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Users' preferred method to account for business combinations under common control
Issues Paper

Objective

1 The objective of this session is to obtain views on how users prefer business combinations under common control ('BCUCC') to be accounted for by considering examples illustrating the application of a current value measurement approach and a predecessor approach.

Background

2 The IASB started a research project on BCUCC in 2014 with the purpose of exploring how to account for transfers of businesses or entity controlled by the same party. Currently, such transactions are outside the scope of IFRS 3 *Business Combinations* and without any specific guidance they are in practice accounted for in different ways. Consequently, it makes it difficult for investors and regulators to compare the effects of those transactions on entities' financial positions and performances.

3 The IASB tentatively decided that the scope of the BCUCC project should include transactions under common control in which the reporting entity obtains control of one or more businesses, regardless of whether IFRS 3 would identify the reporting entity as the acquirer. The focus of the project is how to account for a BCUCC in the financial statements of the receiving entity. This means that the project focuses on how 'Entity A' in the illustrations in paragraphs 6 and 8 below should account for the combination.

4 So far, two main measurement approaches have been considered by the IASB when accounting for transactions within the scope of the project:

(a) **a current value approach** based on the acquisition method as set out in IFRS 3 to consider whether and how that method should be modified to provide the most useful information about the transaction. This approach has been considered for all or some transactions that affect non-controlling interests (NCI) in the receiving entity; and

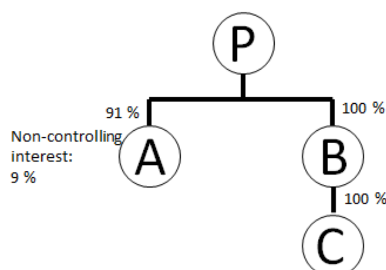
(b) **a predecessor approach** based on preserving the carrying amounts in the transferred entity's financial statements. This approach has been considered for transactions that affect debt and equity investors in the receiving entity, but do not affect NCI.

5 The IASB is planning to publish a discussion paper on the project in the first half of 2020.

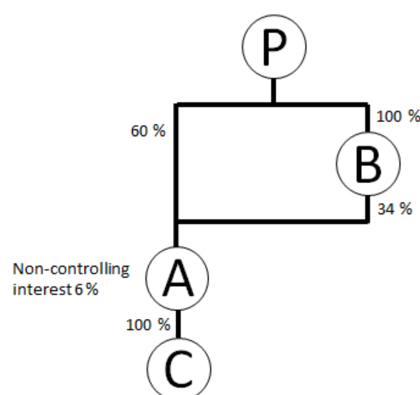
Description of examples

6 As mentioned above, the purpose of this session is to receive views on which of three approaches as described below in paragraph 11 provides the most useful information for users (for different purposes). As the three methods will result in different figures being presented in the statement of financial position and statement of financial performance, this paper accordingly only focuses on those statements. In a real-life case, the statement of cash flows and note disclosures would also be available from the financial statements. The purpose of this session is therefore only to consider what the starting point should be in the statement of financial position and statement of financial performance. The assessment should be made under the assumption that any additional disclosure that would be considered useful, could be provided in addition to the primary financial statements.

7 In order to stimulate the assessment, the effects of the three approaches will be illustrated considering an example. In the example, Entity A is designing and selling clothes. Most of the production of the clothes is outsourced. Entity A is controlled by Entity P which holds 91% of the shares in Entity A. The remaining 9% are held by minority shareholders. Several years ago, Entity P started Entity B, which it controls (100%). Entity B established Entity C, which it controls (100%). Entity C is also designing and selling clothes. There are no transactions between Entity A and Entity C. The structure of the group is presented in the diagram below.



8 Entity P (the controlling party) now decides to restructure the group by transferring entity C (transferee) from entity B (transferor) to entity A (receiving entity) as at 1 January 20X1. The new group structure is shown in the diagram below.



9 Entity A issues new shares to Entity B in exchange for Entity C. The group is operating in a jurisdiction that has minority shareholder protections in place. This means that the estimated fair value of the shares provided from Entity A to Entity B would correspond to the estimated fair value of Entity C.

