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Business Combinations under Common Control Issues Paper

Objective

- 1 The purpose of the session is to provide a summary on the feedback received from EFRAG CFSS members on a questionnaire on the project on Business Combinations under Common Control (BCUCC).
- 2 Additionally, EFRAG Secretariat would like to receive indication from EFRAG CFSS members on whether they consider the level of interest in their jurisdiction sufficient to consider organising outreach activities on the BCUCC project in their jurisdiction following the issuance of the discussion paper in September. This will help us to start shaping the outreach plan.

Background

- 3 In 2016, the IASB added the project on BCUCC to its research agenda to address lack of guidance in IFRS Standards as to how to account for transactions under common control. The focus of the project is how to account for a BCUCC in the financial statements of the **receiving entity**.
- 4 Such transactions are currently excluded from the scope of IFRS 3 *Business Combinations* and entities need to apply the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to develop an accounting policy which would result in relevant information for users of financial statements.
- 5 As a consequence, there is diversity in the way entities account for BCUCC transactions. Some entities apply by analogy the acquisition method as set out in IFRS 3. Other entities use a type of a predecessor approach under which the assets and liabilities of the acquired business are measured at historical carrying amounts. Under the latter approach, divergence also exists as to which historical carrying amounts are used – the amounts in the separate financial statements of the acquired entity or the amounts used when consolidating the entity. Specific disclosures on BCUCC are currently not required. This makes it difficult for users to compare the effects of BCUCC on entities' financial positions and financial performance. Considering such a diversity in practice, **the introduction of new requirements on measurement and disclosure will likely originate material impacts** in the entities operating in the different jurisdictions. Therefore, we consider important to keep the focus and open dialogue with CFSS members on this project.
- 6 The IASB is planning to publish a **discussion paper in September** on BCUCC which addresses measurement and disclosures. The IASB has not decided yet on the comment period for the project. The IASB's tentative decisions to be reflected in the discussion paper were discussed by TEG at several meetings.

- 7 With respect to the upcoming discussion paper and current developments of the BCUCC project, in March, EFRAG Secretariat launched a questionnaire to EFRAG CFSS members to gather information on two main areas of the project:
- (a) To help mapping the likely impacts of the BCUCC project to European jurisdictions and in particular:
 - (i) To determine any existing local guidance on BCUCC; or
 - (ii) Established current accounting practice within local jurisdictions.
 - (b) To obtain EFRAG CFSS members preliminary views on the IASB project's proposals on BCUCC, so far.

Summary of feedback received

- 8 EFRAG received a limited feedback on its questionnaire on BCUCC from EFRAG CFSS members. The questionnaire is replicated in Appendix 1 to this agenda paper. **Only 6 EFRAG CFSS members responded¹** to the questionnaire.
- 9 Based on the feedback received, **half** of the respondents indicated that the majority of BCUCC will be **presented in the separate financial statements** of the receiving entity which are prepared under local GAAP. Such transactions were primarily performed for tax purposes, internal restructurings, or achieving administrative objectives. EFRAG Secretariat considers that this may mean that there will be not direct impact on these jurisdictions (as the transactions in scope of the project are mainly subject to IFRS accounting); however, we know that once established, the IFRS guidance may trigger in the near future adaptation in local GAAP. In addition, there are jurisdictions that allow or require the adoption of IFRS Standards also in the separate financial statements for some categories of entities.
- 10 Respondents found it **difficult to estimate how common BCUCC** are in their jurisdictions (nevertheless, two respondents replied that BCUCC are as frequent, or more frequent, than business combinations that are not under common control, but, as noted by other respondents, they may be presented in consolidated financial statements less frequently than in separate financial statements) and how frequent an entity under common control is transferred to a receiving entity that has to report under IFRS.
- 11 Half of the respondents indicated that there is a local GAAP which provides guidance on BCUCC in their jurisdiction. The local guidance was either based on the pooling of interest method arising from IAS 22 *Business Combinations* or was some type of predecessor method. As said before, EFRAG Secretariat considers that the issuance for the first time of a specific guidance in IFRS literature may trigger revision of the local GAAP or practices.
- 12 There were only **very limited additional disclosure requirements** for BCUCC in two out of six jurisdictions that responded to the questionnaire.
- 13 EFRAG CFSS members provided limited feedback on the IASB tentative decisions on the BCUCC projects. Respondents generally agreed with the IASB direction of the project. However, some concerns were expressed as to:

¹ As some of the positions expressed were not yet authorised by the local national standard-setters boards, we anticipate the need to update the findings in the next steps.

