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Business Combinations under Common Control

Issues paper

Objective and Introduction

- 1 The objective of the session is to discuss project direction options in preparation for the July ASAF meeting.
- 2 In its April 2023 meeting, the IASB discussed whether the current project direction is likely to result in the project moving into the standard-setting phase in the future. The IASB did not make decisions on project direction at that meeting. The IASB Staff also provided a paper on the book value method which outlines some areas of diversity in how a book-value method is applied to support the discussion of options for project direction. Please refer to the Appendix, which provides useful inputs on the book value method for discussing the project direction.

Options for project direction

IASB discussion

- 3 The IASB analysed the *Due Process Handbook* requirements to move a project from the research phase into the standard-setting phase which require the IASB to assess:
 - (a) The criteria for potential standard-setting projects, which include:
 - (i) whether there is a deficiency in reporting particular type of transaction: the extent to which a standard-setting project on BCUCCs would reduce diversity and improve transparency would depend on what requirements the IASB develops;
 - (ii) the importance of the matter for users of financial statements: jurisdictional diversity in user feedback raised questions about whether the project can meet user information needs globally. Otherwise, it may reduce the importance of the project to some investors;
 - (iii) the types of entities likely to be affected: BCUCCs occur frequently in many jurisdictions, but those by listed entities are more prevalent in China than in other jurisdictions; and
 - (iv) the pervasiveness of the matter: developing reporting requirements in line with the IASB's preliminary views would change the applied measurement method mainly for reporting most of the BCUCCs that affect NCS, which should typically involve listed entities (i.e., from book-value to acquisition method).
 - (b) The extent of resources required for the project, also considering the magnitude of the expected steps to develop an exposure draft, which could entail the following possible workstreams:
 - (i) Discussing the remaining aspects of project scope (e.g., group restructurings);

- (ii) Selecting the measurement method (including exemptions or exceptions);
 - (iii) Applying the measurement method (including disclosure); and
 - (iv) Other topics (e.g., transition requirements).
- 4 Considering the aforementioned requirements and based on the feedback received so far, the IASB discussed the following three options for project direction.

Option I - develop recognition, measurement and disclosure requirements

- 5 This option would require the IASB make decisions including:
- (a) which method(s) to apply in principle;
 - (b) exceptions, including exploring possible new exceptions in more detail; and
 - (c) clarification requests / application guidance to make the principle and any exceptions workable in practice.
- 6 The extent to which option I would achieve the project objective of resolving diversity in practice and improving the transparency of reporting for BCUCCs would depend on what requirements the IASB develops. The IASB Staff noted that:
- (a) The IASB’s preliminary views as defined in the DP would not result in one method applying to all BCUCCs but it would reduce diversity in practice among similar circumstances;
 - (b) Jurisdictional diversity in user feedback raised question about whether the project could meet user needs globally, especially for BCUCCs that affect NCS;
 - (c) Since the IASB’s November 2022 discussion, the “NCS choice” principle could be applied deciding which method to apply (i.e., allowing the receiving entity a choice of applying either the acquisition method or a book-value method to BCUCCs that affects NCS);
 - (d) The IASB would need to consider how and whether to develop a single and standardised book-value method reducing the diversity in practice, as further detailed in the following section “Book-value method”.

Option II - develop disclosure-only requirements

- 7 The option to develop only disclosure requirements for BCUCCs could improve transparency of reporting for BCUCCs and provide relevant information to users by requiring an entity, for example, to disclose:
- (a) the recognised amounts of each class of assets received and liabilities assumed regardless of the method applied;
 - (b) to which the acquisition method is applied (e.g., information about the acquired goodwill); or
 - (c) which entity’s book values have been used.
- 8 Furthermore, the IASB Staff noted that this approach would:
- (a) Allow entities to develop an accounting policy choice to meet users’ preferences in the jurisdiction; and
 - (b) Require significantly less resources than option I.

Option III - develop no recognition, measurement or disclosure requirements

- 9 The IASB could choose to not develop any reporting requirements for BCUCCs and discontinue the project. This option would not improve diversity in practice and

transparency of reporting for such transactions. On the other side, it would not require significant additional resources to the IASB.

EFRAG's final comment letter

- 10 In its [comment letter](#), EFRAG welcomed the IASB's Discussion Paper *Business Combinations under Common Control* ('BCUCC'). BCUCC are frequently undertaken for many different reasons to achieve purposes that vary from business combinations of entities not under common control. For example, they may take place to re-organise group activities with an aim to achieve synergies, spin-offs in preparation for an initial public offering (IPO) or to obtain tax efficiency within the group. The often-complex structures and arrangements to effect such changes raise considerable challenges for financial reporting. As IFRS Standards are currently silent on how the entity receiving a BCUCC should account for the transaction, there is diversity in practice which warrants attention.
- 11 Therefore, EFRAG welcomed the IASB's efforts to explore possible reporting requirements for a receiving company that would reduce diversity in practice, improve comparability and consistency of reporting and provide more relevant information for users of financial statements.

