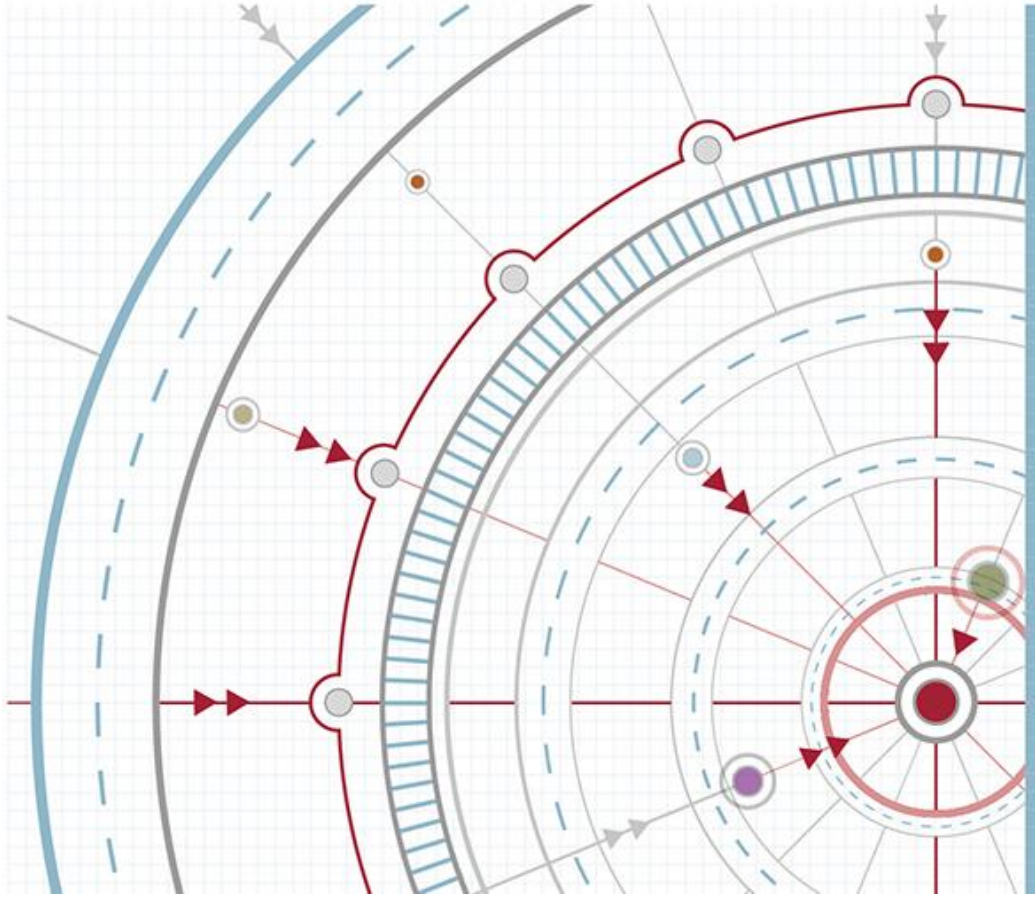
IFRS® Foundation



Business Combination Under Common Control

Tak Ochi, IASB Member

International Accounting Standards Board

Asian-Oceanian Standard-Setters Group, November 2018

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

Agenda

- Background and scope of the project
- Measurement approaches
- Ways forward for transactions affecting NCI

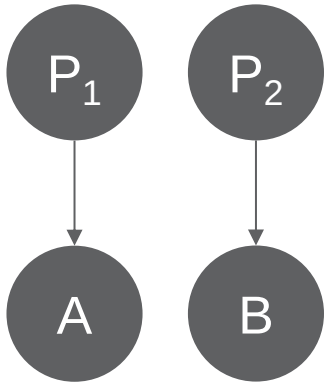
Background and scope of the project

The issue: diversity in practice

Before

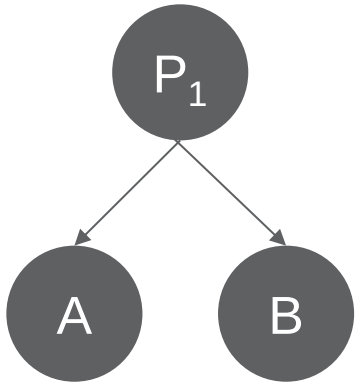
Scenario 1

- Entity A and Entity B are controlled by different parties;
- Entity B is a business.



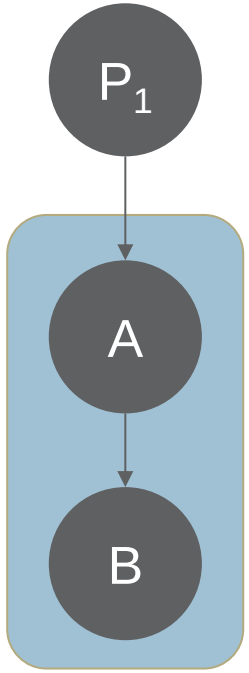
Scenario 2

- Entity A and Entity B are controlled by the same party;
- Entity B is a business.



After

Entity A acquires Entity B



Observations

Scenario 1

- The transaction is a **business combination**
- IFRS 3 *Business Combinations* requires the **acquisition method**
- Entity A reflects identifiable assets and liabilities of Entity B at **fair value**

Scenario 2

- The transaction is a **business combination under common control**
- IFRS Standards do not specify how to account for such transactions which leads to **diversity in practice**
- Entity A reflects identifiable net assets of Entity B at **fair value** or at **predecessor carrying amounts**

IFRS

Scope of the project

focuses on transfers of
Business
(as defined in IFRS 3)
under common control

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

addresses financial reporting
by the **receiving entity**

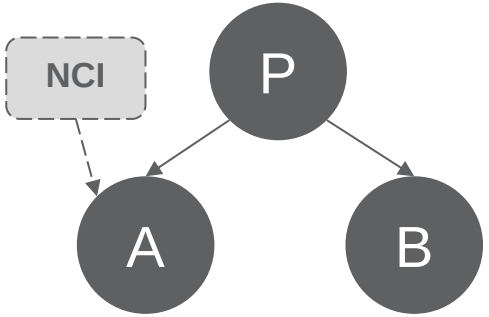
considers
application questions

Example 1—Basic

Before

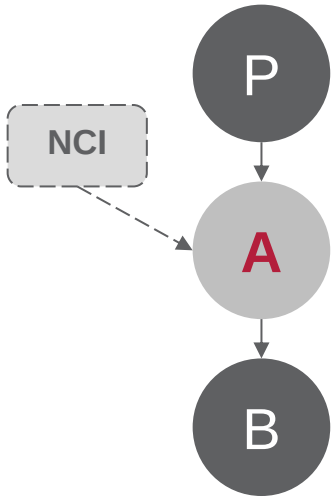
Entity A and Entity B are controlled by Entity P.

Entity A and Entity B are businesses.



Transaction

Entity A acquires Entity B.



Observations

Financial reporting by Entity A is …

in scope

… regardless of whether the combining parties:

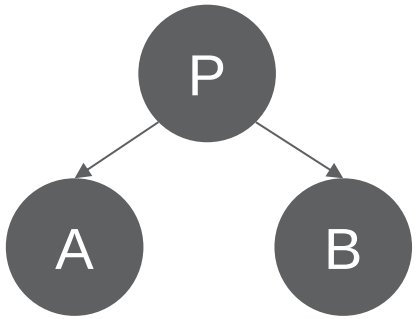
- are fully owned by Entity P or there is NCI in the combining parties; or
- are listed or are privately held.

Example 2—Newco

Before

Entity A and Entity B are controlled by Entity P.

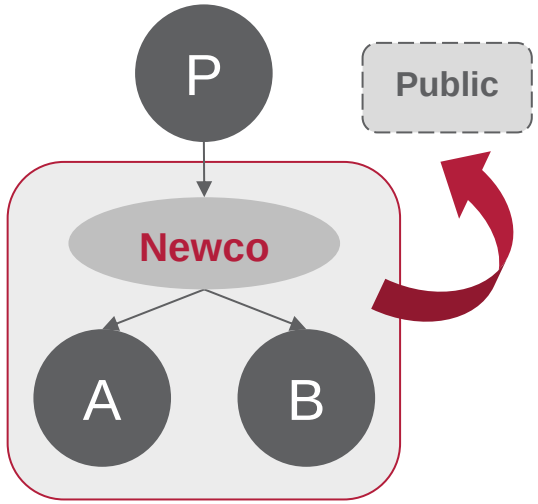
Both Entity A and Entity B are businesses.