- (a) how the exception² to the measurement principle under the acquisition model will be applied in practice;
- (b) why non-controlling shareholders should be considered differently from other types of shareholders; and
- (c) whether a very limited number of non-controlling shareholders should affect the accounting treatment for BCUCC.

Questions for EFRAG TEG and EFRAG CFSS

- 14 Can we conclude that those that didn't reply implicitly consider that the project is not of a material interest for their jurisdictions? EFRAG Secretariat would be keen in increasing the feedback obtained.
- 15 Would EFRAG CFSS members like to further comment on the questions included in the questionnaire as set out in Appendix 1?
- 16 Do EFRAG CFSS members agree with the EFRAG Secretariat preliminary observation that where the transactions are in scope of the local GAAP a new IFRS guidance may trigger adaptation of local GAAP and practice? Please explain.
- 17 Should a special focus be put on those European jurisdictions that allow or require IFRS Standards in the separate financial statements? Please explain.
- 18 Are EFRAG CFSS member interested in testing the proposals of the BCUCC project in their jurisdictions?
- 19 Do EFRAG CFSS agree to the IASB direction of the project? If not, please explain why.
- 20 Do EFRAG CFSS members have any other questions on the project?

² When the receiving entity is privately held and 1) all its on-controlling shareholders are related parties to it; or 2) all its non-controlling shareholders have been informed and do not object; the receiving entity can choose to apply a predecessor approach to measure BCUCC.

Appendix 1: Questionnaire for EFRAG CFSS members

Introduction

- 1 In anticipation of the forthcoming IASB discussion paper on BCUCC, EFRAG is seeking feedback from EFRAG CFSS members on two main areas:
 - (a) **Part 1** - to help assess the importance of the BCUCC project in Europe and determine what is the local guidance and established current accounting practice within the jurisdictions; and
 - (b) **Part 2** – to obtain preliminary views on the tentative decisions of the IASB on the project so far. The EFRAG Secretariat acknowledge that some of those tentative decisions have already been discussed with EFRAG CFSS members in the past, however, as the BCUCC project has advanced, the EFRAG Secretariat would like to obtain members' views on the proposals.
- 2 Additionally, based on the feedback received, EFRAG would like to gather initial indications of EFRAG CFSS members on whether they would like to participate in outreach activities related to the BCUCC project.

