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Update on current BCUCC project developments
Issues Paper

Objective

1 The objective of this paper is to update the EFRAG TEG on the latest IASB discussions on business combinations under common control in April and May 2018. This paper is provided for information only and will not be discussed at the EFRAG TEG meeting in June.

IASB latest deliberations on the BCUCC project

2 At its April and May meetings, the IASB discussed possible approaches to account for a specific subset of transactions within the scope of the BCUCC project. The specific subset of transactions is described under the following scenario:

(a) Entity A and entity B are businesses and are both controlled by entity P;

(b) Entity B is wholly owned by entity P but there are non-controlling shareholders (NCI) in entity A;

(c) Entity A acquires entity B.

3 Additionally, the transaction illustrated in paragraph 2 has been considered from the perspective of **entity A (receiving entity)** and its **NCI**. For this type of transaction, the IASB considered:

(a) What information about the transaction is useful for the NCI in the receiving entity; and

(b) Whether there is anything special about the BCUCC that needs to be reflected in the financial reporting which does not happen in business combinations not under common control.

4 In April, the IASB staff presented two alternative approaches to account for this specific subset of transactions from the perspective of the receiving entity:

(a) Full fair value approach; and

(b) Ceiling approach.

5 Both approaches are being developed for a specific subset of BCUCC transactions based on the underlying principles that:

(a) Fair values exchanged is useful information for NCI; and

(b) Identifying and accounting for any equity transaction would reflect better the specifics of the BCUCC transaction.

6 Both approaches are based on the requirements of IFRS 3 *Business Combinations* and IAS 1 *Presentation of Financial Statements*. **The approaches are built on the presumption that in a BCUCC transaction the fair values of the consideration**

exchanged may or may not be approximately equal. The difference between them would constitute a contribution to equity or a distribution from equity.

7 The application of IFRS 3 does not require determining the fair value of the acquired business as IFRS 3 is based on the presumption that the consideration transferred would normally approximate the fair value of the acquirer's interest in the acquired business. Goodwill is the difference between the fair value of the consideration and the fair value of the acquired identifiable net assets. Goodwill is subsequently tested for impairment and loss is recognised in profit or loss.

Full fair value approach

8 The full fair value approach considers the transaction from the market participant perspective and reflects fair values exchanged. This approach would require determining the fair value of both the consideration transferred and the acquired business. Any difference between them is recognised as a contribution to equity or a distribution from equity.

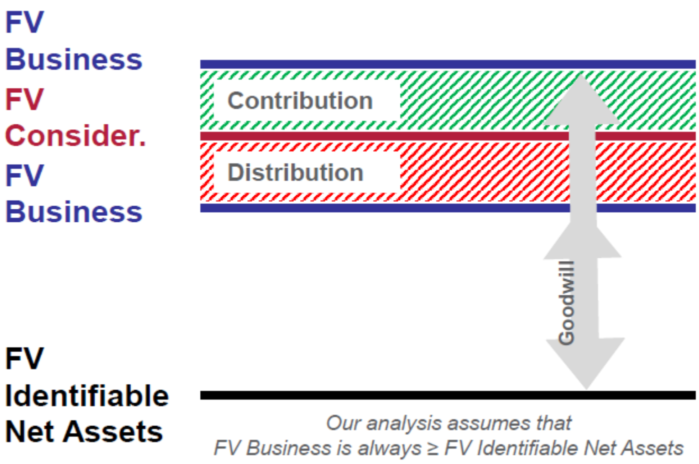
9 Under the full fair value approach, goodwill is recognised as the difference between fair value of the acquired business and FV of the acquired identifiable net assets. A gain on a bargain purchase is never recognised.

10 Consequently, under the full fair value approach an **equity transaction** is recognised if:

(a) FV consideration > FV business – a distribution from equity; or

(b) FV consideration < FV business – a contribution to equity.

11 The following diagram[1] illustrates the mechanics of the full fair value approach.



12 The full fair value approach involves significant measurement uncertainty as it requires recognition of amounts that depend on a single estimate of the fair value of the acquired business. This method is operationally complex as it requires determining the fair value of the acquired business in all scenarios. Furthermore, it does not reflect any synergies between the combining parties.

