Consideration and presentation in equity under the predecessor approach. Disclosures
Issues Paper

Objective

1 The purpose of this session is to seek EFRAG TEG's views on the IASB's latest tentative decisions on its research project on Business Combinations under Common Control (BCUCC), in particular how to:

(a) apply a predecessor approach to measure consideration paid by the receiving entity;

(b) present in equity the difference between the consideration paid and the carrying amounts of the net assets received; and

(c) disclosure requirements for BCUCC.

2 The views expressed in paragraph 1 will be used in preparing the EFRAG draft comment letter on the upcoming discussion paper on BCUCC together with the views already expressed by EFRAG TEG on previous tentative decisions.

Background

3 The IASB's project on BCUCC considers (only) how to account for a business combination under common control in the financial statements of the entity acquiring the business.

4 In 2019, EFRAG TEG discussed the IASB's tentative decisions on when to apply a current value approach or a predecessor approach to BCUCC. According to the IASB's proposals a current value approach would be applied if the BCUCC is affecting non-controlling shareholders of the receiving entity unless:

(a) The reporting entity is privately held, and all its non-controlling shareholders have been informed about and have not objected to the receiving entity applying a predecessor approach. In that case the entity is allowed to apply a predecessor approach.

(b) The reporting entity is privately held, and all non-controlling shareholders are the receiving entity's related parties. In that case the entity is required to apply a predecessor approach.

5 EFRAG TEG members were generally supportive of the IASB's proposals to apply a current value approach based on the acquisition method as set out in IFRS 3 *Business Combinations* to the particular subset of BCUCC, however, members expressed concerns regarding the practical application of the proposed exemption allowing the receiving entity to apply a predecessor approach when its equity instruments are not publicly traded and its non-controlling shareholders do

not object applying that approach. Some members commented that a current value approach should be applied to all BCUCC.

6 EFRAG TEG members considered the IASB proposal to apply the acquisition method and recognise the excess fair value of the acquired identifiable net assets over the fair value of the consideration transferred as a **contribution** to the receiving entity's equity. Members expressed broad support for the proposed application of the acquisition method.

7 Additionally, EFRAG TEG considered some of the application aspects of the predecessor approach, in particular:

(a) a receiving entity should recognise and measure assets and liabilities transferred at the carrying amounts included in the financial statements of the transferred entity; and

(b) pre-combination information in primary financial statements should be provided only about the receiving entity i.e. comparative figures should not be restated for all the combining entities.

8 In January 2020, the IASB discussed the remaining aspects of how to apply a predecessor approach, including:

(a) how to measure the consideration paid in BCUCC and how transaction costs should be accounted for; and

(b) how any difference between the consideration paid and the carrying amounts of assets and liabilities received in BCUCC should be presented.

9 In February 2020, the IASB discussed disclosure requirements for BCUCC.

10 The latest developments on the BCUCC project as mentioned in paragraphs 8 and 9 are included in this paper for EFRAG TEG's consideration.

Consideration paid and transaction costs

11 When considering how to measure the consideration paid in BCUCC, the IASB studied different scenarios as laid out below.

Consideration paid in the form of own shares

12 It is expected that the IASB's forthcoming discussion paper will state that when applying a predecessor approach, the assets and liabilities received in BCUCC would be recognised by the receiving entity at their predecessor carrying amounts and the difference between the consideration paid and the carrying amounts of those assets and liabilities should be recognised in the receiving entity's equity.

13 When the receiving entity pays for the transfer using its own shares, the IASB considered whether to measure those shares at book value or at their fair value. The measurement of the consideration paid would affect the presentation within the receiving entity's equity, however, it would not affect the total carrying amount of that equity as illustrated in Example 1 of Appendix 1.

14 In addition, considering the fact that the measurement of issued shares and presentation requirements in the reporting entity's equity are often subject to legal requirements which are different between jurisdictions, the IASB decided not to prescribe how the receiving entity should measure the consideration paid in its own shares and where in equity it should present the difference between the consideration paid and the carrying amounts of assets and liabilities received.

