IFRS Accounting

Staff paper

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Accounting Standards Advisory Forum meeting

Date	**July 2023**
Project	**Business Combinations under Common Control**
Topic	**Project direction—Book-value method**
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Accounting Standards Advisory Forum meeting, July 2023, Agenda paper 5B

This paper was discussed at the International Accounting Standards Board's (IASB's) April 2023 meeting as Agenda Paper 23B. Agenda papers referred to in this paper are other agenda papers for the IASB's April 2023 meeting, unless otherwise noted.

Introduction and purpose

1. As paragraph 25 of Agenda Paper 23A notes, there is diversity in how a book-value method is applied to business combinations under common control (BCUCCs). This paper outlines two areas of diversity—which book values to use and whether to restate pre-combination information—which the IASB would need to consider if it develops recognition and measurement requirements for BCUCCs (see option I in paragraphs 43–46 of Agenda Paper 23A). The Discussion Paper *Business Combinations under Common Control* (Discussion Paper) acknowledged arguments for different approaches for both of these areas and respondents' feedback was split (see paragraphs 6(b) and 8(b)).

2. In the context of considering the project direction, questions arise about:

(a) the extent of resources required to develop recognition and measurement requirements for a single, specified book-value method (paragraphs 6 and 8); and

(b) the merits of developing recognition and measurement requirements for a single book-value method (paragraph 9).

3. This paper does not ask the International Accounting Standards Board (IASB) for decisions.

Structure of this paper

4. This paper includes:

(a) which book values to use (paragraphs 5–6);

(b) pre-combination information (paragraphs 7–8);

(c) merits of a single book-value method (paragraphs 9); and

(d) Appendix A—illustrative scenarios.

Which book values to use

5. The IASB's preliminary view in the Discussion Paper was to require a receiving entity to measure the assets and liabilities received at the transferred business's book values.[1] In developing the Discussion Paper, the IASB also considered whether a receiving entity should instead use the controlling party's book values.

6. Developing requirements specifying which book values to use may require significant resources because:

[1] For simplicity, the Discussion Paper discussed BCUCCs that involve the transfer of a company to a company. In this and other agenda papers we refer to 'entities' (which includes companies and other types of entities) and 'businesses' (which includes incorporated and unincorporated businesses).

(a) there are various factors to consider including user information needs, structuring and cost—for example, the Discussion Paper acknowledged that using either the transferred business's book values or the controlling party's book values could provide useful information;

(b) feedback from respondents was split (see paragraphs 13–38 of Agenda Paper 23B of the IASB's January 2022 meeting) and respondents provided conflicting arguments relating to the factors in paragraph 6(a); and

(c) we received specific feedback on this issue only from one user representative group—further user outreach may be necessary to understand whether (and in what circumstances) one approach provides more useful information than the other.

Pre-combination information

7. In developing the Discussion Paper, the IASB considered whether a receiving entity should restate pre-combination information. The IASB considered two approaches for the receiving entity including in its financial statements the transferred business's assets, liabilities, income and expenses:

(a) prospectively from the date of the combination, without restating pre-combination information ('prospective approach'); or

(b) retrospectively as if the receiving entity and transferred business had always been combined, with pre-combination information restated ('retrospective approach').

8. We think 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) feedback from respondents was split (see Agenda Paper 23C of the IASB's January 2022 meeting) and respondents provided conflicting arguments relating to the factors in paragraph 8(a); and

(c) user feedback suggests pre-combination information about the transferred business could be useful—most users disagreed with the IASB's preliminary views that receiving entities should not restate, and should not be required to disclose, pre-combination information. Some of these users supported the retrospective approach, some supported requiring receiving entities to disclose pre-combination information and some said pre-combination would be useful but did not express a preference between these alternatives.

Merits of a single book-value method

9. Feedback raises questions about the merits of developing recognition and measurement requirements for a single book-value method. Feedback suggests different approaches to applying a book-value method might be more appropriate in different circumstances (Appendix A illustrates scenarios where feedback suggests different approaches might be more appropriate). Therefore, if the IASB were to develop recognition and measurement requirements for how to apply a book-value method, the IASB could, for example, consider:

(a) prescribing different book-value methods and the circumstances in which each book-value method should be required—however, this may require significant resources to develop and be complex for stakeholders to interpret and apply;