Ceiling approach

13 The ceiling approach considers fair values exchanged with the aim to avoid recognising any inflated goodwill. This approach involves assessing the fair value of the consideration transferred against the fair value of the acquired business.

[1] Source IASB agenda paper 23, April 2018

14 Under the ceiling approach, goodwill is the excess of the consideration transferred over the fair value of the acquired identifiable net assets but is capped at the fair value of the acquired business. A gain is never recognised.

15 Consequently, under the ceiling approach an **equity transaction** and **goodwill** are recognised if:

(a) FV consideration > FV identifiable net assets:

(i) FV consideration > FV business – the receiving entity recognises a distribution from equity (FV consideration – FV business) and goodwill (FV business – FV identifiable net assets); or

(ii) FV consideration < FV business – the receiving entity recognises goodwill (FV consideration – FV identifiable net assets).

(b) FV consideration < FV identifiable net assets - a contribution to equity.

16 Under the ceiling approach, the fair value of the acquired business only affects recognition of goodwill or an equity transaction when the fair value of the consideration transferred is more than the fair value of the acquired business.

17 The following diagram[2] illustrates the mechanics of the ceiling approach.

FV consideration >
FV identifiable net assets

FV C. > FV business

Distribution
(FV C. - FV B)

Goodwill
(FV B - FV I. net assets)

FV C. < FV business

Goodwill
(FV consideration - FV I. net assets

FV consideration <
FV identifiable net assets

Contribution
(FV I. net assets - FV consideration)

18 The ceiling approach involves less measurement uncertainty than the full fair value approach as the fair value of the acquired business only serves as the ceiling for recognising goodwill and the floor for recognising distribution from equity when the fair value of the consideration transferred is more than the fair value of the acquired business. This approach involves similar operational complexities as the full fair value approach as it requires determining the fair value of the acquired business in most scenarios. Also similar to the full fair value approach, the ceiling approach does not reflect any synergies between the combining parties.

19 At its May meeting, the IASB considered a revised version of the ceiling approach. The revised ceiling approach uses the mechanics in IAS 36 *Impairment of assets* to confirm the provisional carrying amount of goodwill and to identify any equity transaction by the end of the measurement period by:

[2] Source IASB agenda paper 23, April 2018

(a) allocating provisional carrying amount of goodwill to each of the receiving entity's CGUs that is expected to benefit from the synergies of the combination;

(b) measuring the recoverable amounts of the CGU(s) to which the provisional carrying amount of goodwill has been allocated; and