Transaction

Entity P forms a Newco and transfers Entity A and Entity B to that Newco.

Newco is not a business.



Observations

Financial reporting by Newco is …

in scope

…regardless of whether the transaction:

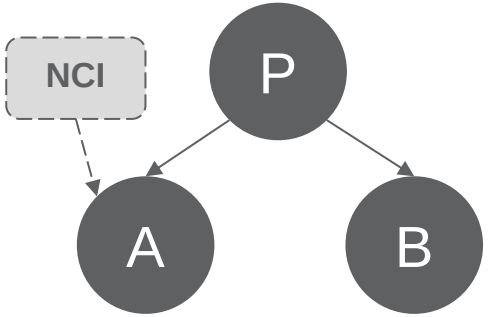
- is effected in preparation for an IPO; or
- is conditional on the success of Newco's IPO.

Example 3—Controlling party

Before

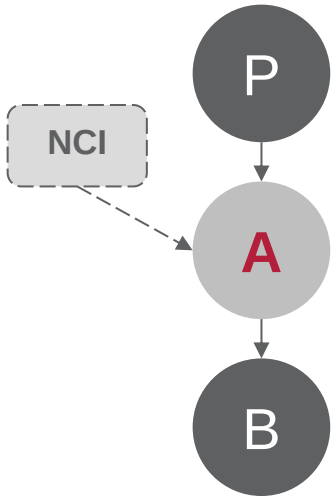
Entity A and Entity B are controlled by Entity P.

Entity A and Entity B are businesses.



Transaction

Entity A acquires Entity B.



Observations

Financial reporting by Entity P is …

NOT in scope

… because:

- the project focuses on the receiving entity's financial statements.
- at the level of the controlling party there was no transfer of business (ie before and after the transaction, same entities are controlled and nothing is acquired).

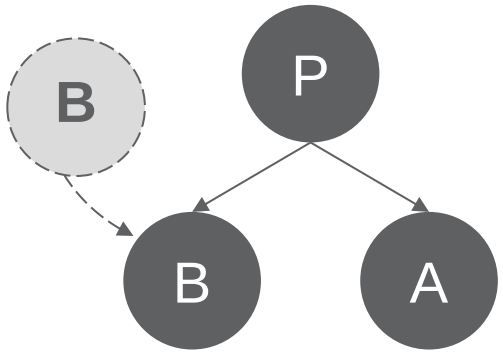
Example 4—Transitory control

Before

Entity A is controlled by Entity P.

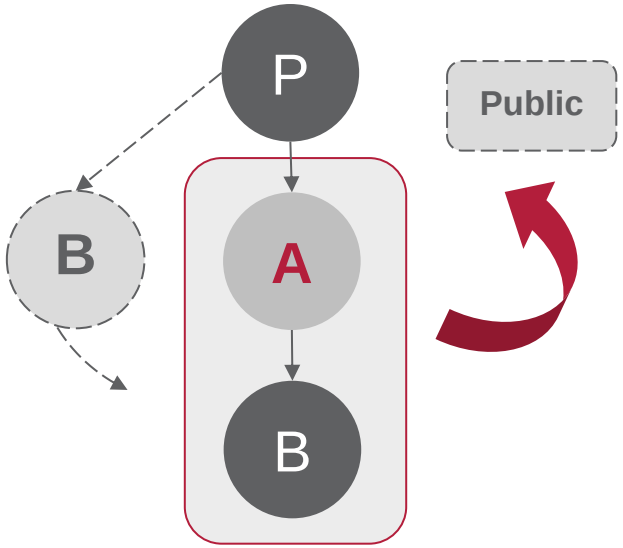
Entity P acquires Entity B from external parties.

Both Entity A and Entity B are businesses.



Transaction

Entity A acquires Entity B from Entity P.



Observations

Financial reporting by Entity A is …

in scope

…regardless of whether the transaction:

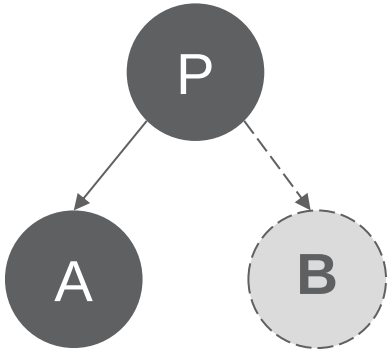
- is preceded by an external acquisition of one or more combining parties; and/or
- followed by an external sale of the combining parties.

Example 5—Associates

Before

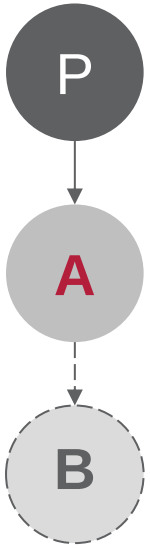
Entity P controls Entity A.

Entity P has a significant influence over Entity B.



Transaction

Entity P transferred Entity B to Entity A.



Observations

Financial reporting by Entity A is …

NOT in scope

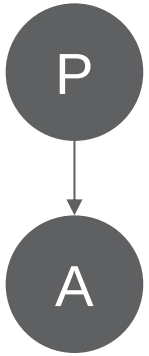
… because the transaction is a transfer of an associate, not a business combination.

Example 6—One business

Before

Entity A is controlled by Entity P.

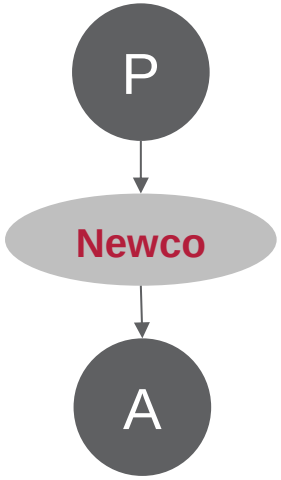
Entity A is a business.



Transaction

Entity P forms a Newco and transfers Entity A to that Newco.

Newco is not a business.



Observations

Financial reporting by Newco is …

in scope

…regardless of whether Newco would be identified as the 'acquirer' if IFRS 3 was applied to the transaction.

Scope of the project–recap

Accounting for transactions under common control that involve a transfer of one or more businesses from the perspective of the receiving entity, regardless of whether:

- the receiving entity would be identified as the ‘acquirer’, if IFRS 3 was applied to the transaction;
- the transaction is conditional on a loss of control over the combining parties, for example as a result of a future sale or a future IPO;
- the transaction is either preceded by an external acquisition or followed by an external sale of one or more of the combining parties, or both.

Measurement approaches

Who we are focusing on

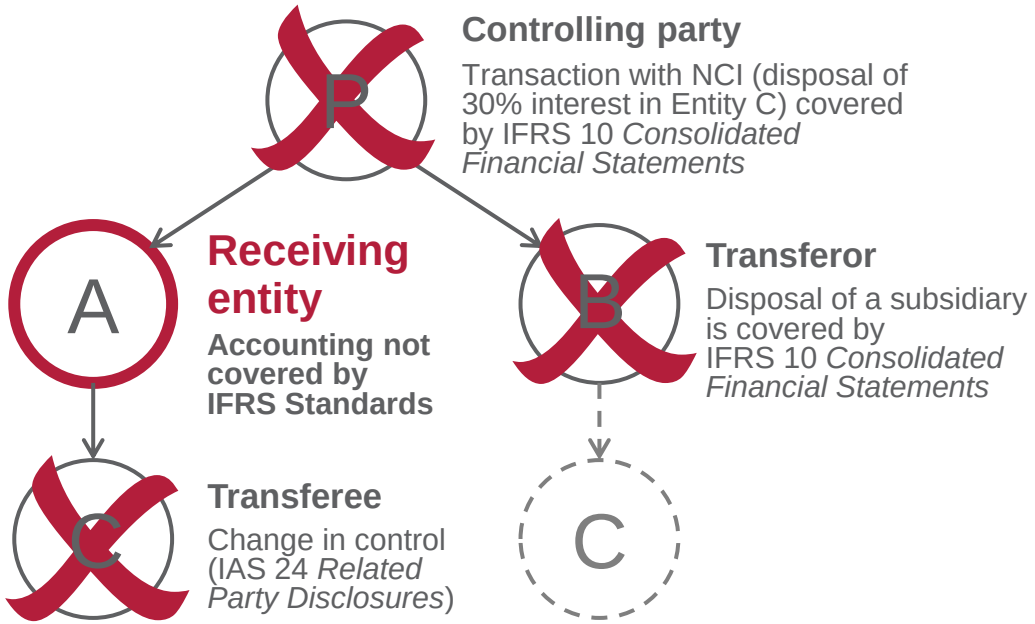
The project focuses on the **primary users** of the **receiving entity's** financial statements.