EFRAG Secretariat analysis

- 12 EFRAG issued a Discussion Paper as part of its proactive work in October 2011. This Discussion Paper represented a first step in responding to the diversity that exists in practice. Responses to EFRAG's Discussion Paper (as per the [feedback statement](#) – 27 CL) included that the majority agreed that the information needs of users are an important consideration when determining an accounting method for BCUCC. They also commented that ultimately, the method used to account for BCUCC transactions should be capable of satisfying the needs of users. Also, generally respondents supported diversity of accounting treatment when facts and circumstances merit it. Therefore, there was support to address the existing diversity in practice.
- 13 Subsequent to this, in 2012, as per their agenda consultation, the IASB added the project BCUCC to its research agenda. The IASB then published a Discussion Paper in November 2020.
- 14 14 comment letters were received in response to EFRAG's draft comment letter relating to the IASB's Discussion Paper issued in November 2020. A majority of the respondents of respondents from the comment letters received welcomed the DP's proposals and the IASB's efforts to address the current lack of guidance on the accounting for BCUCC.
- 15 There needs to be a robust framework which addresses diversity in practice. Therefore, the EFRAG Secretariat suggests the IASB continue to explore developing recognition, measurement and disclosure requirements (option I above). In particular, to achieve the project objectives, the EFRAG Secretariat continues to agree with the following as indicated in EFRAG's comment letter:
 - (a) Not having a single measurement method for all the BCUCCs;
 - (b) Providing preparers with relief allowing some exceptions and exemptions;
 - (c) Applying the criterion "affect NCS" to determine the applicable measurement method for each BCUCCs based on practical considerations.
- 16 Based on the reasoning provided above, the EFRAG Secretariat does not support Option III which is to discontinue the project. Option II could be critically discussed in light of comments made by some stakeholders. With a disclosure-only approach, the information is lost over time, as the information is only required in the transaction year (and possibly in the subsequent period).

Questions for EFRAG FR TEG-CFSS

- 17 What problems do EFRAG FR TEG-CFSS consider are caused by the gap in IFRS Accounting Standards for reporting BCUCCs? Since the project was added to the IASB's agenda in 2007, is practice largely settled or are there significant challenges in accounting for BCUCCs?
- 18 Do EFRAG FR TEG-CFSS members have specific examples where the reporting for a BCUCC resulted in financial statements that were misleading or failed to provide useful information about the BCUCC? How common are such examples?
- 19 Which option do EFRAG FR TEG-CFSS members consider that the IASB should choose?
 - (a) Option I: Recognition, measurement and disclosure requirements;
 - (b) Option II: Disclosure-only requirements; or
 - (c) Option III: No recognition, measurement or disclosure requirements (discontinue the project).
- 20 Does EFRAG FR TEG-CFSS consider that a robust framework, therefore, limited accounting policy choices, for the accounting of BCUCC transactions, is needed in order to reduce diversity in practice? Please explain.

Appendix: Some areas, indicated by the IASB Staff, of diversity in how a book-value method is applied to support the discussion of options for project direction

Book-value method

IASB discussion

1 The IASB discussed two areas of diversity the IASB would need to consider if it decides for option I (i.e., to develop recognition, measurement and disclosure requirements) as follows:

- (a) Which book value to use; and
- (b) Whether to restate pre-combination information

Which book value to use

2 In developing the DP the IASB considered whether a receiving entity should use either:

- (a) The transferred business' book value (IASB's preliminary views); or
- (b) The controlling party's book values.

3 The IASB staff noted that:

- (a) there are various factors to consider including user information needs, structuring and cost;
- (b) mixed views and conflicting arguments were received by respondents to the DP relating the factors to be considered; and
- (c) further user outreach may be necessary to understand whether (and in what circumstances) one approach provides more useful information than the other.

4 Furthermore, in developing recognition and measurement requirements for how to apply a book-value method, the IASB could consider:

- (a) prescribing different book-value methods and the circumstances in which each book-value method should be required;
- (b) prescribing one standardised book-value method; or
- (c) allowing entities a choice of how to apply a book-value method.

Whether restate pre-combination information

5 In developing its DP, the IASB considered two approaches for the receiving entity including in its financial statements the transferred business' assets, liabilities, income and expenses:

- (a) prospectively from the date of the combination, without restating pre-combination information ("prospective approach") (IASB's preliminary view); or
- (b) retrospectively as if the receiving entity and transferred business had always been combined, with pre-combination information restated ("retrospective approach").

6 The IASB Staff noted that developing requirements specifying whether to restate pre-combination information may require significant resources because:

- (a) there are various factors to consider including user information needs, practical challenges and cost;
- (b) mixed views and conflicting arguments were received by respondents to the DP relating the factors to be considered; and

- (c) user feedback suggests pre-combination information about the transferred business could be useful.

EFRAG's Final Comment Letter

- 7 With reference to the book-value method, in its comment letter EFRAG considered that:
 - (a) both the use of the carrying amounts in the consolidated financial statements of the transferred company's controlling party and the use of the carrying amounts in the financial statements of the transferred company can provide decision-useful information for users; and
 - (b) using one or the other approach would depend on facts and circumstances of the receiving company including cost/benefit considerations. For this reason, EFRAG proposed an accounting policy option to allow the use of the carrying amounts in the consolidated financial statements of the transferred company's controlling party. EFRAG further suggested that the accounting policy choice should be applied on a transaction-by-transaction basis and be supported by additional disclosures explaining that choice.
- 8 With respect to providing pre-combination information under the book-value method in its comment letter EFRAG stated that the respondents to EFRAG's consultation expressed mixed views. A majority of EFRAG Board members supported an accounting policy option between providing pre-combination information prospectively (from the combination date) or retrospectively (until the beginning of the reporting period); the option would work on a case-by-case basis, based on facts and circumstances of the BCUCC transaction.