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Business combinations under common control

Issues Paper

Objective

- 1 The purpose of this issues paper is the following:
 - (a) to provide a summary of EFRAG TEG's written comments on an issues paper discussing how to apply the predecessor approach and the current value approach to a business combination under common control (BCUCC); and
 - (b) to seek EFRAG TEG's views and suggestions on a questionnaire to be distributed to EFRAG CFSS members in March on existing guidance and possible outreach activities with national standard-setters on the BCUCC project. The questionnaire is included in Appendix 1.

Summary of EFRAG TEG's written comments

- 2 In January 2020, EFRAG TEG was asked to provide written comments on an issues paper on BCUCC discussing the application of the predecessor approach and the current value approach by the receiving entity when accounting for transactions within the scope of the BCUCC project.
- 3 Ten EFRAG TEG members responded to the written consultation and provided their comments by the end of the comment period, Friday 7 February. Those comments have been summarised in the following paragraphs.
- 4 Regarding the application of the predecessor approach, two alternatives have been identified to be used by the receiving entity in BCUCC:
 - (a) **Alternative A** – to recognise assets and liabilities of the transferred entity at the carrying amounts included in the financial statements of the transferred entity; or
 - (b) **Alternative B** - to recognise assets and liabilities of the transferred entity at the carrying amounts included in the consolidated financial statements of the transferred entity's controlling party which could be an immediate parent of the transferred entity, an intermediate parent or the ultimate parent of the transferred entity.
- 5 The majority of EFRAG TEG members disagreed with the IASB tentative decision that the receiving entity should use the carrying amounts of assets and liabilities in the financial statements of the transferred entity to account for BCUCC as reflected in Alternative A.
- 6 Six EFRAG TEG members preferred that the receiving entity measure the acquired net assets in a BCUCC by recognising the assets and liabilities of the transferred entity at the carrying amounts included in the consolidated financial statements of the transferred entity's controlling party which could be the immediate parent, an

intermediate parent or the ultimate parent of the transferred entity (Alternative B). The main reasons for disagreement were the following:

- (a) existing local guidance – which prescribes the receiving entity to use the carrying amounts included in the consolidated financial statements of the transferred entity’s controlling party. Members providing this reason noted that there is no sufficient justification to change the established practice;
 - (b) Alternative B will facilitate consolidation; and
 - (c) ensure continuity at group level reporting.
- 7 The majority of EFRAG TEG members agreed with the IASB tentative decision to present pre-combination information in the primary financial statements only about the receiving entity i.e. the comparative figures should not be presented to reflect how they would have been had the transfer taken place at the start of the comparative periods. One EFRAG TEG member disagreed and commented that the combined financial statements prepared retrospectively might contain different numbers than the first IFRS financial statements following the BCUCC transaction.
- 8 All EFRAG TEG members agreed with the IASB tentative decision to require the receiving entity to recognise a contribution in its equity and measure it at the difference between the fair value of the acquired identifiable net assets and the fair value of the consideration transferred instead of recognising a gain on a bargain purchase in the statement of profit or loss. An additional comment was made that the IASB should give further consideration to the reciprocal accounting treatment by the transferring entity – whether the transferring entity should show a profit or loss on disposal or should limit any profit or loss by the contribution recognised by the receiving entity.
- 9 EFRAG TEG members were split as to whether the next due process document on the BCUCC project should be a discussion paper or an exposure draft. Those in favour of a discussion paper considered that the IASB proposals on the project were not sufficiently consulted and researched upon, therefore, the project would benefit from the input received from a discussion paper.
- 10 In addition, some EFRAG TEG members commented that:
- (a) the forthcoming discussion on how to deal with the difference between the fair value of the consideration transferred and the carrying amounts of assets and liabilities received might impose wider use of current value accounting;
 - (b) the exception to apply a current value approach to transaction affecting non-controlling shareholders of the receiving entity when the receiving entity’s equity instruments are not publicly traded and all its shareholders have been informed and agreed to apply predecessor approach is not practical and should be removed;
 - (c) the IASB tentative decision to differentiate the accounting model for BCUCC based on the existence of non-controlling shareholders in the receiving entity should be challenged through a discussion paper.

Questions for EFRAG TEG

- 11 Do EFRAG TEG members have any additional comments on the summary of feedback provided?