Conceptual Framework:

Objective of general purpose financial reporting is to provide financial information…that is useful to existing and potential investors, lenders and other creditors (primary users).

Primary users

- controlling party(ies);
- non-controlling interest;
- potential investors;
- lenders and other creditors.



Entity A acquires Entity C from Entity B. Entities A, B and C are all controlled by Entity P. Entity C is a business.

Information needs of primary users

Primary users of the receiving entity's financial statements

Non-controlling shareholders	Lenders and creditors	Controlling party	Prospective capital providers
Indefinite interest in the receiving entity. Transaction may affect the value of their existing interest. Exposed to residual equity risks.	Finite interest in the receiving entity. Transaction may affect the value of their existing interest. Exposed to credit and liquidity risks.	Controls all combining entities before and after the transaction. Does not solely rely on the receiving entity's financial statements to meet its information needs.	No existing interest in any of the combining entities at the time of the transaction.

Information needs and cost-benefit analysis can be different for different primary users

Possible approaches for BCUCC

How should the receiving entity measure acquired assets and liabilities in a BCUCC?

Conceptual Framework

Historical cost

Receiving entity will allocate the consideration across the acquired identifiable assets and liabilities (eg based on their relative fair values). No goodwill is recognised.

Existing practice

Current value

Receiving entity will reflect acquired identifiable assets and liabilities at their current values (eg at fair values). Goodwill is measured as a residual.

Consistent with the acquisition method required by IFRS 3 for business combinations

Predecessor carrying amounts

Receiving entity will reflect acquired assets and liabilities at their predecessor carrying amounts (eg the carrying amounts reflected in the transferee's financial statements).

Questions considered

Consider the transaction illustrated on slide 14 from the perspective of Entity A (receiving entity) and its NCI.

Question ❶

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 ❷

Is there **anything special about BCUCC** that:

- needs to be reflected in financial reporting; and
- does not happen in business combinations not under common control?

Illustrative scenario

For a business combination under common control, let's consider information provided in the receiving entity's financial statements by the measurement bases identified on slide 16.

The scenarios considered are:

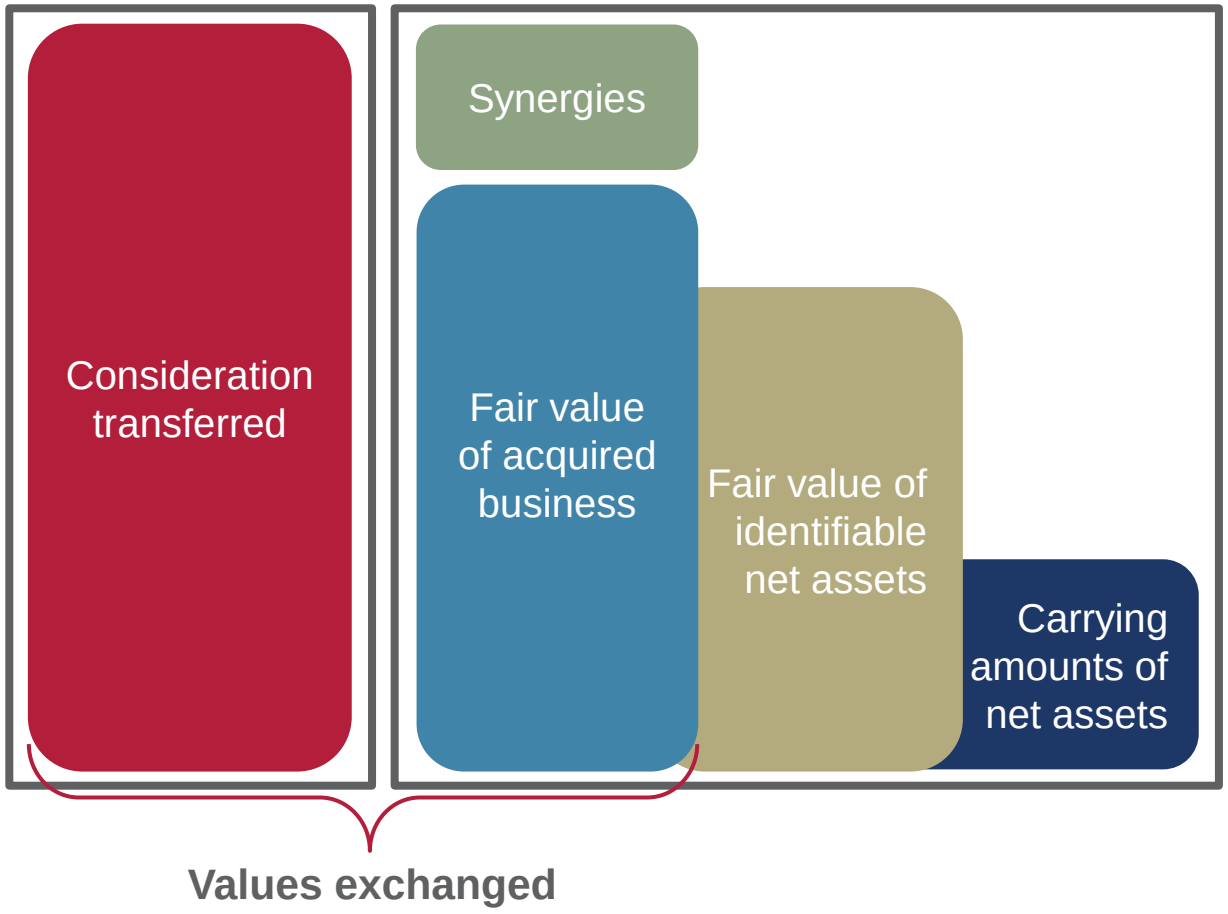
- Equal values are exchanged;
- Higher value is given up;
- Higher value is received.

In all scenarios the following are kept constant:

- Any synergies arising from the combination;
- Fair value of the acquired business;
- Fair value of the acquired identifiable net assets; and
- Pre-combination carrying amounts of the acquired net assets.

Different scenarios result from changing consideration transferred.