Consideration paid in the form of assets

15 In contrast, measuring the consideration paid in the form of assets other than cash at fair value or at their carrying amounts at the date of combination would affect any gain or loss recognised by the receiving entity on derecognition of those assets. If the consideration is measured at the carrying amounts of those assets, no gain or loss on disposal would be recognised, however, if consideration is measured at fair value, a gain or loss on disposal would be recognised.

16 Similar to measuring consideration paid in its own shares, measuring consideration paid in the form of assets at fair value or at their carrying amounts would also affect presentation within the receiving entity's equity but would not affect the total carrying amount of the entity's equity as illustrated in Example 2 of Appendix 1.

17 The IASB considered measuring the consideration paid in the form of assets at fair value, however, the following concerns were expressed:

(a) BCUCC is an equity transaction with owners in their capacity as owners and not a simple sale transaction; and

(b) measuring the consideration paid in the form of assets at fair value does not meet users' needs as there is no cash flow to the receiving entity but rather to the ultimate parent.

18 Consequently, the IASB tentatively decided to require entities to measure consideration paid in assets at the carrying amounts of those assets at the date of the combination.

Consideration paid by incurring liabilities to or assuming liabilities from the transferor

19 In limited circumstances, the receiving entity might provide part or all of the consideration paid for BCUCC by incurring new liabilities, or by assuming existing liabilities of the transferring entity such instances can be incurring or assuming financial liabilities, performance obligations, pensions, provisions.

20 The measurement of the consideration paid by incurring liabilities to or assuming liabilities from a transferor at fair value or at the carrying amounts of those liabilities, determined using applicable IFRS Standards on initial recognition of those liabilities, at the date of combination would not have an effect on any gain or loss recognised by the receiving entity in the profit or loss. However, measurement of the consideration paid in such liabilities would affect the carrying amount of the receiving entity's equity.

21 The IASB has tentatively decided to measure the consideration paid in the form of incurred liabilities towards the transferor or liabilities assumed from the transferor at the carrying amounts of those liabilities, as determined in accordance with applicable IFRS Standards, on the initial recognition of those liabilities at the date of the combination.

Transaction costs

22 The IASB staff has conducted a review of requirements or guidance on reporting transaction costs in national GAAPS in different jurisdiction. The review showed that when such guidance existed, transaction costs directly attributable to BCUCC are required to be recognised as an expense in profit or loss.

23 Similar to the accounting for acquisition-related costs when applying the acquisition method, the IASB staff is of the view that transaction costs directly attributable to BCUCC should be recognised as an expense in the statement of profit or loss in the period in which they are incurred. This is because those costs do not represent

assets for the receiving entity in BCUCC because the benefits are consumed as the services are received.

24 Furthermore, the costs of issuing debt and equity instruments are included in the initial measurement of those instruments in accordance with the requirements in with IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments*.

25 Consequently, the IASB tentatively decided to require entities to recognise transaction costs as an expense in the statement of profit or loss in the period in which they are incurred. Respectively, to recognise costs related to the issue of debt or equity instruments in accordance with IAS 32 and IFRS 9.

Questions for EFRAG TEG

26 Does EFRAG TEG agree with the IASB's tentative decision not to prescribe how the receiving entity should measure the consideration paid in its own shares and where in equity it should present the difference between the consideration paid and the carrying amounts of assets and liabilities received as referred to in paragraph 14?

27 Does EFRAG TEG agree with the IASB's tentative decision to require entities to measure consideration paid in assets at the carrying amounts of those assets at the date of the combination as described in paragraph 18?

28 Does EFRAG TEG agree with the IASB's tentative decision to measure the consideration paid in the form of incurred liabilities towards the transferor or liabilities assumed from the transferor at the carrying amounts of those liabilities as reflected in paragraph 21?

