November 2020

IFRS® Standards
Discussion Paper

Snapshot
Business Combinations under Common Control

This Snapshot provides an overview of the Discussion Paper *Business Combinations under Common Control* published by the International Accounting Standards Board (Board).

The Board's objective:	To explore possible reporting requirements for business combinations under common control that would reduce diversity in practice, improve transparency in reporting these combinations and provide users of financial statements with better information.
Project stage:	The Board has published a Discussion Paper that sets out its preliminary views. The Board is seeking comments on: • the selection of the measurement method; • how to apply each measurement method; and • the disclosure of information about these combinations.
Next steps:	The Board will consider the comments received on the Discussion Paper before deciding whether to develop an exposure draft containing proposals to implement any or all of its preliminary views.
Comment deadline:	1 September 2021

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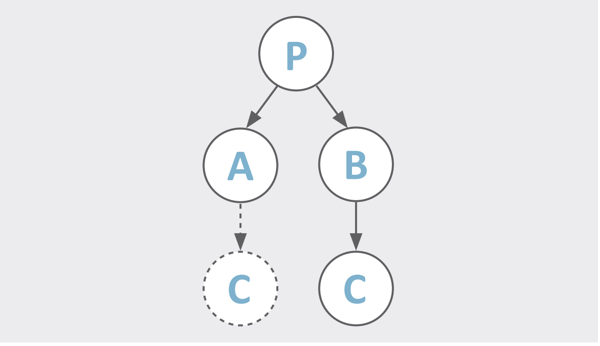
Why is the Board undertaking this project?

What are business combinations under common control?

Business combinations under common control are mergers and acquisitions involving companies within the same group. Diagram 1 shows a simple example of a business combination under common control. Companies A, B and C are all controlled by the same party, Company P. Company C is transferred from Company A to Company B.

Diagram 1—A business combination under common control



What problem is the project trying to solve?

IFRS 3 *Business Combinations* sets out reporting requirements for business combinations and requires the use of the acquisition method. However, no IFRS Standard specifically applies to business combinations under common control.

As a result of this gap in IFRS Standards, companies report these combinations in different ways. In some cases, they use the acquisition method. That method measures the assets and liabilities received in the combination at fair value and recognises goodwill. In other cases, companies use a book-value method. That method measures those assets and liabilities at their existing book values. There is a variety of book-value methods used in practice. Furthermore, companies often provide little information about these combinations.

What has the Board heard?

Diversity in practice makes it difficult for investors to understand the effects of these transactions and to compare companies that undertake them.

These combinations are common in many countries around the world, particularly in emerging economies.

Developing reporting requirements for these combinations should be a priority. Listed companies and those preparing for listing are a particular concern.

The project is considering whether and when the acquisition method and a book-value method should be used for business combinations under common control to provide users of financial statements with better information about these combinations.

What is the scope of the project?

The project focuses on filling the gap in IFRS Standards.

Which transactions?

The project is considering transfers of businesses under common control. In Diagram 2, Company C is a business, and its transfer is therefore within the scope of the project. The project is not considering transfers of assets under common control or transfers of companies that do not have a business.

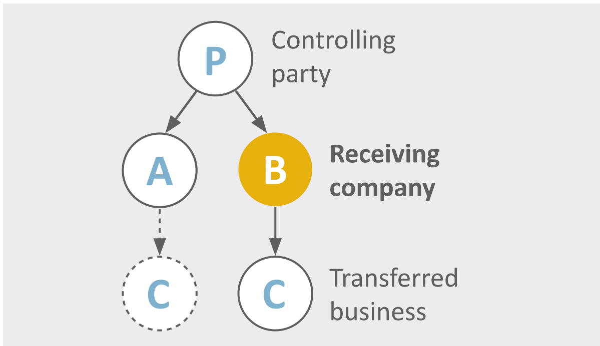
Which company?

The project is considering reporting by the receiving company. In Diagram 2, the receiving company is Company B. The project is not considering reporting by other parties affected by the transaction.

Which financial statements?

The possible reporting requirements explored in the project will typically affect the receiving company's consolidated financial statements only.

Diagram 2—Illustrating the scope of the project



The possible reporting requirements explored in this project would apply, for example, to receiving companies that are listed on a stock exchange and to those preparing for listing.