10 Entity A, Entity B and Entity C apply the same accounting policies, which correspond to the accounting policies adopted by Entity P. Entity P and Entity B have the same carrying amounts of Entity C's assets, liabilities and equity.

11 The EFRAG Secretariat has considered three different approaches to account for the transfer of Entity C to Entity A in the consolidated financial statements of Entity A. The three approaches are:

(a) An **acquisition method** as described in IFRS 3. Under this approach, when Entity A obtained control of Entity C on 1 January 20X1, it recognised identifiable assets acquired and liabilities assumed separately from goodwill and measured these at fair value with the following exceptions:

(i) Contingent liabilities were recognised as of the acquisition date, irrespectively of whether it would meet the recognition criteria in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, if it is a present obligation that arises from past events and its fair value can be measured reliably.

(ii) Deferred tax assets or liabilities arising from the assets acquired and liabilities assumed were recognised and measured in accordance with IAS 12 *Income Taxes*.

(iii) Liabilities (or assets, if any) related to Entity C's employee benefit arrangements were recognised and measured in accordance with IAS 19 *Employee Benefits*.

Acquired intangible assets were recognised and measured at fair value in accordance with the principles to the extent they were separable or arose from other contractual rights, irrespective of whether Entity C had recognised the asset prior to the business combination occurring.

Goodwill was recognised and measured as the difference between:

(i) the fair value of the consideration transferred (the fair value of the shares in Entity A that were transferred); and

(ii) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

(b) A **predecessor approach without restatement of previous period's financial statements**. Under this approach, Entity A will reflect the transferred assets and the liabilities assumed at their predecessor carrying amounts as presented in Entity C's financial statements without restating previous period financial information. This means that in periods following the transfer, the consolidated statement of financial performance will for each line item show the sum of the amounts included in the financial statements of Entity A and Entity C. The same applies to the assets and liabilities presented in the consolidated statement of financial position. No goodwill is recognised under this method. 'Common stock' reflects of the common stock of Entity A. 'Capital surplus' reflects the additional paid in capital in Entity A before the transfer plus the difference between the par value of the shares issued by Entity A to Entity B and the paid in capital in Entity C ('Common stock' and 'Capital surplus').

(c) A **predecessor approach with restatement of previous period's financial statements**. This approach is similar to the predecessor approach without restatement of previous period's financial statements except that under this approach, the comparative figures in the financial statements are restated to reflect how they would have been had the transfer taken place at the beginning of the first period for which comparative figures are presented. This means that in all periods presented, the consolidated statement of financial performance shows for each line item the sum of the amounts included in the financial statements of Entity A and Entity C. The same applies to the assets and liabilities presented in the consolidated statement of financial position.

12 The considered variations of the predecessor approach are based on the EFRAG Secretariat interpretations of the method which have not yet been discussed by the IASB.

13 Entity A's consolidated statement of financial position and Entity A's consolidated statement of financial performance are presented below for each of the three approaches.