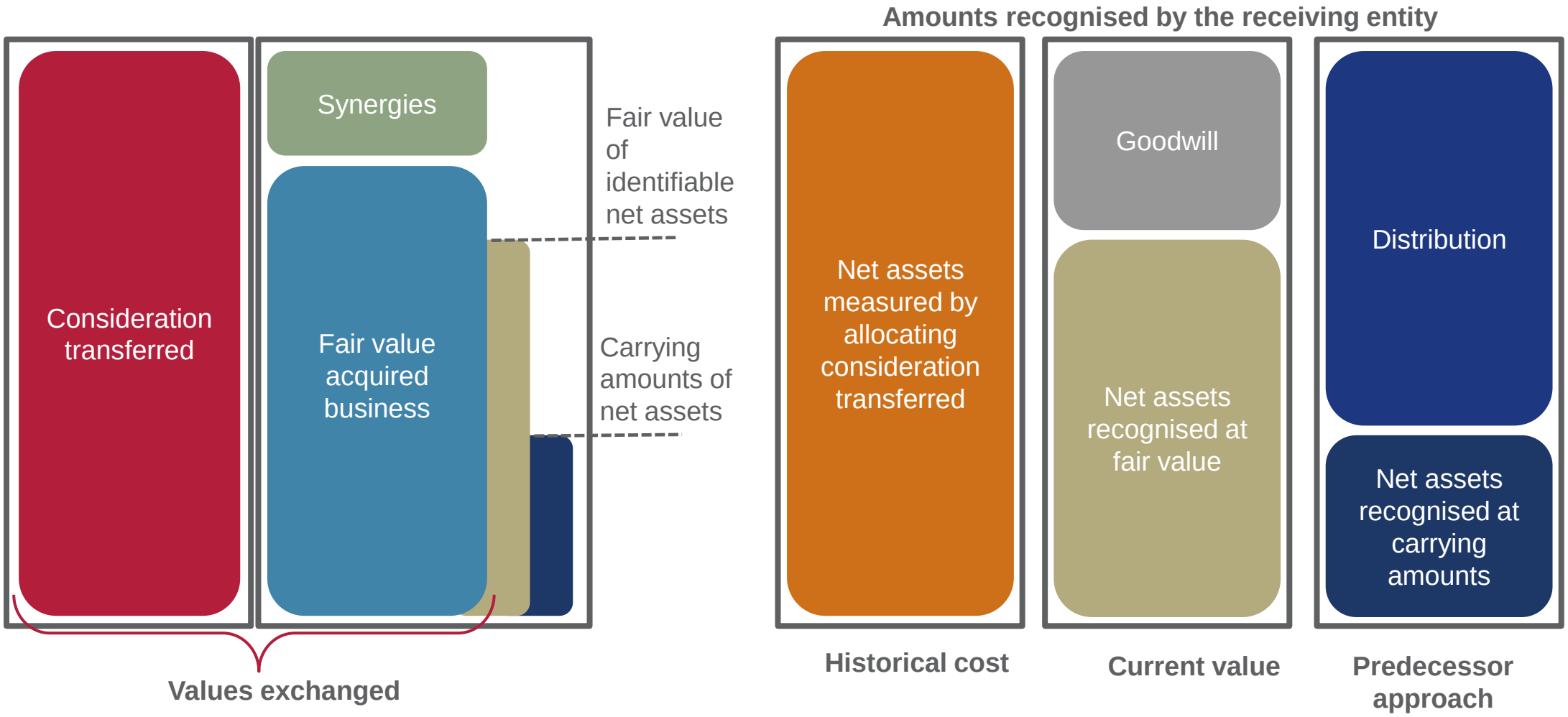
For simplicity, assume the consideration is paid in cash.



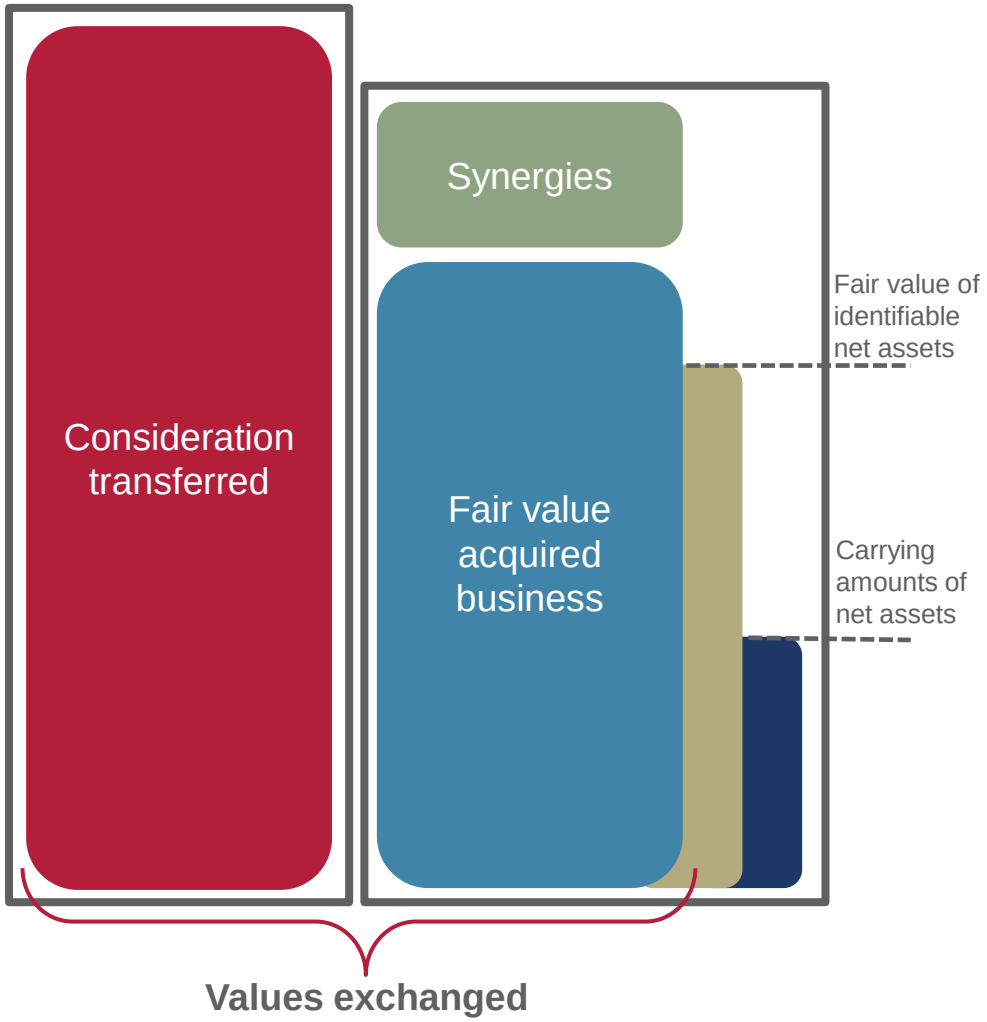
Health warning

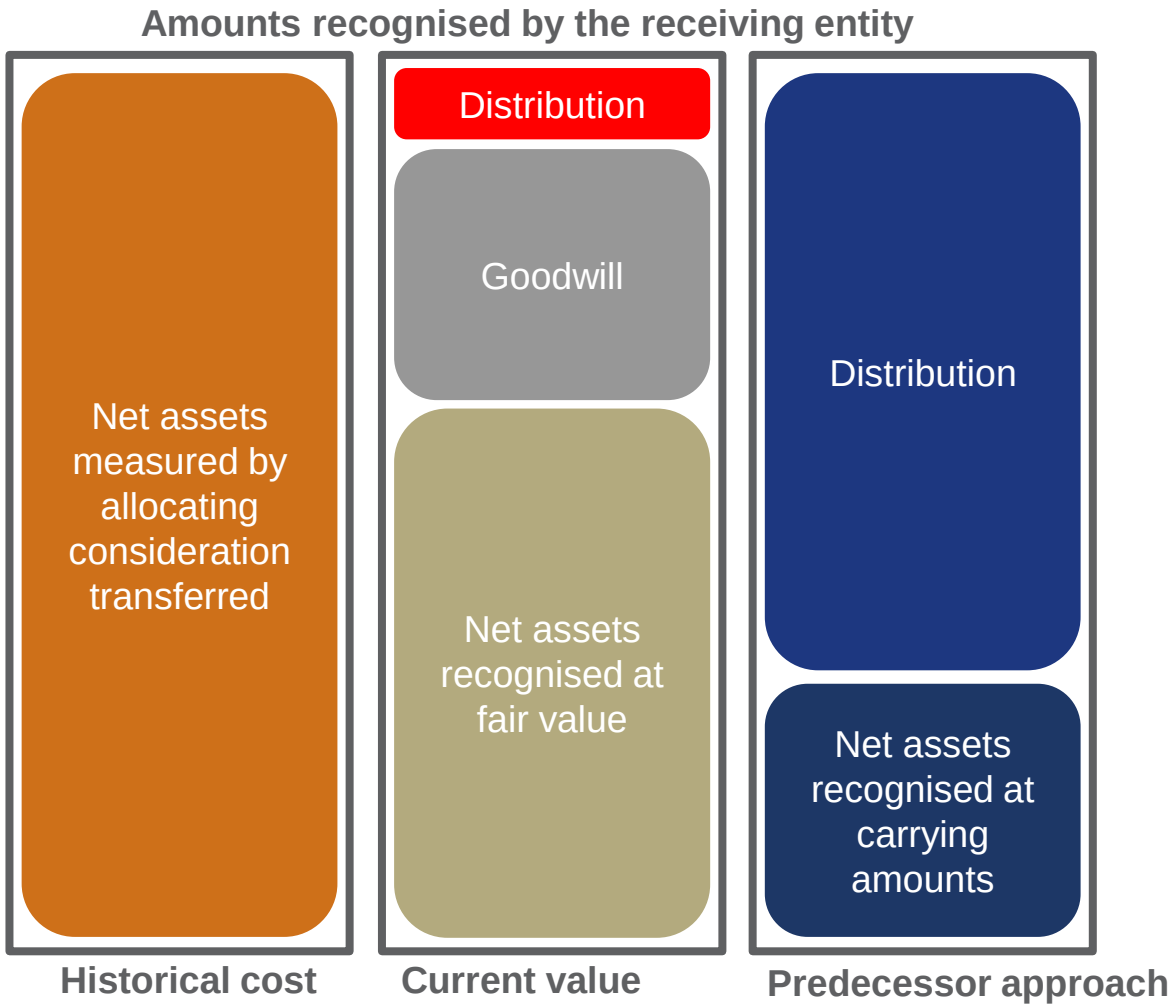
- The staff acknowledge that a price in a business combination results from negotiations and **falls within a range** between the minimum price the seller will accept and the maximum price the buyer will pay. However, in principle, consideration transferred includes a payment for the acquired business and for combination synergies.
- The following **illustrations are simplified** and are designed to demonstrate whether and how different scenarios will be reflected under various approaches. The illustrations are not intended to suggest how often each scenario might happen and how different the amounts might be. They merely illustrate the mechanics. Finally, the illustrations assume that the items can be measured.

