	CU 20	CU 380	CU 20
Brand name	-	CU 50	-
Other net assets	CU 40	CU 40	CU 40
Goodwill	-	CU 30	-
Net assets recognised	**CU 60**	**CU 500**	**CU 60**

The Board's preliminary view

IFRS 10 *Consolidated Financial Statements*

4) Did you consider measurement uncertainty?

Some stakeholders say that using the acquisition method for BCUCC would…

- Involve significant uncertainty in measuring at fair value assets and liabilities transferred in a related party transaction
- Result in measuring goodwill at an amount not evidenced by a transaction price between independent parties

However…

- Measuring fair values of the assets and liabilities of the transferred business is not affected by whether it was acquired in a related party transaction
- Goodwill recognised in a business combination under common control will be subject to subsequent testing for impairment
- The acquisition method would only be applied to transactions that affect NCS and are therefore likely to be conducted at fair value

Discussion questions—which method to apply

1) Do you agree that in principle 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?
2) For privately-held companies, do you agree with:
   a) the related-party exception to the acquisition method
   b) the optional exemption from the acquisition method?
3) Do you agree that the optional exemption from the acquisition method would be workable and that it should only be available for privately held companies? If not, what do you suggest instead?

How to apply the acquisition method

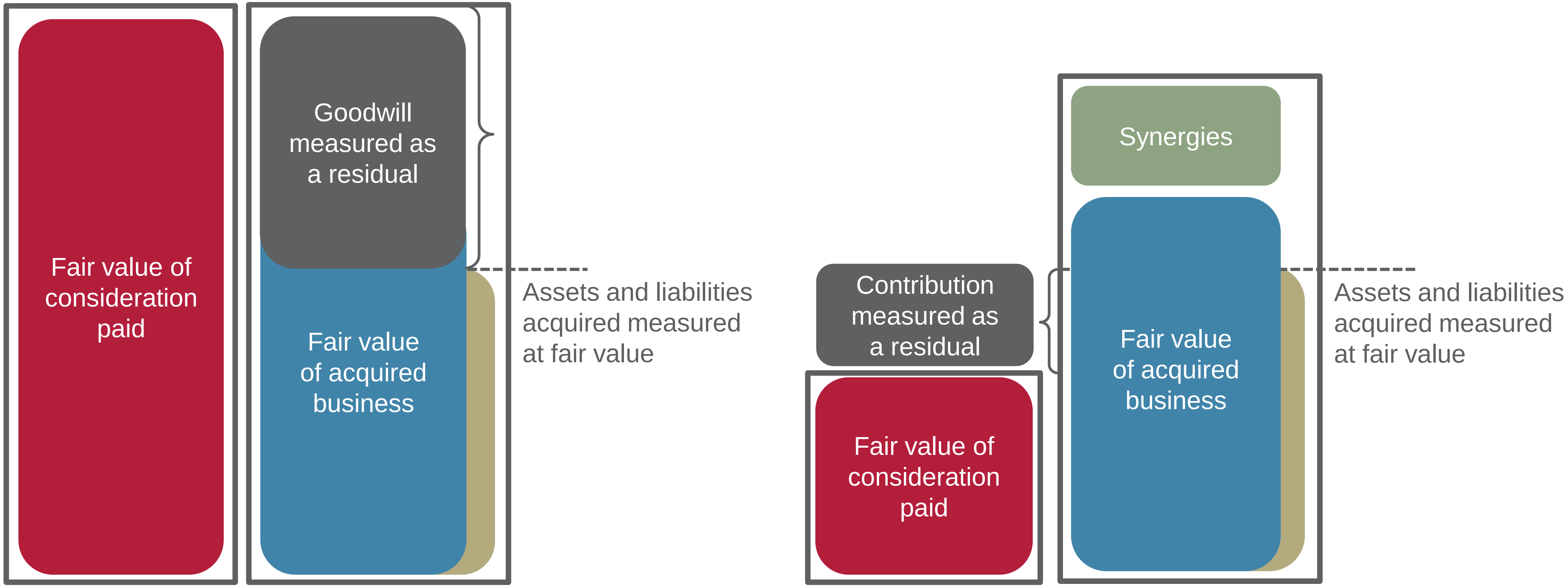
The IASB’s preliminary views—at a glance