Statement of financial position	**Acquisiton method**		**Predecessor method without restatement**		**Predecessor method with restatement**	
	20X0	**20X1**	**20X0**	**20X1**	**20X0**	**20X1**
Assets						
Non-current assets						
Rights over leased assets	505	842	505	832	917	832
Intangible assets	407	920	407	650	572	650
Goodwill		2,863	-	-	-	-
PPE	7,283	12,894	7,283	12,331	11,558	12,331
Investment property	21	21	21	21	21	21
Financial investments	231	312	231	312	291	312
Shares in C	-	-	-	-	-	-
Other non-current assets	554	617	554	617	681	617
Deferred tax assets	722	782	722	782	752	782
Total non-current assets	**9,723**	**19,251**	**9,723**	**15,545**	**14,792**	**15,545**
Current assets						
Inventories	2,549	5,220	2,549	5,160	4,949	5,160
Trade receivables	861	1,903	861	1,903	2,548	1,903
Other current assets	107	807	107	807	482	807
Current financial investments	2,265	1,772	2,265	1,772	2,865	1,772
Cash and cash equivalents	4,116	9,581	4,116	9,581	8,616	9,581
Total current assets	**9,898**	**19,283**	**9,898**	**19,223**	**19,460**	**19,223**
Total assets	**19,621**	**38,534**	**19,621**	**34,768**	**34,252**	**34,768**
Non-current liabilities						
Provisions	242	709	242	709	677	709
Long-term debt	-	681		671	675	671
Deferred tax liabilities	257	479	257	380	347	380
Other long-term liabilities	920	2,980	920	2,880	2,645	2,880
Total non-current liabilities	**1,419**	**4,849**	**1,419**	**4,640**	**4,344**	**4,640**
Current liabilities						
Short-term bank loans	62	87	62	87	129	87
Trade payables	5,095	10,156	5,095	10,156	10,645	10,156
Other current liabilities	294	481	294	481	631	481
Total current liabilities	**5,451**	**10,724**	**5,451**	**10,724**	**11,405**	**10,724**
Common stock	94	144	94	144	144	144
Capital surplus	20	9,970	20	80	80	80
Retained earnings	12,637	12,847	12,637	19,180	18,279	19,180
Equity	**12,751**	**22,961**	**12,751**	**19,404**	**18,503**	**19,404**

Consolidated statement of financial performance

Statement of financial performance	**Acquisiton method**			**Predecessor method**			**Predecessor method**	
	20X0	**20X1**		**20X0**	**20X1**		**20X0**	**20X1**
Net sales	23,311	44,836		23,311	44,836		47,686	44,836
Cost of sales	- 10,032	- 22,176		- 10,032	- 21,576		- 22,782	- 21,576
Gross profit	**13,279**	**22,660**		**13,279**	**23,260**		**24,904**	**23,260**
Operating expenses	- 8,176	- 16,219		- 8,176	- 16,219		- 14,476	- 16,219
Other losses and income, net	- 20	- 413		- 20	- 413		- 545	- 413
Gross operating profit	**5,083**	**6,028**		**5,083**	**6,628**		**9,883**	**6,628**
Amortization and depreciation	- 1,062	- 1,528		- 1,062	- 1,436		- 1,490	- 1,436
Net operating profit	**4,021**	**4,501**		**4,021**	**5,193**		**8,393**	**5,193**
Financial results	10	84		10	84		48	84
Results of equity accounted entities	47	42		47	42		47	42
Profit before taxes	**4,078**	**4,627**		**4,078**	**5,319**		**8,488**	**5,319**
Income tax	- 917	- 978		- 917	- 979		- 1,292	- 979
Net profit	**3,161**	**3,649**		**3,161**	**4,340**		**7,196**	**4,340**

Questions for EFRAG TEG/User Panel

14 Consider that you are a minority shareholder in Entity A, and you want to assess whether to keep your shares or sell them (i.e. you are going to value the company). What would be the information each of the three approaches listed in paragraph 11 could provide/not provide, and which of the three approaches would you, on balance, consider provides the most useful information?

15 When assessing whether to provide a loan to an entity, lenders may be also interested in the unconsolidated financial statements as they would only be entitled to the assets of the legal entity in case of a bankruptcy. However, in the example described in paragraphs 7 - 10, the methods mentioned in paragraph 11 will only affect the consolidated financial statements. Consequently, the example could be amended so that Entity C could simply have become a part of Entity A (i.e. Entity A acquires a business) instead of Entity C becoming a subsidiary of Entity A. Entity A's unconsolidated statement of financial position and unconsolidated statement of financial performance would then be the same as the statements provided in paragraph 13. Under this scenario, consider that you are assessing whether to provide a loan to Entity A. What would be the information each of the three approaches listed in paragraph 11 could provide/not provide, and which of the three approaches in your view, on balance, provides the most useful information?

16 When answering the questions in paragraphs 14 and 15, it is assumed that the financial statements of 20X1 would be the most recent financial statements. Consider that some years have now passed and financial statements for 20X4 are now available. Would the benefits and disadvantages of each of the methods identified when answering questions in paragraphs 14 and 15 also apply when considering how future financial statements will be affected by the method chosen to account for the transfer in 20X1?