Users of financial statements

This project focuses on the information needs of users of the receiving company's financial statements who must rely on that company's financial statements for much of the information they need. Such users are the receiving company's existing non-controlling shareholders, potential shareholders, and its lenders and other creditors.

The project does not seek to address the controlling party's information needs. In Diagram 2, the controlling party is Company P. The controlling party controls the receiving company and, therefore, can direct that company to provide the information the controlling party needs. It does not need to rely on the receiving company's financial statements for that information.

When to apply each method—introduction

How did the Board reach its preliminary views?

The Board considered:

- whether and when business combinations under common control are similar to business combinations covered by IFRS 3;
- what information would be useful to investors and other users of the receiving company's financial statements;
- the trade-off between the costs and the benefits of providing particular information; and
- whether particular approaches would be complex, or could create opportunities to structure transactions to achieve a particular accounting outcome.

What has the Board heard?

Business combinations covered by IFRS 3 and business combinations under common control are ...

View A	View B	View C
always different from each other, because ...	**always similar to each other, because ...**	**similar in some, but not all, cases, because ...**
the transfer of a business under common control does not change the ultimate control of that business. The controlling party simply moves its economic resources from one 'location' to another within the group.	the receiving company gains control of a business in either combination. The controlling party's perspective is irrelevant because the project considers reporting by the receiving company.	business combinations under common control are not all the same. They might be similar to combinations covered by IFRS 3 if, for example, the receiving company has non-controlling shareholders outside the group.
A book-value method should be used in all cases.	**The acquisition method should be used except when not justified on cost-benefit grounds.**	**The method used should depend on the circumstances.**

The Board's view is that one size does not fit all—for some business combinations under common control, the acquisition method should be used, and for the others a book-value method should be used.

When to apply each method—outside shareholders

Combinations that affect non-controlling shareholders

Diagrams 3 and 4 illustrate a business combination and a business combination under common control that affect non-controlling shareholders of the receiving company. In both scenarios, Company B gains control of Company C. As a result, non-controlling shareholders acquire an ownership interest in the economic resources transferred in the combination in both scenarios. From the point of view of both the receiving company and those shareholders, the transactions are similar.

The users of the receiving company's financial statements are also similar in both scenarios and comprise its existing non-controlling shareholders, potential shareholders, and its lenders and other creditors. Because both the combinations are similar and the users of the financial statements are similar, the users' information needs about these combinations are similar too.

The Board's view is that the acquisition method should be used for combinations that affect non-controlling shareholders, subject to the cost-benefit trade-off.