The acquisition method is already specified in IFRS 3

General principle	Apply the acquisition method as set out in IFRS 3
Special feature	Recognise a contribution in a ‘bargain purchase’
Disclosure	Disclose information about how the transaction price was determined

Illustrating the Board's preliminary views

Applying the acquisition method to business combinations under common control



Discussion questions—the acquisition method

4) The Board is <u>not</u> suggesting a requirement for the receiving company to identify, measure and recognise a distribution from equity in a business combination under common control. Do you agree?
5) The Board is suggesting that any ‘underpayment’ in a business combination under common control should be recognised as a contribution to equity, not as a gain on a ‘bargain purchase’. Do you agree?
6) Do you 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?

How to apply a book-value method

How to apply a book-value method—at a glance

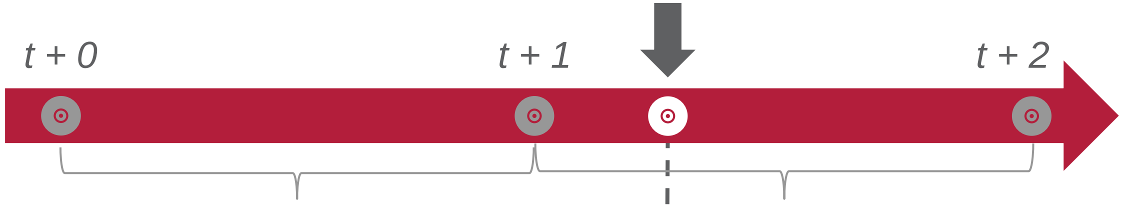
A single book-value method to be specified in IFRS Standards

Assets and liabilities received	Measure at transferred company's book values
Consideration paid	Generally measure at book value
Transaction costs	Generally recognised as an expense
Difference	Recognise as an increase or decrease in equity
Pre-combination information	Include the transferred company prospectively, without restatement
Disclosure	A subset of IFRS 3 disclosure requirements and the difference in equity

How to provide pre-combination information?

Retrospective approach

Combination date



Comparative period

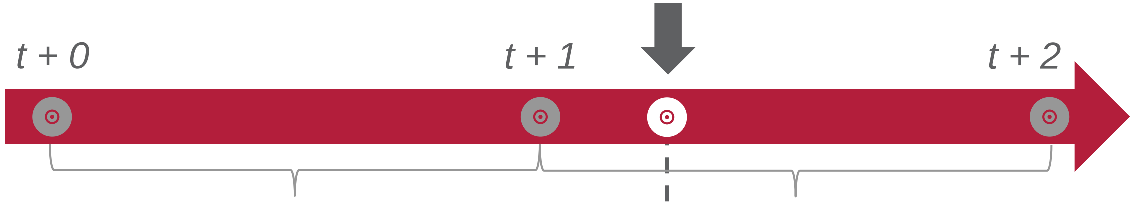
Current reporting period

Information is restated to include all combining companies

Consolidated information

Prospective approach

Combination date



Comparative period

Current reporting period

Information is provided only about the receiving company and not restated

Consolidated information

The Board's view is that pre-combination information should not be restated

Pre-combination information about all combining companies is useful but hypothetical

Discussion questions—a book-value method

7) Do you agree that the receiving company should measure assets and liabilities received at the book values reported by the transferred company?
8) Do you agree that the receiving company should include the transferred company in its financial statements from the combination date, without restating pre-combination information?
9) The Board is not suggesting a requirement to disclose pre-combination information for the combining companies as though they had already been combined. Do you agree? If not, what particular information would be useful?
10) Do you have other comments on a book-value method? In particular, in your view, what other aspects of a book-value method should the Board consider in the next stage of the project?

Useful resources

For more information, please refer to the following materials on the IFRS website:

- Debrief *Business Combinations under Common Control*
- Fact Sheet *Business Combinations under Common Control—At a glance*
- Snapshot *Discussion Paper* Business Combinations under Common Control
- Project update *Combinations of businesses under common control—one size does not fit all*
- Webinar *Explaining Discussion Paper* Business Combinations under Common Control
- Discussion Paper *Business Combinations under Common Control*
- Investor webcast: *The IASB seeks investor views on how to account for M&As between companies under common control*

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