Appendix 1: Questionnaire for EFRAG CFSS members

Introduction

- 1 In anticipation of the forthcoming IASB discussion paper on BCUCC, EFRAG is seeking feedback from EFRAG CFSS members on two main areas:
 - (a) **Part 1** - to help assess the importance of the BCUCC project in Europe and determine what is the local guidance and established current accounting practice within the jurisdictions; and
 - (b) **Part 2** – to obtain preliminary views on the tentative decisions of the IASB on the project so far. The EFRAG Secretariat acknowledge that some of those tentative decisions have already been discussed with EFRAG CFSS members in the past, however, as the BCUCC project has advanced, the EFRAG Secretariat would like to obtain members' views on the proposals.
- 2 Additionally, based on the feedback received, EFRAG would like to gather initial indications of EFRAG CFSS members on whether they would like to participate in outreach activities related to the BCUCC project.

Questions to EFRAG CFSS members

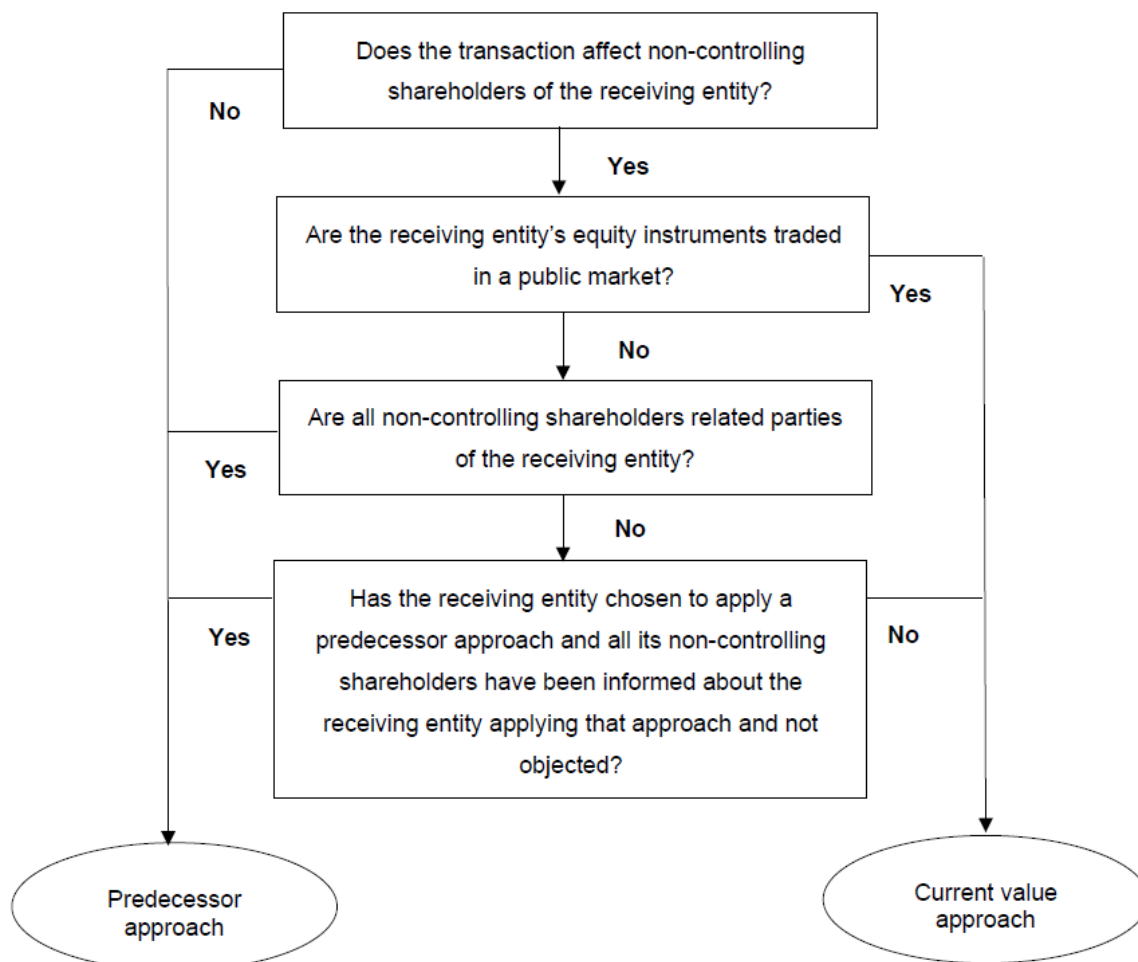
Part 1 - to assess the importance of the BCUCC project in a European perspective