Diagram 3—Non-controlling shareholders: Combination covered by IFRS 3

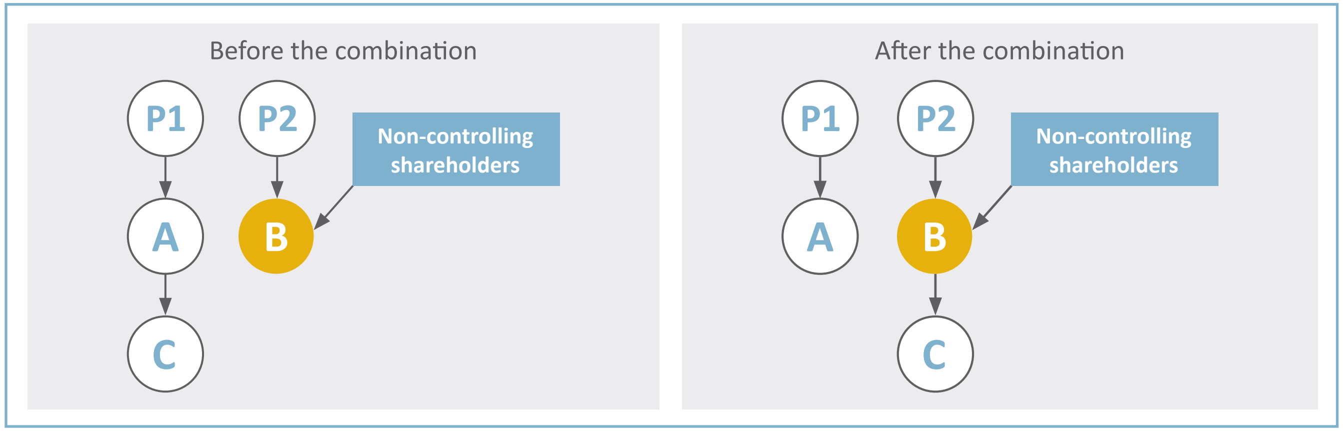
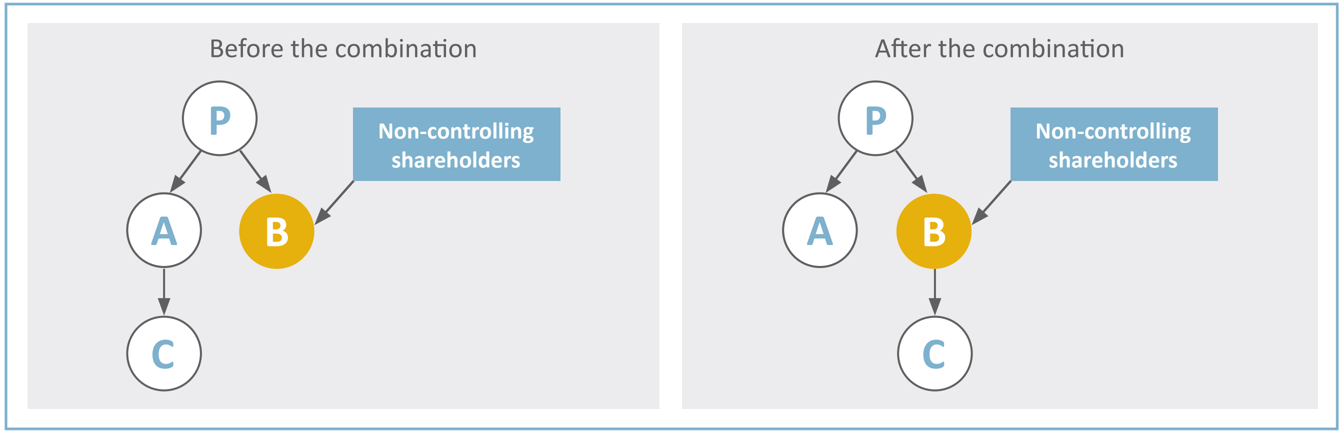


Diagram 4—Non-controlling shareholders: Common control



When to apply each method—costs and benefits

What has the Board heard?

The acquisition method should be applied only if the ownership interest of non-controlling shareholders is 'substantive'.

The costs of applying the acquisition method might not be justified when those shareholders have only a 'small' ownership interest.

If all of the receiving company's shareholders are its related parties, the costs of applying the acquisition method might not be justified.

Opportunities to structure transactions to achieve a particular accounting outcome might arise if the acquisition method is required for *all* combinations that affect non-controlling shareholders.

Receiving company's shares are publicly traded

The Board's view is that the costs of applying the acquisition method would be justified for publicly traded companies. Typically, listing requirements or capital market regulations would:

- prevent the listing of a 'small' number of shares; and
- limit how many shares can be held by the company's related parties.

Therefore, the Board's view is that publicly traded receiving companies should be required to apply the acquisition method.

Receiving company's shares are privately held

The Board's view is that the costs of applying the acquisition method might not always be justified for privately held companies and is therefore suggesting special conditions for such companies, namely:

An optional exemption—a privately held receiving company would be *permitted* to use a book-value method if it has informed all of its non-controlling shareholders that it proposes to use that method and they have not objected.

A related-party exception—a privately held receiving company would be *required* to use a book-value method if all non-controlling shareholders are related parties of the company.

The Board is not suggesting that the related-party exception to or the optional exemption from the acquisition method should apply to publicly traded companies. However, the Board is seeking feedback about whether (and, if so, how) the exception or the exemption should also apply to such companies.