Questions to EFRAG CFSS members

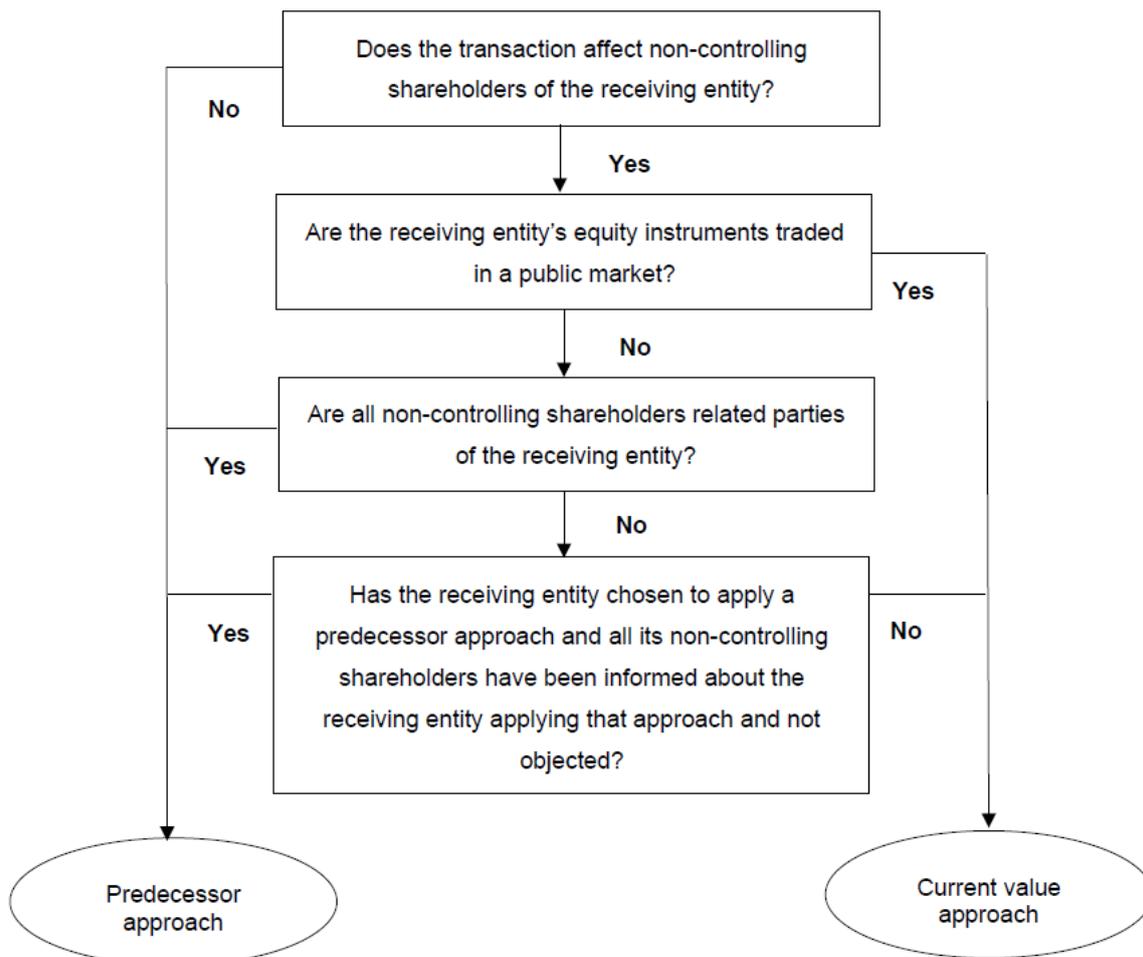
Part 1 - to assess the importance of the BCUCC project in a European perspective

- 3 EFRAG would like to seek EFRAG CFSS members input with regard to how common BCUCC are and whether local guidance on BCUCC exists within your jurisdictions:
 - (a) **Question 1** – How common is it in your jurisdiction that an entity under common control is transferred to a receiving entity that has to prepare its separate and/or consolidated financial statements in accordance with IFRS Standards (please specify if the answer relate to separate financial statements only, to consolidated financial statements or both)?
 - (i) It happens about as regularly or more regularly than business combinations that are not under common control.
 - (ii) A rough estimate would be that it only happens between five and eight times for every ten business combinations that are not under common control.
 - (iii) A rough estimate would be that it only happens between one and four times for every ten business combinations that are not under common control.
 - (iv) A rough estimate would be that it only happens between one and nine times for every hundred business combinations that are not under common control. It happens less than once for every hundred business combinations that are not under common control.
 - (b) **Question 2** – Is the frequency for how often an entity under common control is transferred to a receiving entity that has to report under IFRS significantly higher for some entities than others? If so, are there any characteristics that are common for the entities for which the frequency is higher? If so, what are those characteristics?
 - (c) **Question 3** – Does local GAAP in your jurisdiction include any guidance on how to account for BCUCC? If so, what does the guidance say?
 - (d) **Question 4** – Is there a common practice in your jurisdiction for how to account for BCUCC? If so, please explain the practice.

- (e) **Question 5** – Does local GAAP in your jurisdiction include any requirements for disclosures around BCUCC (in addition to any general disclosure requirements on business combinations)? If so, what are those requirements?
- (f) **Question 6** - What financial reporting issues are you aware of in relation to reporting BCUCC for preparers, regulators or users of financial information?

Part 2 - to obtain EFRAG CFSS's preliminary views on the IASB tentative decisions on the BCUCC project so far. The tentative decisions of the IASB on how to account for a BCUCC in the receiving entity's financial statements are presented below.

- 4 The graph below illustrates the IASB tentative decisions as to when to apply a current value approach or a predecessor approach when accounting for BCUCC.



Source: the IASB

- 5 The IASB concluded that a single measurement approach for all business combinations under common control was not appropriate. Therefore, the IASB tentatively decided that to the extent BCUCC are similar to acquisitions within the scope of IFRS 3, a current value approach should be applied; for all other BCUCC a predecessor approach should be applied. BCUCC affecting the non-controlling shareholders of the receiving entity are similar to acquisitions within the scope of IFRS 3 and therefore, applying a current value approach would provide the most useful information to primary users. In this respect, do you consider that the IASB tentative decision to apply different measurement approaches to BCUCC depending

on whether the BCUCC affects the non-controlling shareholders of the receiving entity is well justified?