If equal values are exchanged

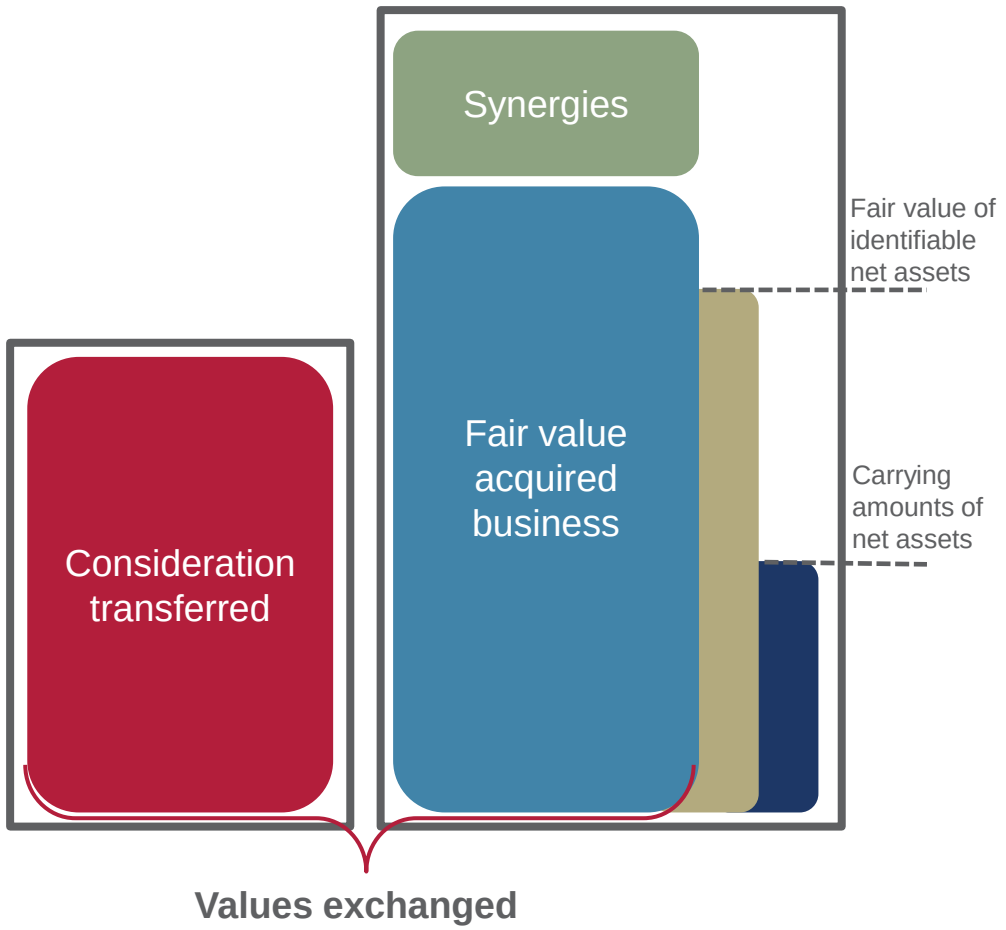


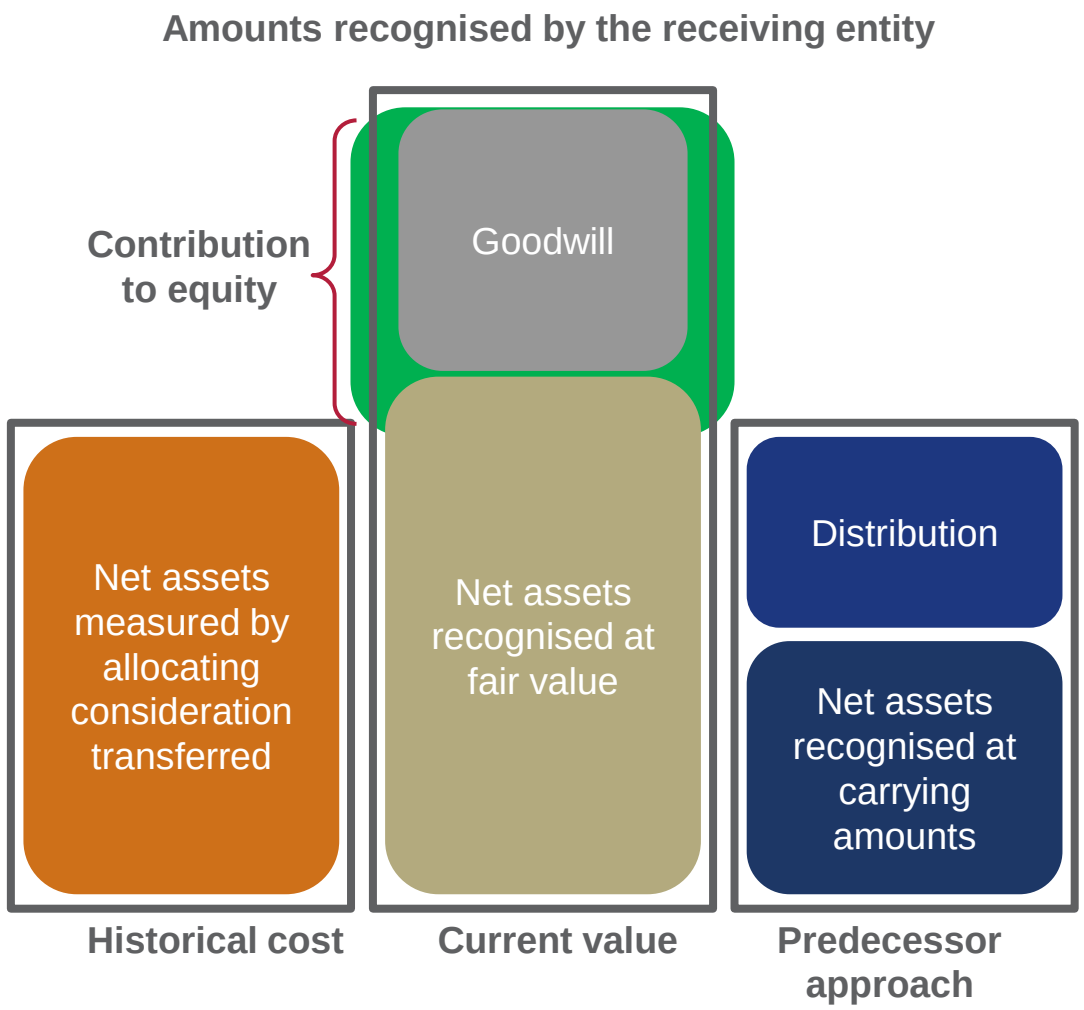
If a higher value is given up





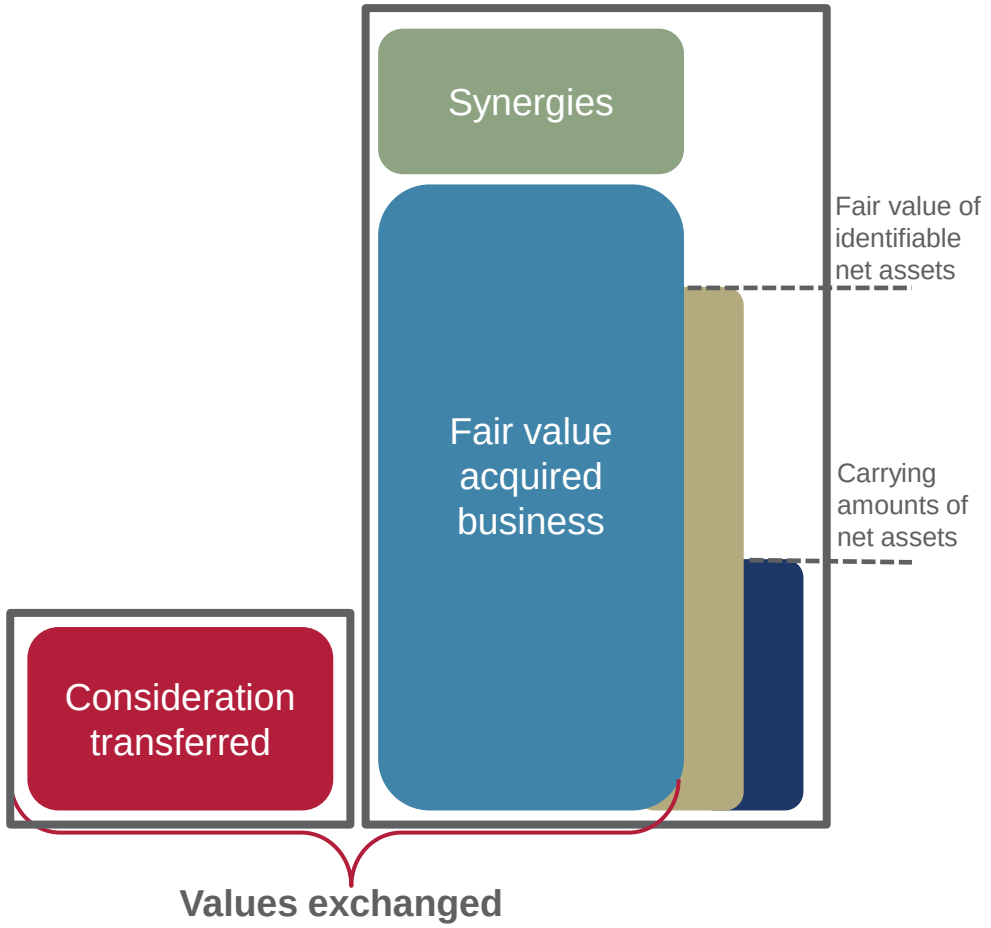
If a higher value is received* (1/2)

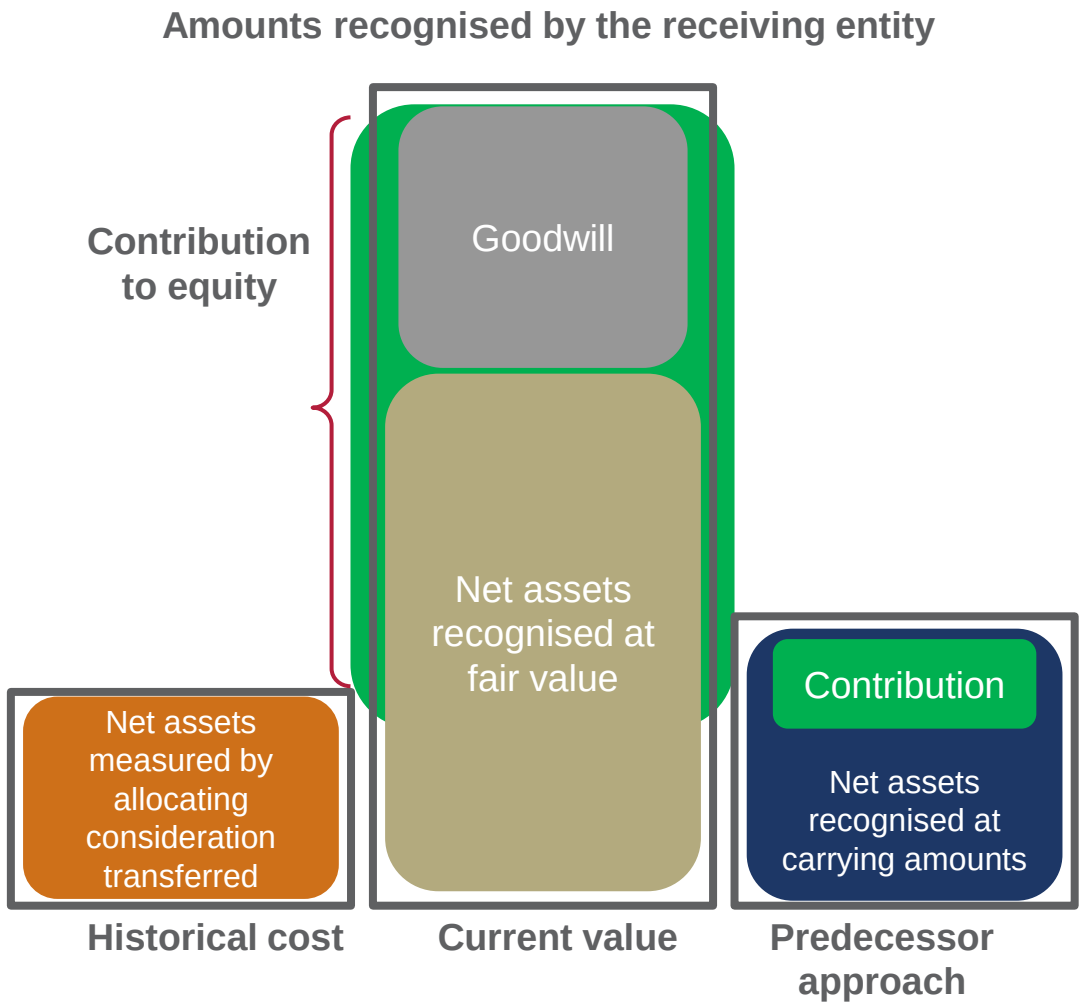




* Fair value of identifiable net assets > consideration transferred
Carrying amount of net assets < consideration transferred

If a higher value is received* (2/2)





* Fair value of identifiable net assets > consideration transferred
Carrying amount of net assets > consideration transferred

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

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).

Predecessor carrying amounts

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).

Fair values exchanged

Staff's view

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 including expected synergies.

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 14 from the perspective of Entity A (receiving entity) and its NCI.

Question ❶

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

Reflecting the transaction at fair values exchanged

Question ❷

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

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

A combination of the acquisition method and IAS 1 requirements

June 2018

The Board decided to pursue an approach that uses the **acquisition method** as the basis and to consider whether and how that approach may need to be modified for BCUCC.

What measurement approach provides the most useful information?

What measurement approach taking into consideration costs and benefits, would provide the most useful information to the primary users of the receiving entity's financial statements?

Non-controlling shareholders	Lenders and creditors	Controlling party	Prospective capital providers

Staff's initial assessment

Current value	???	???	???

Question 1

Q

In your view, which measurement basis would provide the most **useful** information to **existing non-controlling shareholders** of the receiving entity?