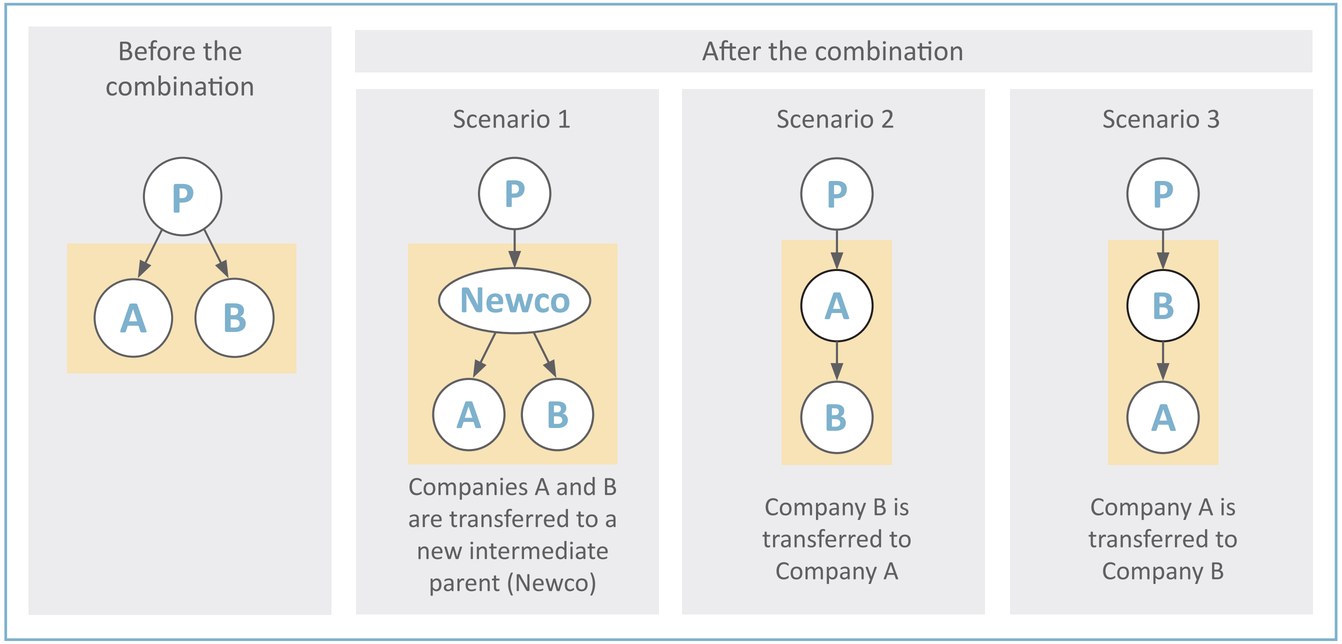
When to apply each method—no outside shareholders

Combinations that do not affect non-controlling shareholders

In Diagram 5, the controlling party, Company P, decides to restructure its wholly-owned subsidiaries, companies A and B, in preparation for an initial public offering. It could undertake that restructuring in various ways. However, in all scenarios potential shareholders would be investing in the same economic resources, as indicated by the shaded area in Diagram 5.

A book-value method would provide useful information about these combinations to potential shareholders of the combining companies, because the information produced by that method does not depend on how the combination is structured. A book-value method would also avoid the difficulties that could arise if the acquisition method was applied to combinations that do not affect non-controlling shareholders. For example, it would avoid the need to decide which company is the 'economic' acquirer. That decision is fundamental in applying the acquisition method but could be difficult to make for combinations illustrated in Diagram 5.