29 Does EFRAG TEG agree with the IASB's tentative decision to require entities to recognise transaction costs as an expense in the statement of profit or loss in the period in which they are incurred except for costs related to the issue of debt or equity instruments which should be accounted for under the requirements of IAS 32 and IFRS 9 as explained in paragraph 25?

The difference between the consideration paid and the carrying amounts of assets and liabilities received

30 Applying a predecessor approach, the difference between the consideration paid and the carrying amounts of assets and liabilities received in BCUCC is recognised in equity, however such presentation within equity could vary.

31 Generally, changes in equity arise either from transactions with owners in their capacity with owners or from comprehensive income. The difference between the consideration paid and the carrying amounts of assets and liabilities received applying a predecessor method does not represent either of those events or at least not in its totality. The difference could include the following components:

(a) any difference between the carrying amounts of assets and liabilities and their fair values;

(b) any difference between the fair value of assets and liabilities received and the fair value of the transferred business as a whole;

(c) any difference between the fair value of the transferred business and the total amount of the consideration paid.

32 However, when a predecessor method is used, separating the difference into some or all of its components could be complex and not even possible. Such separation could create costs and complexity for preparers; involve a significant degree of measurement uncertainty and create additional complexity for users to understand.

33 Consequently, the IASB has tentatively decided to require entities to recognise as a change in equity any difference between the consideration paid and the carrying amounts of assets and liabilities received. However, the IASB has decided not to prescribe in which component or components of equity the receiving entity would present that difference.

Question for EFRAG TEG

34 Does EFRAG TEG agree with the IASB's tentative decision to require entities to recognise as a change in equity any difference between the consideration paid and the carrying amounts of assets and liabilities received and not to prescribe where in equity this difference should be presented as reflected in paragraph 33?

Disclosure for BCUCC

35 In February 2020, the IASB discussed and tentatively decided what information about BCUCC should be disclosed by reporting entities depending on the measurement approach used to account for the transaction.

36 Business combinations under common control that affect the non-controlling shareholders of the receiving entity were considered to be similar to acquisitions under the scope of IFRS 3. The IASB therefore assessed that the non-controlling shareholders in such transactions need similar information about all business combinations regardless of whether the transactions are under common control or not.

37 Consequently, the IASB tentatively decided that when the **acquisition method** is used to account for BCUCC the receiving entity would apply all disclosure requirements in IFRS 3 and all preliminary views on disclosure to be published in the discussion paper *Business Combinations – Disclosures, Goodwill and Impairment*.

38 The IASB also tentatively decided that it should provide guidance on applying the disclosure requirements of IFRS 3 and IAS 24 *Related Party Disclosures* for BCUCC.

39 When the **predecessor method** is used to account for BCUCC, the IASB tentatively decided that the receiving entity should:

(a) apply the following disclosure requirements in IFRS 3 and in the discussion paper *Business Combinations – Disclosures, Goodwill and Impairment*:

(i) the disclosure objective of providing information to help users of financial statements to evaluate the nature, the financial effect and the expected benefits of a combination (paragraph 59 of IFRS 3);

(ii) the name and the description of the transferred entity, the combination date, the percentage of voting equity interests transferred to the receiving entity, the primary reasons for the combination and a description of how the receiving entity obtained control (paragraphs B64(a)-(d) of IFRS 3);

(iii) the recognised amounts of each major class of assets and liabilities assumed, including information about recognised amounts of liabilities arising from financing activities and defined benefit pension liabilities (paragraph B64(i) of IFRS 3 and the suggestions included in the discussion paper *Business Combinations – Disclosures, Goodwill and Impairment*);

(iv) the carrying amount of non-controlling interest (paragraph B64(o) of IFRS 3);

(v) the requirement to provide aggregate information for individually immaterial combinations (paragraph B65 of IFRS 3);

(vi) the disclosure requirements for combinations that occur after the end of the reporting period but before the financial statements are authorised for issue (paragraph B66 of IFRS 3);

(vii) the amount and an explanation of any gain or loss that relates to assets and liabilities received if such disclosure is relevant to understanding the combined entity's financial statements (paragraph B67(e) of IFRS 3); and

(viii) the requirement to disclose whatever additional information is necessary to meet the applicable disclosure objectives (paragraph 63 of IFRS 3).