(a) Historical cost
(b) Current value
(c) Predecessor carrying amounts

Question 2

In your view, which measurement basis would provide the most **useful** information to **existing lenders and creditors** of the receiving entity?

(a) Historical cost
(b) Current value
(c) Predecessor carrying amounts

Question 3

In your view, which measurement basis would provide the most **useful** information to **the controlling party** of the receiving entity?

(a) Historical cost
(b) Current value
(c) Predecessor carrying amounts

Question 4

In your view, which measurement basis would provide the most **useful** information to **prospective capital providers** of the receiving entity?

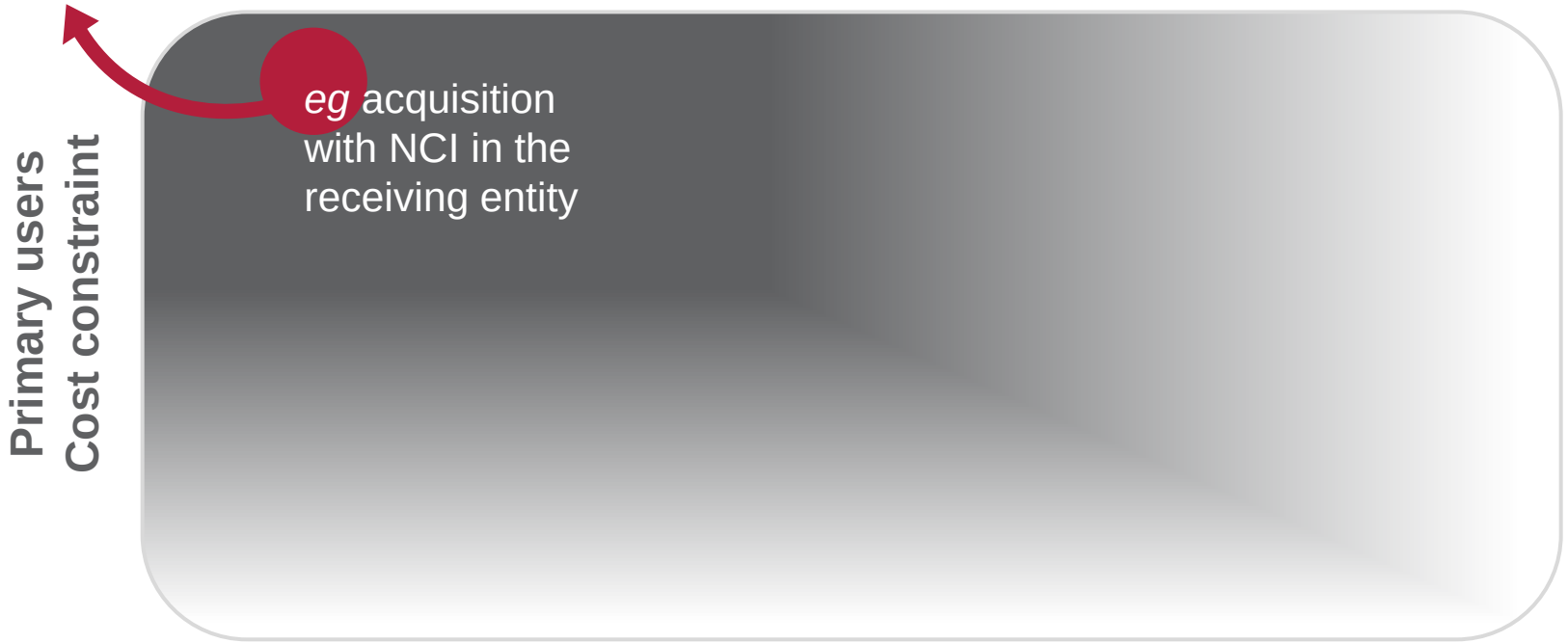
(a) Historical cost
(b) Current value
(c) Predecessor carrying amounts

Ways forward for transactions affecting NCI

Approaches being developed

The Board discussed potential approaches for transactions that affect NCI.

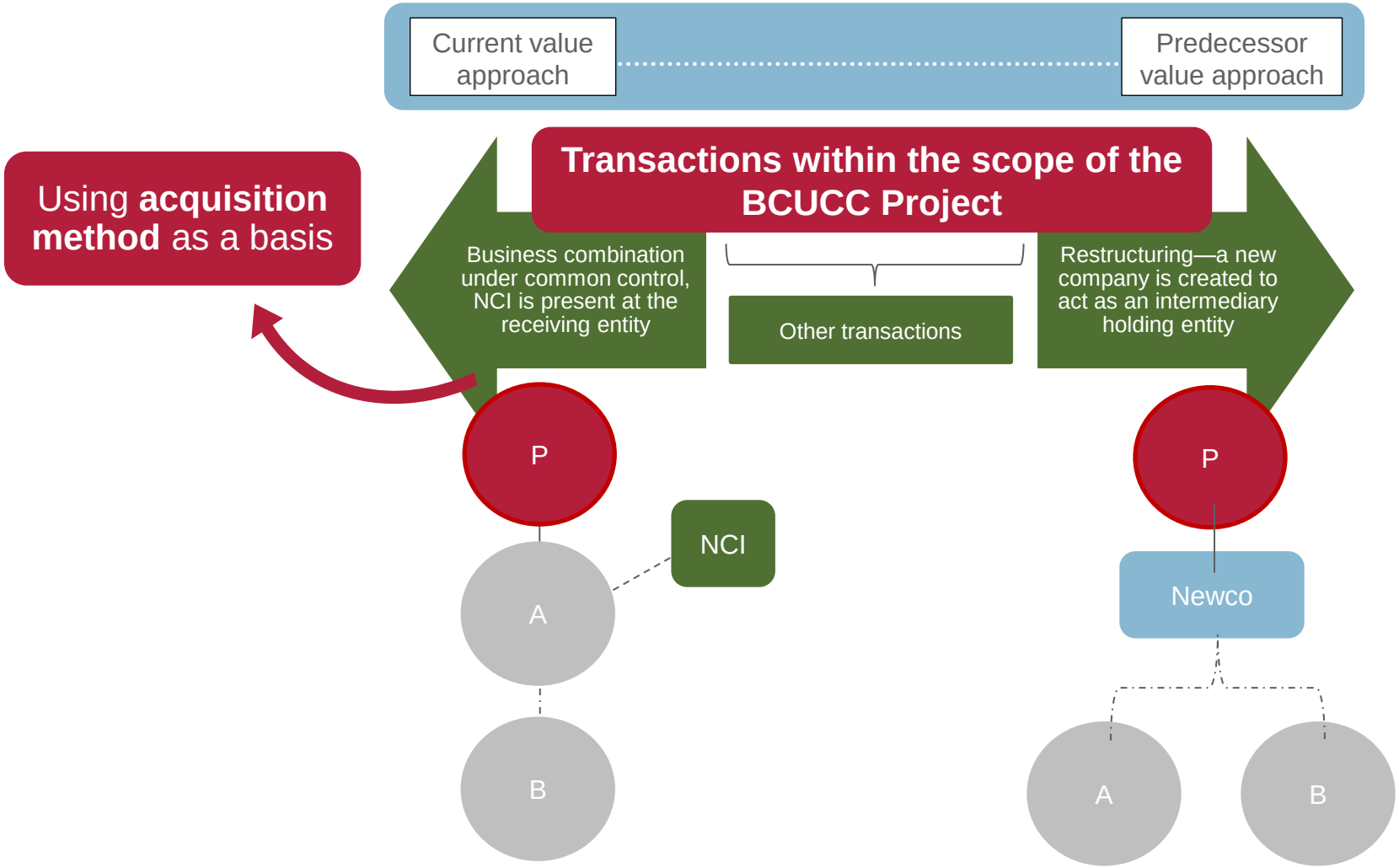
Using **acquisition method** as a basis



Transactions within the scope of the BCUCC project

Approaches being developed

The Board discussed potential approaches for transactions that affect NCI.