Diagram 5—Group restructuring in preparation for an initial public offering



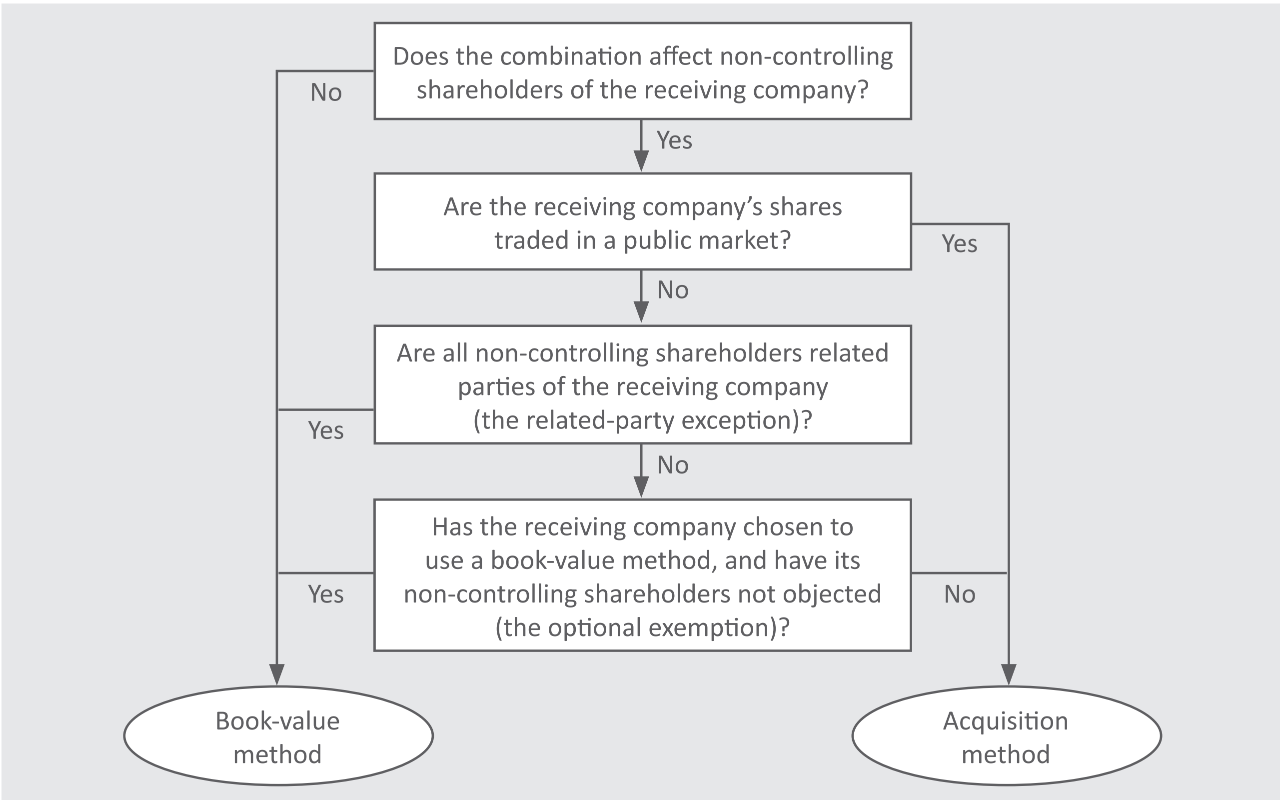
The Board's view is that a book-value method should be applied to business combinations under common control that do not affect non-controlling shareholders of the receiving company.

When to apply each method—in summary

Diagram 6 summarises the criteria that would determine when a receiving company should use the acquisition method and when it should use a book-value method. All those criteria are objective and designed to produce similar outcomes in similar circumstances, while taking into account cost-benefit considerations.

The Board's view is that its suggested approach would not be unduly complex, because both methods are already in use. Furthermore, all of the criteria for selecting the method are based on conditions already used in IFRS Standards. For example, IFRS Standards describe a public market and define related parties. The condition used in the optional exemption is also used in IFRS Standards for exempting privately held companies from particular requirements in specified circumstances.

Diagram 6—Summary of the Board's preliminary views



How to apply the acquisition method

A recap of the acquisition method

The acquisition method set out in IFRS 3 assumes that the consideration paid in the combination is negotiated at arm's length and reflects the fair value of the acquired business and the price paid for any synergies expected from the combination.

The acquisition method measures the assets and liabilities received in the combination at fair value.[1] The difference between the fair value of those assets and liabilities and the fair value of the consideration paid is recognised as goodwill. In an arm's length transaction, goodwill is expected to comprise, as illustrated in Diagram 7A:

- goodwill that exists in the acquired business. It is measured as the difference between the fair value of that business as a whole and the fair value of its assets and liabilities.
- the price paid for the expected synergies.

In a rare case of a bargain purchase, a gain is recognised in the statement of profit or loss. The gain is equal to the difference between the fair value of the consideration paid and the fair value of the assets and liabilities received.

1 The acquisition method recognises all identifiable assets and liabilities acquired in a business combination.

What is the issue?

In principle, the Board's view is that the acquisition method should be applied just as set out in IFRS 3. However, in a business combination under common control, the consideration paid might not have been negotiated. Instead, it might have been set by the controlling party. If that consideration differs from the consideration that would have been paid in an arm's length transaction, that difference suggests that the combination includes an additional component that is not present in a combination between unrelated parties—a distribution from, or a contribution to, the receiving company's equity, as illustrated in Diagrams 7A and 7B.