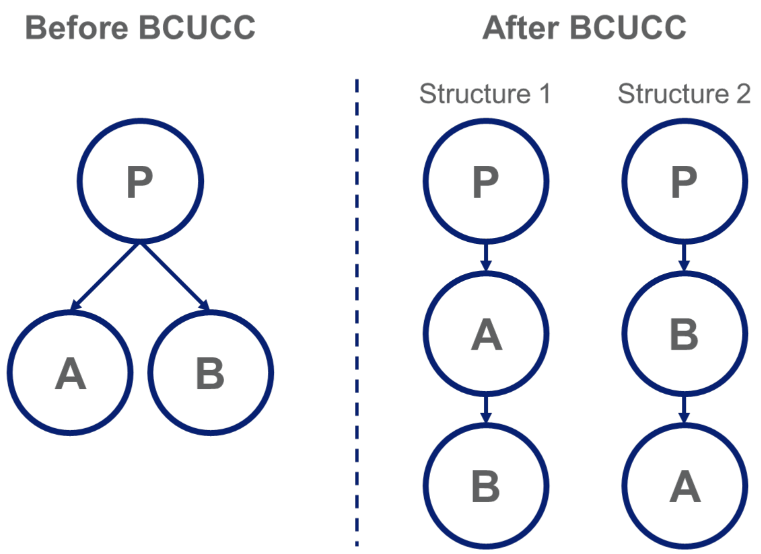
(b) prescribing one standardised book-value method—however, this may not provide the most useful information for some BCUCCs which may reduce the importance of the project to users (see paragraphs 29–30 of Agenda Paper 23A); or

(c) allowing entities a choice of how to apply a book-value method—however, this would not reduce diversity which may reduce the importance of the project to users (see paragraphs 29–30 of Agenda Paper 23A).

Appendix A—Illustrative scenarios

A1. Paragraphs 6(b) and 8(b) explain that feedback was split on two areas of how to apply a book-value method—which book values to use and whether to restate pre-combination information. Considering the feedback, we developed two scenarios that illustrate respondents' arguments for using different book values and restating (or not restating) pre-combination information. We assume these illustrative scenarios are BCUCCs to which, applying the IASB's preliminary views on selecting the measurement method, a book-value method would apply.

Illustrative scenario one—re-organising subsidiaries

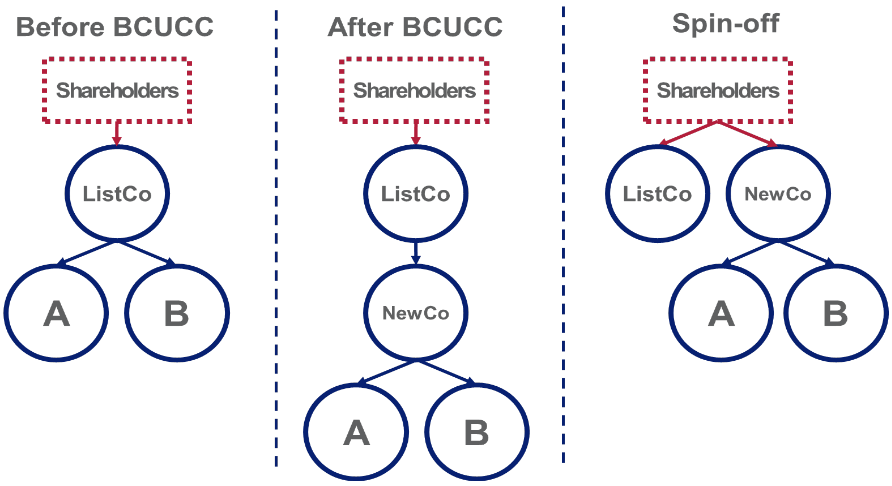


A2. A controlling party (P) could reorganise its wholly-owned subsidiaries (A and B) in various ways—the diagram illustrates two such ways. Consistent with the IASB's preliminary views, feedback suggests:

(a) using the transferred business's book values means A and B will continue to measure their assets and liabilities on the same basis regardless of whether P uses Structure 1 or Structure 2; and

(b) restating pre-combination information would provide a picture of a group which did not exist ('hypothetical' information).

Illustrative scenario two—spin-off



A3. A listed entity (ListCo) is owned by various shareholders and controls various businesses including A and B (for simplicity, the diagram excludes other businesses). ListCo decides to spin-off A and B to be listed together. ListCo first transfers A and B to a new wholly-owned entity (NewCo) which will be the new listed entity.

A4. A and B have not publicly released financial statements (individually or combined) so investors would not be familiar with the book values of A and B (the transferred businesses). ListCo discloses information about A and B together as a single reportable segment applying IFRS 8 *Operating Segments* so investors are familiar with the book values of ListCo (the controlling party).

A5. The shareholders who will become shareholders of NewCo as a result of the spin-off are already shareholders of ListCo and, in contrast with the IASB's preliminary views, feedback suggests:

(a) the book values of ListCo (the controlling party) could be more useful because they would reflect the initial investment ListCo made to acquire A and B; and

(b) restating pre-combination information would allow those shareholders to perform trend analysis to assess the subsequent performance of that investment, whereas a prospective approach would provide no information about the pre-combination periods (for example, any comparative periods).