A current value approach for BCUCC affecting NCI

Acquisition method

+

Additional disclosures

+

Recognise a contribution if it is a bargain purchase (not gain)

+

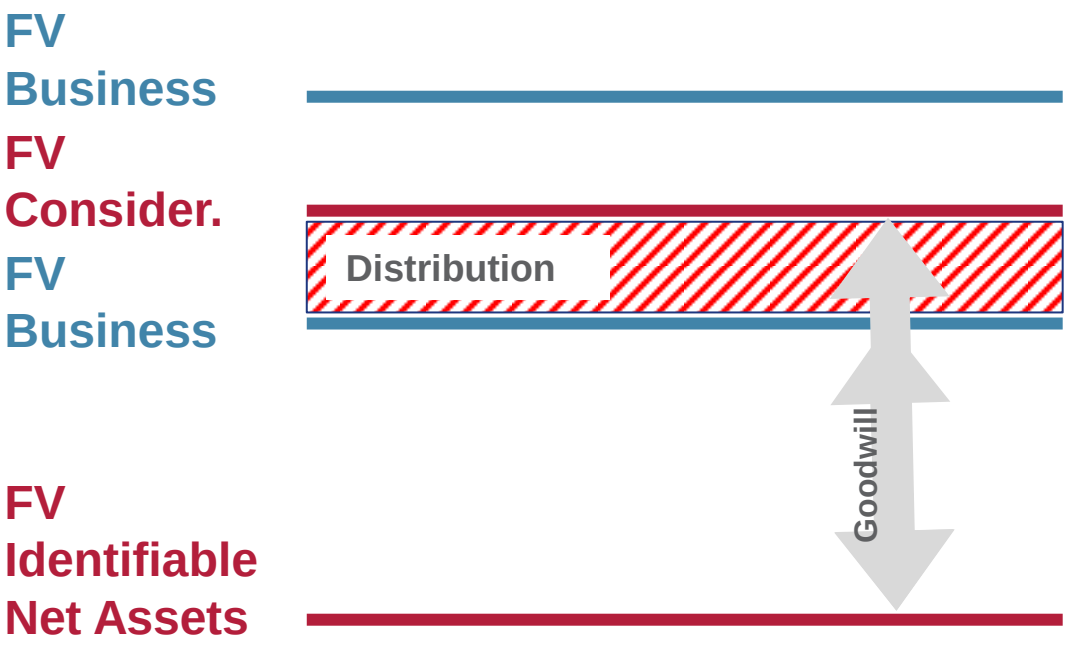
Recognise a distribution if there is an excess consideration (not goodwill)

The Board decided to pursue an approach that uses the **acquisition method** as the basis and to consider whether and how that approach may need to be modified for BCUCC.

***Ceiling* approach**

***Revised ceiling* approach**

Ceiling approach



Assess 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.

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

Gain is never recognised.
Bargain purchase is recognised as contribution to equity.

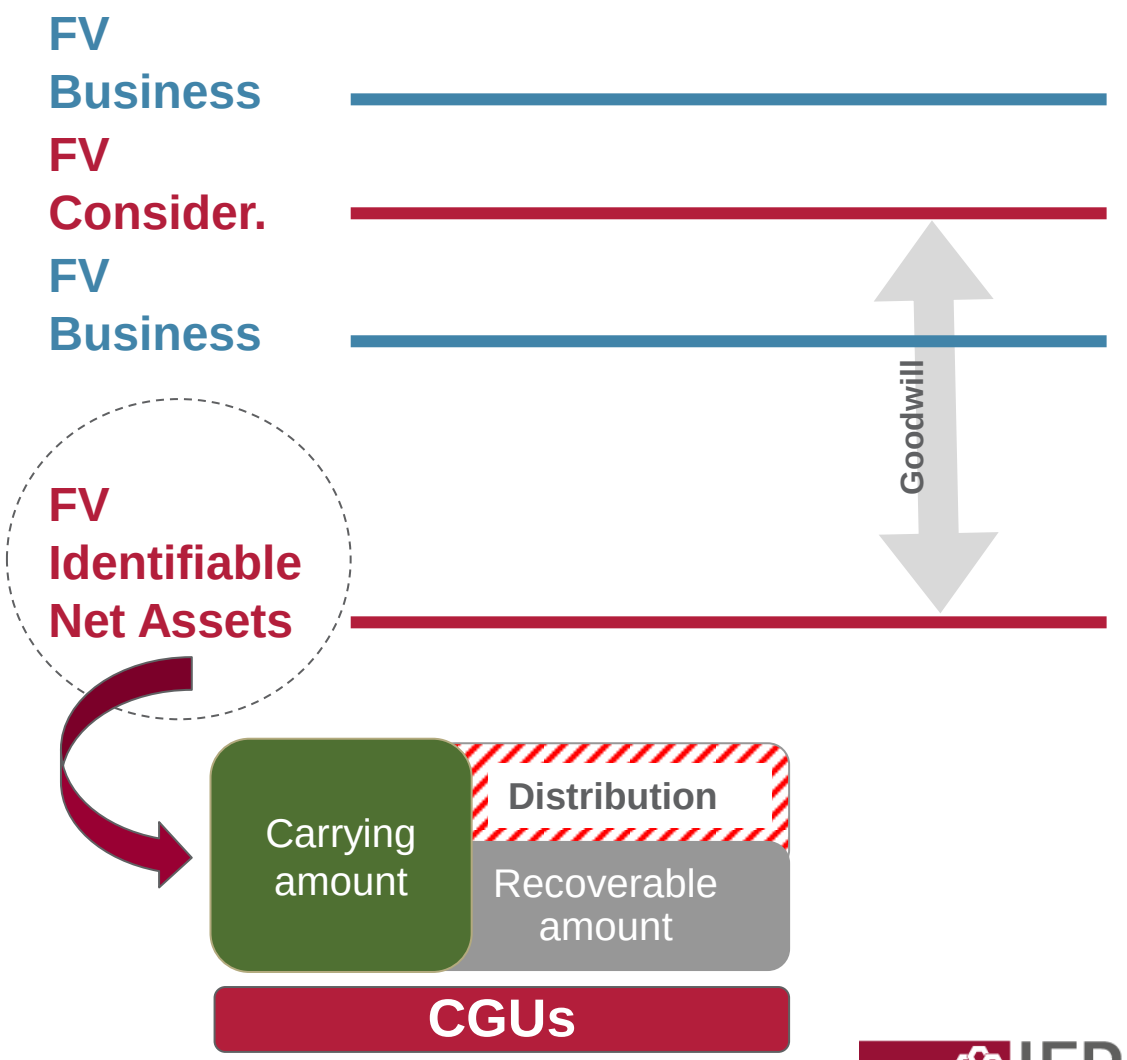
Revised Ceiling approach

Apply the mechanics of IAS 36 re: *impairment of goodwill*
Provisional goodwill is allocated to CGU(s) and tested to confirm the provisional amount and identify any distribution from equity

Any excess of the carrying amount over the recoverable amount of the CGU(s) is recognised as a **distribution from equity**

- Goodwill is calculated as the excess of the fair value of the consideration over the fair value of the acquired identifiable net assets but is capped
- **Gain** is never **recognised**

IFRS 3 | **IAS 36**



Question 5

In your view, should a current value approach be applied whenever **NCI** are present in the receiving entity?

(a) Yes—in all cases.
(b) Yes—in some but not all cases (eg depending on the nature and size of the NCI).
(c) No—a different measurement approach should be applied.
(d) No—other reason/s.

Question 6

What **potential modifications** to the acquisition method do you think would result in the most useful information about a business combination under common control affecting NCI?

Select all that applies.

(a) No modification. Apply acquisition method as set out in IFRS 3.
(b) Require additional disclosures.
(c) Recognise contribution if there is a ‘bargain purchase’.
(d) Introduce a ‘cap’ on recognition of goodwill—following the *ceiling approach.*
(e) Introduce a ‘cap’ on recognition of goodwill—following the *revised ceiling approach.*
(f) Others.

Get involved

Find out more: www.ifrs.org

Follow us: @IFRSFoundation

IFRS Foundation
International Accounting Standards Board

IFRS Foundation

IFRS Foundation

Join our team: go.ifrs.org/careers