Measurement approaches for BCUCC
Cover Note

Objective

1 The objective of this session is to obtain EFRAG TEG and EFRAG CFSS views on:

(a) when a current value approach and a predecessor approach should be applied to transactions within the scope of the project on Business Combinations under Common Control (BCUCC) based on updated analysis contained in agenda paper 06-03; and

(b) particular aspects of how a current value approach and a predecessor approach should be applied to such transactions.

Background

2 The purpose of the project on BCUCC is how to account for transfers of businesses or entity controlled by the same party both before and after the transaction. Currently, such transactions are excluded from the scope of IFRS 3 *Business Combinations* and there is diversity in practice as to how such transactions are accounted for which reduces comparability across entities. In particular, the focus of the BCUCC project is what should be the measurement approach applied in the financial statements of the receiving entity.

3 So far, the IASB has considered the nature of the BCUCC and what information would be useful taking into account the cost constraint and complexity of the proposed measurement approach. Based on the analysis performed, the IASB explored the following measurement approaches for BCUCC:

(a) a **current value approach** based on the acquisition method - under this approach the assets acquired and liabilities assumed are recognised at their fair values. This approach was considered for transactions that affect the non-controlling shareholders (NCS) of the receiving entity. Consideration has been given as to whether to apply a current value approach to **some but not all** transactions that affect NCS depending on whether:

(i) the NCS are ‘substantive’ – however, the term ‘substantive’ has not yet been defined;

(ii) the equity instruments of the receiving entity are traded in a public market; or

(iii) the NCS would decide whether they require current value information; and

(b) a **predecessor approach** - under this approach the assets acquired and liabilities assumed are recognised at their predecessor carrying amounts. This measurement approach was considered for transactions that do not affect NCS but affect lenders and other creditors, and potential equity investors (for example in an IPO) of the receiving entity.

Transactions that affect non-controlling shareholders

4 Considering various criteria to distinguish between transaction that affect NCS and apply different measurement approaches to them, the IASB Staff is proposing to make the distinction as follows:

(a) transactions affecting the **NCS of a publicly held receiving entity** – the IASB Staff is proposing to apply a current value approach when the receiving entity's equity instruments are traded in a public market;

(b) transactions affecting the **NCS of a privately held receiving entity** – the IASB Staff is proposing to apply:

(i) a predecessor approach for private NCS when the receiving entity and the transferred entity are related parties; and

(ii) a mixed approach for private NCS not related to the receiving entity such as:

- a predecessor approach is applied unless at least some NCS inform the receiving entity that they wish to receive current value information (NCS 'opt-in' for current value); and
- a current value approach is applied unless all NCS do not object to receiving predecessor information (NCS 'opt-out' from current value).

5 The advantage of the approach suggested in paragraph 4(b)(ii) is that it meets information needs of NCS and avoids accounting arbitrage opportunities for the receiving entity. Conversely, the approach may be difficult to apply in practice and may not always effectively consider the cost constraint efficiently.

Question for EFRAG TEG and EFRAG CFSS

6 Do EFRAG TEG and EFRAG CFSS members consider that a current value approach should be required only when a receiving entity's equity instruments are traded in a public market or should it be extended to privately held receiving entities? If the latter, do you support the opt-in or opt-out approach (see paragraph 4(b)(ii)) or a different approach for privately held entities (e.g. a quantitative threshold for percentage of non-controlling shareholders in the receiving entity)?

Transactions that do not affect NCS

7 The IASB Staff is of the view that transactions that do not affect NCS are different from the ones that do in the following respects:

(a) there is no acquisition of a residual interest (equity claim) in the transferred entities, or businesses, by non-controlling shareholders; and

(b) the identification of an acquirer may not be possible or may not result in useful information about the transaction.

Question for EFRAG TEG and EFRAG CFSS

8 Do EFRAG TEG and EFRAG CFSS members agree with the observations in paragraph 7 that transactions that do not affect non-controlling shareholders of the receiving entity are different from those that do? If not, why?

How to apply a current value approach

9 The IASB tentatively decided to use the acquisition method as a starting point when developing an approach for transactions that affect non-controlling shareholders of the receiving entity. Under that approach to the extent that those transactions are similar to business combinations, similar information should be provided and to the extent they are different, different information should be provided.