Diagram 7A—Consideration paid is higher than in an arm's length transaction

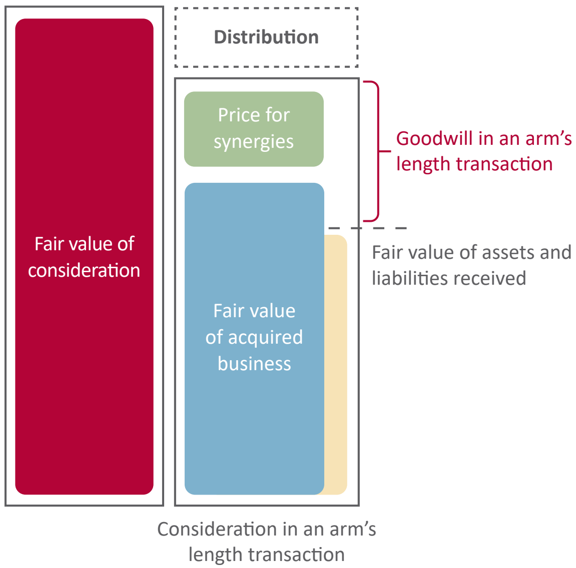
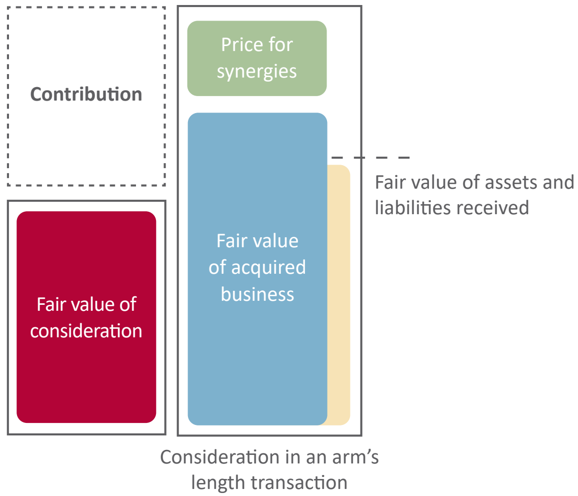


Diagram 7B—Consideration paid is lower than in an arm's length transaction



How to apply the acquisition method (continued)

Should the receiving company identify, measure and recognise a distribution from, or a contribution to, equity in a business combination under common control when the acquisition method is used?

What has the Board heard?

A distribution or a contribution is unlikely to occur in a transaction that affects non-controlling shareholders.

A distribution would be difficult to measure. An 'overpayment' can also occur in a business combination covered by IFRS 3 and is not reported separately.

Investors need information about how the transaction price was set so that they can make their own assessments.

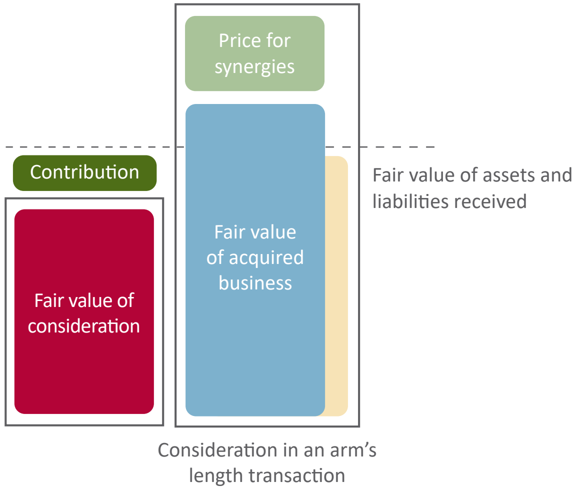
Should a distribution from equity be recognised?

The Board's view is that the receiving company should not be required to identify, measure and recognise a distribution from equity. Instead, the receiving company should disclose information about the terms of the combination, including how the transaction price was set. Any 'overpayment' would be included in goodwill that would be subject to impairment testing, just as occurs in reporting a business combination covered by IFRS 3.

Should a contribution to equity be recognised?

The Board's view is that the receiving company should recognise a contribution to equity if the fair value of the assets and liabilities received in a business combination under common control exceeds the fair value of the consideration paid, as illustrated in Diagram 8—instead of recognising that difference as a gain on a bargain purchase in the statement of profit or loss, as required by IFRS 3.

Diagram 8—Measuring a contribution to equity



How to apply a book-value method

What is the issue?

A book-value method is not described in IFRS Standards. In practice, a variety of book-value methods are used. The Board's view is that IFRS Standards should prescribe a single book-value method.