(b) disclose the amount recognised in equity for the difference between the consideration paid and the carrying amounts of assets and liabilities received, and the component of equity in which that difference is recognised.

Next steps

40 In February 2020, the IASB concluded its deliberation on its research project BCUCC. The IASB decided to publish a discussion paper as a next consultation document. The discussion paper is expected to be published at the end of June 2020 and the comment period for the discussion paper will be determined at a future IASB meeting.

Questions for EFRAG TEG

41 Does EFRAG TEG agree with the IASB tentative decision regarding disclosure requirements for BCUCC when the **acquisition method** is used to account for the transaction (paragraph 37)?

42 Does EFRAG TEG agree with the IASB tentative decision regarding disclosure requirements for BCUCC when the **predecessor method** is used to account for the transaction (paragraph 39)?

Appendix 1: Supporting examples

Introduction

1 The following two examples are provided for illustration purposes, in particular:

(a) Example 1 illustrates how the different measurement of consideration paid in own shares would affect presentation within the receiving entity's equity; and

(b) Example 2 illustrates how the different measurement of consideration paid in the form of assets would affect presentation within the receiving entity's equity.

2 The examples were prepared by the IASB staff and included in agenda paper 23B for the IASB meeting in January 2020.

Example 1: Measurement of consideration paid in own shares

Parent A wholly owns and controls Entity B and Entity C. Entity B issues 1,000 shares to Parent A to acquire Entity C. Par value of the shares of Entity B is CU2 per share. At the date of the combination, the fair value of shares of Entity B is CU2.2 per share. The carrying amount of the assets and liabilities of Entity C at the date of the combination is CU2,500. Entity B could reflect the combination as follows:

	Alternative 1–shares issued are measured at par value		**Alternative 2–shares issued are measured at fair value**	
	Debit	*Credit*	*Debit*	*Credit*
Net assets received	CU2,500		CU2,500	
Equity: share capital		CU2,000		CU2,000
Equity: share premium		—		200[(a)]
Equity: difference arising applying a predecessor approach [(b)]		500		300

(a) Difference between the fair value and the par value of the shares issued.

(b) Difference between the consideration paid (the par value or the fair value of the shares issued applying Alternative 1 and Alternative 2 respectively) and the carrying amounts of the assets and liabilities received.

As illustrated in the example applying Alternative 1 and Alternative 2, measurement of the consideration paid in the form of own shares would affect presentation within the receiving entity's equity but would not affect the total carrying amount of its equity.

Example 2: Measurement of consideration in the form of assets

Parent A wholly owns and controls Entity B and Entity C. Entity B acquires Entity C in exchange for an item of Entity B's property. At the date of combination, the carrying amount of that property is CU2,000 and its fair value is CU2,200. Carrying amount of the assets and liabilities of Entity C at the date of the combination is CU2,500. Entity B would reflect the combination as follows:

	Alternative 1–consideration is measured at the carrying amount of the transferred asset		**Alternative 2–consideration is measured at the fair value of the transferred asset**	
	Debit	*Credit*	*Debit*	*Credit*
Net assets received	CU2,500		CU2,500	
Asset transferred		CU2,000		CU2,000
Profit or loss / retained earnings		—		200[a]
Equity: difference arising applying a predecessor approach [b]		500		300

(a) Difference between the fair value and the carrying amount of the asset transferred.

(b) Difference between the consideration paid (the carrying amount or the fair value of the transferred asset applying Alternative 1 and Alternative 2 respectively) and the carrying amounts of the assets and liabilities received.

As illustrated in the example applying Alternative 1 and Alternative 2, measurement of the consideration paid in the form of assets would affect any gain or loss on disposal recognised in the statement of profit or loss and would affect presentation within the receiving entity's equity but would not affect the total carrying amount of its equity.