- 3 EFRAG would like to seek EFRAG CFSS members input with regard to how common BCUCC are and whether local guidance on BCUCC exists within your jurisdictions:
 - (a) **Question 1** – How common is it in your jurisdiction that an entity under common control is transferred to a receiving entity that has to report under IFRS?
 - (i) It happens about as regularly or more regularly than business combinations that are not under common control.
 - (ii) A rough estimate would be that it only happens between five and eight times for every ten business combinations that are not under common control.
 - (iii) A rough estimate would be that it only happens between one and four times for every ten business combinations that are not under common control.
 - (iv) A rough estimate would be that it only happens between one and nine times for every hundred business combinations that are not under common control. It happens less than once for every hundred business combinations that are not under common control.
 - (b) **Question 2** – Is the frequency for how often an entity under common control is transferred to a receiving entity that has to report under IFRS significantly higher for some entities than others? If so, are there any characteristics that are common for the entities for which the frequency is higher? If so, what are those characteristics?
 - (c) **Question 3** – Does local GAAP in your jurisdiction include any guidance on how to account for BCUCC? If so, what does the guidance say?
 - (d) **Question 4** – Is there a common practice in your jurisdiction for how to account for BCUCC? If so, please explain the practice.
 - (e) **Question 5** – Does local GAAP in your jurisdiction include any requirements for disclosures around BCUCC (in addition to any general disclosure requirements on business combinations)? If so, what are those requirements?

- (f) **Question 6** - What financial reporting issues are you aware of in relation to reporting BCUCC for preparers, regulators or users of financial information?

Part 2 - to obtain EFRAG CFSS's preliminary views on the IASB tentative decisions on the BCUCC project so far. The tentative decisions of the IASB on how to account for a BCUCC in the receiving entity's financial statements are presented below.

- 4 The graph below illustrates the IASB tentative decisions as to when to apply a current value approach or a predecessor approach when accounting for BCUCC.



Source: the IASB

- 5 The IASB concluded that a single measurement approach for all business combinations under common control was not appropriate. Therefore, the IASB tentatively decided that to the extent BCUCC are similar to acquisitions within the scope of IFRS 3, a current value approach should be applied; for all other BCUCC a predecessor approach should be applied. BCUCC affecting the non-controlling shareholders of the receiving entity are similar to acquisitions within the scope of IFRS 3 and therefore, applying a current value approach would provide the most useful information to primary users. In this respect, do you consider that the IASB tentative decision to apply different measurement approaches to BCUCC depending on whether the BCUCC affects the non-controlling shareholders of the receiving entity is well justified?
- 6 Do you agree with the IASB tentative decision to apply a current value approach based on the acquisition method as set out in IFRS 3 to all or some transactions that affect non-controlling shareholders of the receiving entity except when the

receiving entity's equity instruments are not publicly traded and one of the following conditions applies:

- (a) all non-controlling shareholders are related parties to the receiving entity; or
- (b) the receiving entity chooses to apply a predecessor approach and all its non-controlling shareholders have been informed about and do not object it?

7 Do you agree with the IASB tentative decision to apply a form of a predecessor approach to all other transactions within the scope of the project?

8 The IASB tentatively decided on the particular application aspects of the predecessor approach including:

- (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.

What are EFRAG CFSS members views on the particular aspects as to how the predecessor approach should be applied?

9 In December 2019, the IASB tentatively decided to modify the acquisition method when applied to BCUCC and to present a contribution to the receiving entity's equity when the acquired identifiable net assets exceed the consideration transferred instead of recognising that excess as a gain on a bargain purchase in the statement of profit or loss. On the other hand, the IASB concluded that a symmetrical recognition of a distribution from the receiving entity's entity, when the consideration transferred in excess of the value received, would be infrequent as it would represent overpayment on the part of the receiving entity. Therefore, the IASB decided **not** to require recognition of a distribution and include the excess consideration in the initial measurement of goodwill. Based on these tentative decisions, the questions for you are:

- (a) do you agree with the tentative decision of the IASB to apply the acquisition method set out in IFRS 3 to 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?
- (b) do you agree with the IASB tentative decision **not** to identify, recognise and measure a **distribution** when the consideration transferred is higher than the fair value of the acquired identifiable net assets?