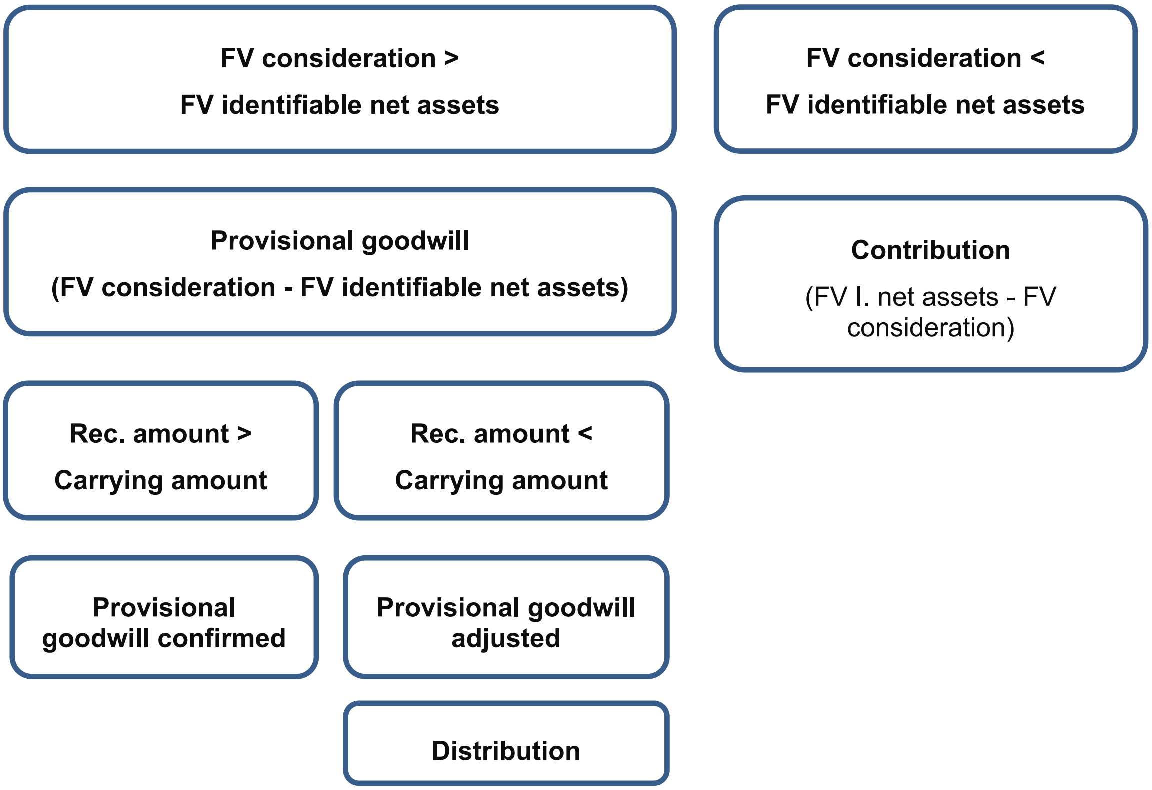
(c) comparing the recoverable amount of the CGU(s) with the carrying amounts of the CGU(s) to which the provisional carrying amount of goodwill has been allocated:

  (i) any excess of the carrying amount over the recoverable amounts of the CGU(s) to which the provisional carrying amount of goodwill had been allocated results in adjustment of the provisional goodwill and recognition of a **distribution from equity**;

  (ii) any excess of the recoverable amount over the carrying amounts of the CGU(s) to which the provisional carrying amount of goodwill had been allocated confirms the provisional carrying amount of goodwill; and

(d) a **contribution to equity** is recognised when the fair value of the consideration transferred is less than the fair value of the acquired identifiable net assets. A gain is never recognised.

20 The following diagram[3] illustrates the mechanics of the revised ceiling approach.



21 The revised ceiling approach reduces the challenges arising under the full fair value and the ceiling approaches related to:

(a) measurement uncertainty and the costs and complexity involved in determining the fair value of the acquired business; and

(b) reflect the existence of potential synergies between the receiving entity and the acquired business.

[3] Source IASB agenda paper 23, April 2018

22 For reference purposes, Appendix 1 includes a summary of the IASB tentative decisions on BCUCC project so far. As next steps, the IASB staff will continue to explore other scenarios within the scope of the project.

Question for EFRAG TEG

23 Does EFRAG TEG have any questions or comments on the approaches presented by the IASB staff to account for BCUCC transactions?

Appendix 1: IASB tentative decisions on BCUCC project to date

Setting the scope (June 2014)	The IASB tentatively decided that the BCUCC project should consider: • business combinations under common control that are currently excluded from IFRS 3 *Business Combinations*; • group restructurings; and • the need to clarify the description of business combinations under common control, including the meaning of 'common control'.
Clarifying the scope (Oct 2017)	The IASB clarified that the scope of the BCUCC project includes transactions under common control in which a reporting entity obtains control of one or more businesses, regardless of whether IFRS 3 would identify the reporting entity as the acquirer if IFRS 3 were applied to the transaction.
Clarifying the scope (Dec 2017)	The IASB tentatively decided that the scope of the project also includes transactions involving transfers of one or more businesses where all of the combining parties are ultimately controlled by the same controlling party or parties, and the transactions are: • preceded by an external acquisition and/or followed by an external sale of one or more of the combining parties; or • conditional on a future sale such as in an IPO.
Staring point in the analysis (Feb 2018)	The IASB tentatively decided to use the acquisition method set out in IFRS 3 as the starting point in its analysis of transactions within the scope of the project. This, however, will not determine whether the IASB will ultimately propose applying the acquisition method to all, or even to many, transactions within the scope of the project.