10 In some cases, BCUCC may be directed by the controlling party and as such be undertaken to produce benefits for other entities within the group instead of the receiving entity. Additionally, in some countries, regulation may exist to require the BCUCC to be conducted at fair value. Consequently, the IASB Staff is proposing to modify the acquisition method as set out in IFRS 3 in order to reflect the specifics of the BCUCC by recognising:

(a) **distribution** from the receiving entity's equity – if the difference between the consideration transferred exceeds the fair value of the acquired interest; or

(b) **contribution** to the receiving entity's equity - if the fair value of the acquired net assets exceeds the fair value of the consideration transferred; or

(c) provide additional **disclosures** to help users of the receiving entity's financial statements understand the effects of the transaction.

11 When applying a current value approach to providing information about a **distribution** in a BCUCC, the IASB Staff have identified two alternatives as to how the receiving entity could measure this distribution. In particular, the recognised distribution could be measured:

(a) as the excess of the consideration over the fair value of the acquired business; or

(b) by immediately testing goodwill for impairment applying the mechanics of IAS 36 *Impairment of Assets*.

12 When applying a current value approach to providing information about a **contribution** in a BCUCC, the IASB Staff is proposing that the excess of the fair value of the acquired net assets over the fair value of the consideration transferred represents a contribution to the receiving entity's equity rather than a gain and should be recognised as such.

13 As an alternative to the recognition of contribution to or distribution from equity, entities could provide **disclosure** about the BCUCC to help users evaluate the effects of the transaction on the receiving entity's financial position and performance. Consequently, instead of being recognised separately, any distribution from equity would be subsumed within goodwill that is subject to subsequent annual impairment tests.

Questions for EFRAG TEG and EFRAG CFSS

14 Are EFRAG TEG and EFRAG CFSS members aware of any existing legal requirements in their jurisdiction related to the transaction price in a business combination under common control and if so, what are they and which transactions do they apply to (see paragraph 10)?

15 Which alternative for reporting a distribution applying a current value approach to transactions that affect non-controlling shareholders identified in paragraph 11 do you prefer, and why?

16 Do EFRAG TEG and EFRAG CFSS members agree that in a business combination under common control any excess of fair value of the acquired assets and liabilities over consideration should be recognised as contribution to the receiving entity's equity (see paragraph 12)?

How to apply a predecessor approach

17 The IASB tentatively decided to pursue a predecessor approach for transactions that do not affect non-controlling shareholders of the receiving entity. However, the predecessor method is not described in IFRS Standards and there is diversity as to how the approach is applied in practice, in particular:

(a) pre-combination information - currently entities reflect a BCUCC from the date it occurred or as if the entities were combined from the beginning of the comparative period; or from a date when entities were first under common control, if later;

(b) predecessor carrying amounts - entities recognise acquired assets and liabilities assumed at their predecessor carrying amounts which can be either the carrying amounts at the transferred entities or the carrying amounts at the controlling party;

(c) presentation in equity - the difference between the consideration transferred and the predecessor carrying amounts of the acquired net assets is recognised in equity. However, presentation in equity is generally not prescribed in IFRS guidance.

18 With respect to reporting pre-combination information, the IASB Staff has considered two alternatives:

(a) Alternative A - acquired assets, liabilities and results of operations are recognised from the beginning of the comparative period. Combined or carveout pre-combination information is provided for all combining entities. While the *Conceptual Framework* addresses combined financial statements, carveout financial statements are not defined. Consequently, preparing combined and particularly carveout information can be difficult as it would involve judgements and estimates.

(b) Alternative B - acquired assets, liabilities and results of operations are recognised from the date of the transaction. Pre-combination information for all combining entities is only provided if it was previously reported. If not, pre-combination information is provided only for the receiving entity. Identifying the receiving entity in a way that provides useful information can be difficult in some cases.

19 Additionally, the alternatives identified in paragraph 18 above could result in providing the same pre-combination information depending on whether there is continuation of a previous reporting entity in a new legal form or a new set of assets, liabilities and results of operations are reported together for the first time.

Question for EFRAG TEG and EFRAG CFSS

20 Which alternative for providing pre-combination information applying a predecessor approach to transactions that do not affect non-controlling shareholders identified in paragraph 18 do you prefer, and why?

Agenda Papers

21 In addition to this cover note, agenda papers for this session are:

(a) Agenda paper 06-02 – ASAF 1A Alternative measurement approaches– for background only; and

(b) Agenda paper 06-03 – ASAF 1B Transactions that do not affect non-controlling shareholders – for background only.