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EFRAG TEG's view on the predecessor method
Issues Paper

Objective

1 The purpose of this paper is to ask for EFRAG TEG's view on the predecessor method. That is:

(a) Whether the method can provide useful information that a method similar to the one used in IFRS 3 *Business Combinations* does not provide (or whether the model should only be applied because fair values cannot be estimated reliably in some BCUCC or because it is less costly to apply than the model used in IFRS 3).

(b) Whether comparative figures should be adjusted when applying the method.

(c) Whether the nature of consideration affects if comparative figures should be adjusted and how useful the information resulting from the predecessor method would be.

Background

2 At a previous EFRAG TEG meeting, the EFRAG Secretariat presented the argument that information resulting from the predecessor method could be useful as it would present information as if a transferred entity had also previously been part of the receiving party. In short, the argument was that:

(a) Users of financial statements seem primarily to use the statement of profit or loss when predicting future cash flows. Accordingly, instead of reflecting the cash generating potentials in the measurement of assets and liabilities (at fair value), the figures reported in profit or loss should be useful for predicting future cash flows – and in the past, EFRAG's view has been that a mixed measurement model provides the most useful information when estimating future cash flows.

(b) Comparative figures reflecting the manner in which the entity is currently generating its cash flows are useful for estimating future cash flows (if cash flows will be generated in a similar manner in the future).

(c) Providing information based on a mixed measurement model with comparative figures would therefore provide the most useful information for estimating future cash flows in cases in which the cash generation would not be changed following the transfer.

3 The argument assumed a version of the predecessor method under which comparative figures would be adjusted.

4 Some EFRAG TEG members, however, commented that:

(a) When the receiving party is not transferring its own equity instruments, but e.g. in cash, adjusted comparative figures do not completely show how the financial statements would have looked like had the transferred entity previously been part of the receiving party.

(b) Providing comparative figures as if the transferred business or entity previously had been part of the receiving party would not reflect reality, and would therefore not provide useful information for predicting future cash flows.

5 EFRAG TEG members also commented that when a transfer affects minority interests, the transfer of a business or entity would be similar to an acquisition. Under a mixed measurement model, acquired assets would be measured at the price paid for them – rather than what the seller had paid for them. The most useful measurement basis would, accordingly, be a fair value model similar to the one required by IFRS 3. This comment is considered in paper 03-02. When considering the following paragraphs, it should therefore be assumed that the transfer does not affect minority interests.

Possible alternative views

6 Based on the past comments of some EFRAG TEG members, the EFRAG Secretariat could group views on the processor methods for BCUCC into views about comparative figures and about the benefits of the method. These groups of views are considered separately below.

Comparative figures

7 The possible alternative views on presenting comparative figures when a predecessor method is applied by the receiving party are:

(a) Comparative figures should never be adjusted to reflect how the financial statements would have looked like had the transferred business or entity also in previous years been part of the receiving party. Such an adjustment would reflect a situation that did not exist and would accordingly not provide the most useful information.

(b) Comparative figures should always be adjusted to reflect how the financial statements would have looked like had the transferred business or entity also in previous years been part of the receiving party.

(c) Comparative figures should be adjusted to reflect how the financial statements would have looked like had the transferred business or entity also in previous years been part of the receiving party, only when the cash flows are not expected to be materially affected by the transfer. Such an adjustment would facilitate estimations of future cash flows.

(d) Comparative figures should be adjusted to reflect how the financial statements would have looked like had the transferred business or entity also in previous years been part of the receiving party, only when the receiving party is transferring its own equity instruments as consideration. In other cases, comparative figures should not be adjusted.

(e) Comparative figures should be adjusted to reflect how the financial statements would have looked like had the transferred business or entity also in previous years been part of the receiving party, only when both the following apply:

(i) the cash flows are not expected to be materially affected by the transfer; and

(ii) the receiving party is transferring its own equity instruments as consideration.

In other cases, comparative figures should not be adjusted.

Usefulness of the information resulting from applying the predecessor method

8 The possible alternative views on the usefulness of the information resulting from applying a predecessor method are:

(a) A predecessor method could provide information that is more relevant when estimating future cash flows than a fair value method similar to the one applied for business combinations in IFRS 3, if the expected cash flows are not materially affected by the transaction and the comparative figures are adjusted to reflect how the financial statements would have looked like had the transferred business or entity also in previous years been part of the receiving party.

(b) A predecessor method would not result in more relevant information than a method similar to the one applied for business combinations in IFRS 3, but is preferable:

(i) When the fair values of the identifiable net assets transferred cannot be estimated sufficiently reliably; or

(ii) When the additional benefits of applying a method similar to the one in IFRS 3 compared to applying a predecessor method do not outweigh the additional costs.

Questions for EFRAG TEG

9 Do EFRAG TEG members have any other views that would be relevant to consider in relation to comparative figures in addition to those listed in paragraph 7 above?

10 Do EFRAG TEG members have any other views that would be relevant to consider in relation to the usefulness of a predecessor method in addition to those listed in paragraph 8 above?

11 Which of the views (of those listed in paragraph 7 above and those that may follow from the question in paragraph 9 above) in relation to comparative figures would represent EFRAG TEG's preliminary view? When replying to the question, please note that any decisions about how long back in time any adjustment of comparative figures would have to be made would still be open (e.g. whether it should be from the date the transferred entity or business became under common control with the receiving entity or from the date the transferred entity was created).

12 Which of the views (of those listed in paragraph 8 above and those that may follow from the question in paragraph 10 above) in relation to the usefulness of the information resulting from applying a predecessor method would represent EFRAG TEG's preliminary view? When replying to the question, please note that any decisions about how to account for reverse acquisitions would still be open. Accordingly, when applying to the question, it should be assumed that the transaction could not be characterised as a reverse acquisition.