- 6 Do you agree with the IASB tentative decision to apply a current value approach based on the acquisition method as set out in IFRS 3 to all or some transactions that affect non-controlling shareholders of the receiving entity except when the receiving entity's equity instruments are not publicly traded and one of the following conditions applies:
- (a) all non-controlling shareholders are related parties to the receiving entity; or
 - (b) the receiving entity chooses to apply a predecessor approach and all its non-controlling shareholders have been informed about and do not object it?
- 7 Do you consider that the option under paragraph 6(b) is practicable to apply?
- 8 Do you agree with the IASB tentative decision to apply a form of a predecessor approach to all other transactions within the scope of the project?
- 9 The IASB tentatively decided on the particular application aspects of the predecessor approach including:
- (a) a receiving entity should recognise and measure assets and liabilities transferred at the carrying amounts included in the financial statements of the transferred entity; and
 - (b) pre-combination information in primary financial statements should be provided only about the receiving entity i.e. comparative figures should not be restated for all the combining entities.

What are EFRAG CFSS members views on the particular aspects as to how the predecessor approach should be applied?

- 10 In December 2019, the IASB tentatively decided to modify the acquisition method when applied to BCUCC and to present a contribution to the receiving entity's equity when the acquired identifiable net assets exceed the consideration transferred instead of recognising that excess as a gain on a bargain purchase in the statement of profit or loss. On the other hand, the IASB concluded that a symmetrical recognition of a distribution from the receiving entity's entity, when the consideration transferred in excess of the value received, would be infrequent as it would represent overpayment on the part of the receiving entity. Therefore, the IASB decided **not** to require recognition of a distribution and include the excess consideration in the initial measurement of goodwill. Based on these tentative decisions, the questions for you are:
- (a) do you agree with the tentative decision of the IASB to apply the acquisition method set out in IFRS 3 to recognise the excess fair value of the acquired identifiable net assets over the fair value of the consideration transferred as a **contribution** to the receiving entity's equity?
 - (b) do you agree with the IASB tentative decision **not** to identify, recognise and measure a **distribution** when the consideration transferred is higher than the fair value of the acquired identifiable net assets?
- 11 Do you agree with the IASB tentative decisions regarding how to measure the **consideration paid** in a BCUCC under the predecessor method when:
- (a) the consideration paid is in the **form of own shares** – the IASB tentatively decided not to prescribe how the receiving entity should measure the consideration paid in its own shares as it is usually subject to legal requirements which are different between jurisdictions;

- (b) the consideration paid is in the **form of assets** - the IASB tentatively decided to require entities to measure the consideration paid in assets at the carrying amounts of those assets at the date of the combination;
 - (c) consideration paid by **incurring liabilities to or assuming liabilities from the transferor** - the IASB tentatively decided to measure the consideration paid in the form of incurred liabilities towards the transferor or liabilities assumed from the transferor at the carrying amounts of those liabilities, as deemed in accordance with applicable IFRS Standards.
- 12 Do you agree with IASB tentative decision to require receiving entities applying the **predecessor approach** to recognise **transaction costs** as an expense in the statement of profit or loss in the period in which they are incurred? Respectively, to recognise costs related to the issue of debt or equity instruments in accordance with IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments*.
- 13 Do you agree with IASB tentative decision to **not to prescribe** in which component or components of equity the receiving entity would present the difference between the consideration paid and the carrying amounts of assets and liabilities received **under the predecessor approach**?
- 14 Do you agree with IASB tentative decisions regarding disclosure requirements for BCUCC when:
- (a) BCUCC are reported using the **acquisition method** – the IASB tentatively decided that the receiving entity should apply all disclosure requirements in IFRS 3 *Business Combinations* and the disclosures suggested in the discussion paper *Business Combinations – Disclosures, Goodwill and Impairment*.
 - (b) BCUCC are reported using the **predecessor method** - the receiving entity should apply particular disclosure requirements in IFRS 3 and in the DP *Business Combinations – Disclosures, Goodwill and Impairment*. In addition, the receiving entity should disclose where in equity it recognised the difference between the consideration paid and the carrying amounts of assets and liabilities received.