# Potential sweep issues on published DP on BCUCC
# Issues Paper

## Objective

1 The objective of this paper is to provide EFRAG TEG with a high-level comparison of the IASB Discussion Paper *Business Combinations under Common Control* ('DP') that was published on 30 November compared to the IASB tentative decisions and to inform EFRAG TEG of any sweep issues.

2 The comment period deadline for the IASB is 1 September 2021.

## IASB DP compared to the IASB tentative decisions

3 Below are additional elements for EFRAG TEG to consider for EFRAG's draft comment letter ('DCL') based on a high-level comparison of the IASB's DP with the IASB's tentative decisions.

*General*

4 The general objective of the DP is now clearly articulated in that the IASB aims to provide users of financial statements with information that is:

a) more relevant - by setting up reporting requirements based on user information needs; and

b) more comparable - by requiring similar transactions to be reported in a similar way.

5 The IASB highlights the interaction with other projects that might affect the development of the business combinations under common control (BCUCC) requirements, namely the discussion paper *Business Combinations – Disclosures, Goodwill and Impairment* project as well as the post-implementation review of IFRS 10, IFRS 11 and IFRS 12.

*Scope*

6 The DP now provides a more detailed explanation of the scope of BCUCC especially on the impact on consolidated or separate financial statements. Refer to paragraphs 1.10 to 1.30 of the IASB DP included in Agenda Paper 01-04. In addition to the core proposals of the DP, Appendix B of the DP illustrates several examples of:

a) which transactions are within or outside the project's scope;

b) which company's reporting of those transactions is considered in the project; and

c) which types of financial statements those transactions are reported.

7 The IASB clarifies that the DP is not considering reporting requirements for other types of transactions under common control that do not involve the transfer of a business, for example, transfers of assets. However, transfer of a business that may not meet the definition of a business combination, e.g. a newly established company (Newco), might be a transaction within the scope of the DP.

8 When discussing the reporting requirements that apply to entities that are not the receiving party in a BCUCC transaction, the DP now provides clear references to the applicable standards (IFRS 10, IAS 24) covering the accounting of those entities.

9 The types of financial statements potentially affected are now illustrated in the DP. In general, the DP is addressing how a receiving company should report a business combination under common control in its consolidated financial statements. This might include consolidated financial statements that are required if a company is preparing to issue shares in a public market or consolidated financial statements issued by an intermediate parent.

10 The IASB clarified that the DP is not addressing how a receiving company should report in its separate financial statements an investment in a subsidiary received in a business combination under common control. However, in case of a transfer of an unincorporated business, the proposals in the DP may also apply in the separate financial statements of the receiving company.

*Selecting the measurement method*

11 There are no changes to the IASB tentative decisions in this section.

12 The DP clarifies that the main considerations in selecting the measurement method for BCUCC are:

a) whether and when BCUCC are similar to business combinations covered by IFRS 3 *Business Combinations*;

b) what information would be most useful to users of the receiving company's financial statements; and

c) whether the benefits of providing that information would justify the costs of providing it.

13 The DP deliberates that extending further the exemption from the acquisition method to publicly traded entities, might require that exemption to be designed in a different way than the exemption for privately held companies in order for it to achieve appropriate accounting outcomes and be operational in practice.

14 Similarly, extending the related-party exception to publicly traded entities may have little practical effect as capital market regulations often limit how many shares of a publicly traded company can be held by parties that are considered to be related to the company.

*Applying the acquisition method*

15 No changes to the IASB tentative decisions.

16 There is a clarification that if an overpayment occurs, the initially recognised goodwill would be addressed through subsequent testing of goodwill for impairment, just as occurs in a business combination covered by IFRS 3.

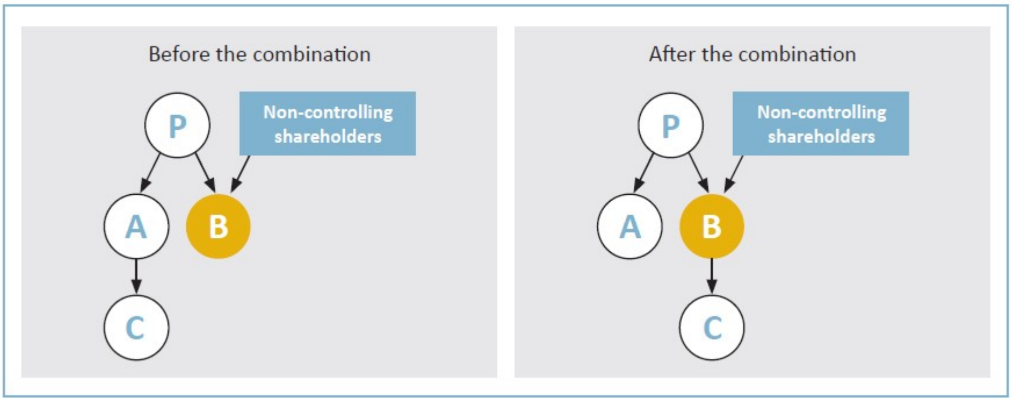
17 In addition, Appendix C of the DP describes two approaches to measure the distribution from equity:

a) measuring a distribution as the excess of the fair value of the consideration transferred over the fair value of the acquired business (the fair-value-based approach) (paragraphs C.6–C.8 of the DP); and

b) measuring a distribution by applying the requirements on testing goodwill for impairment in IAS 36 Impairment of Assets (the impairment-based approach) (paragraphs C.9–C.10 of the DP).

c) The IASB did not discuss which, if any, of the two it should propose if it were to require companies to recognise a distribution from equity but there is a question in the DP to constituents.

*Further information on the two approaches*




18 Suppose that:

a) the fair value of Company C's identifiable assets and liabilities is CU90;

b) the fair value of Company C's business is CU100; and

c) the fair value of the consideration paid by Company B is CU130.

19 Applying the acquisition method, the excess consideration of CU40 (see below diagram) would need to be divided between a distribution from equity and goodwill. Below are two possible approaches:

| | **Acquisition method** |
|---|---|
| FV of consideration paid by Company B | 130 |
| FV of Company C's identifiable assets and liabilities | -90 |
| Excess consideration | **40** |

| | **Fair-value based approach** | **Impairment-based approach** | |
|---|---|---|---|
| DR Goodwill (in Company B's accounts) | 100 - 90 = 10 | Total of 40 allocated between Goodwill and Equity | Based on IAS 36:<br>(a) apply the goodwill impairment test at the combination date;<br>(b) measure goodwill at the recoverable amount calculated in the impairment test; and<br>(c) treat any excess goodwill over that recoverable amount as a distribution from equity rather than as an impairment loss. |
| DR Equity (in Company B's accounts) | 130 - 100 = 30 | | |

*Applying the book-value method*

20 No changes to the IASB tentative decisions.

21 There is an expansion in the reasoning why the IASB has reached the preliminary view that the receiving company should measure the consideration paid in assets at the receiving company's book values of those assets at the combination date. That is, measuring the consideration paid in assets at their fair values could be costly and could involve significant measurement uncertainty. Also, information about the gain or loss on disposal may be of limited use to users of the receiving company's financial statements.

*Disclosure requirements*

22 There are no changes to the IASB tentative decisions on disclosures when applying the acquisition method and a book-value method.

23 Additionally, the DP includes a table of disclosure requirements in IFRS 3 which, in the IASB's preliminary view, should not be required for BCUCC to which a book-value method applies. The table is included below and notes the main reason for not considering each requirement for BCUCC to which a book-value method is applied.

*IFRS 3 disclosures that should not be required when a book-value method is applied*

| Main reason for the Board's preliminary view | Disclosure requirement |
|---|---|
| These combinations may not be similar to combinations covered by IFRS 3 | Strategic rationale, management's objectives for the acquisition and subsequent performance of the acquisition (preliminary view discussed in the IFRS 3 Discussion Paper relating to paragraph B64(d) of IFRS 3) |
| | Description, timing and estimated amount of expected synergies (preliminary view discussed in the IFRS 3 Discussion Paper relating to paragraph B64(e) of IFRS 3) |
| The book-value method differs from the acquisition method | Description of factors that make up acquired goodwill and reconciliation of its carrying amount at the beginning and at the end of the reporting period (paragraphs B64(e) and B67(d) of IFRS 3) |
| | Description and estimate of financial effects of contingent liabilities recognised (paragraphs B64(j) and B67(c) of IFRS 3) |
| | Amount of gain recognised in a bargain purchase (paragraph B64(n) of IFRS 3) |
| The costs of providing the information outweigh the benefits | Fair value of the consideration transferred and of each major class of consideration at the acquisition date (paragraph B64(f) of IFRS 3) |
| | Fair value and gross contractual amount of acquired receivables (paragraph B64(h) of IFRS 3) |
| | Amount of goodwill deductible for tax purposes (paragraph B64(k) of IFRS 3) |
| | Pro forma information for the current period as though the acquisition had occurred at the beginning of the annual reporting period (paragraph B64(q) of IFRS 3 and the related preliminary view discussed in the IFRS 3 Discussion Paper) |
| The Board has not yet discussed all aspects of a book-value method and the disclosure relates to a matter not yet considered | Amount at the acquisition date (and subsequent changes in that amount) and description of contingent consideration and indemnification assets (paragraphs B64(g) and B67(b) of IFRS 3) |
| | Description and amount recognised for separate transactions (paragraphs B64(l) and B64(m) of IFRS 3) |
| | Fair value of the equity interest in the acquiree in a business combination achieved in stages (paragraph B64(p) of IFRS 3) |
| | Information to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods (paragraphs 61, 62 and B67(a) of IFRS 3) |

**Questions for EFRAG TEG**

24 Referring to paragraphs 17 - 19 above on approaches to measure the distribution from equity, which of the two possible approaches do you recommend or do you have a different recommendation? Please explain.

25 Does EFRAG TEG have any other points that they would like to be incorporated in EFRAG's DCL? Please explain.