The Board focused on how the receiving company should:

- measure the assets and liabilities received;
- measure the consideration paid;
- report the difference between those amounts; and
- provide pre-combination information.

The Board also considered what disclosures a company should provide when it applies a book value method.

How to measure the assets and liabilities received?

In practice when applying a book-value method, companies sometimes measure the assets and liabilities received using their book values reported by the transferred company. In other cases, they use the book values reported by the controlling party.

Those book values would typically be identical if the controlling party has controlled the transferred company since the creation of that company. However, those book values could differ if, for example, the transferred company has previously been acquired from a party outside the group.

The Board's view is that the receiving company should measure the assets and liabilities received at their book values reported by the transferred company.

How to measure the consideration paid?

In practice when applying a book-value method, companies sometimes measure the consideration paid at fair value. In other cases, they measure the consideration paid at book value—or, in case of the consideration paid in the receiving company's own shares, at their par value or a nominal value.

The Board's view is that the consideration paid should be measured as follows:

- If consideration is paid in assets—at the book values of those assets.
- If consideration is paid by incurring a liability—at the amount determined on recognition of that liability applying IFRS Standards.

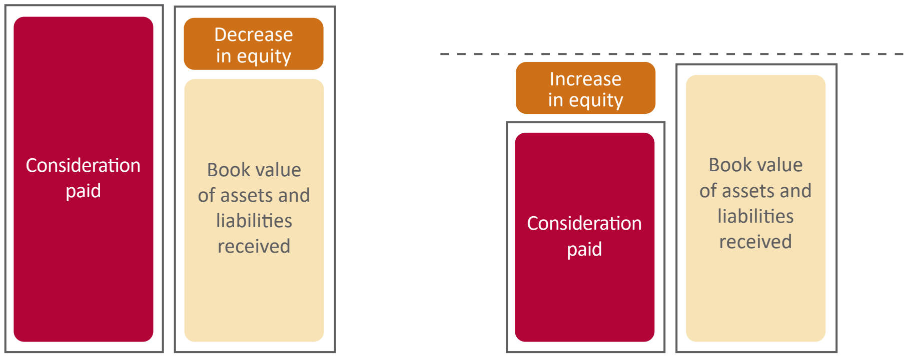
The Board's view is that it should not prescribe how the consideration paid in the receiving company's own shares should be measured.

How to apply a book-value method (continued)

How to report the difference between the consideration paid and the assets and liabilities received?

The Board's view is that the difference between the consideration paid and the assets and liabilities received should be recognised in equity, as illustrated in Diagram 9. This approach is consistent with current practice.

Diagram 9—Illustrating a book-value method



Consideration paid is higher than book value of assets and liabilities received

Consideration paid is lower than book value of assets and liabilities received

How to provide pre-combination information?

In practice when applying a book-value method, companies sometimes include the transferred company in their financial statements from the combination date and do not restate pre-combination information.

In other cases, companies include the transferred company in their financial statements from the beginning of the comparative period and restate pre-combination information.

The Board's view is that the receiving company should include the transferred company in its financial statements from the date of combination and, hence, should not restate its pre-combination information.

What information to disclose?

The Board's view is that:

- some, but not all, of the disclosure requirements in IFRS 3 are appropriate when applying a book-value method; and
- the receiving company should disclose the amount recognised in equity for the difference between the consideration paid and the book value of the assets and liabilities received, and the component, or components, of equity that includes that difference.

How to apply each method—in summary

	How to apply the acquisition method?	How to apply a book-value method?
	Generally, the acquisition method should be applied as set out in IFRS 3.	**IFRS Standards would specify a single book-value method.**
How to measure the assets and liabilities received?	Measure the assets and liabilities received at their fair values.	Measure the assets and liabilities received at their existing book values reported by the transferred company.
How to measure the consideration paid?	Measure all forms of the consideration paid at fair value.	In general, measure the consideration paid at book value (the Board would not prescribe how to measure the consideration paid in own shares).
How to report the difference between those amounts?	Recognise any such difference as goodwill or, in rare cases, as a contribution to equity instead of as a gain in the statement of profit or loss.	Recognise any such difference as a decrease or increase in equity.
How to provide pre-combination information?	Include the transferred company from the combination date, without restating pre-combination information.	Include the transferred company from the combination date, without restating pre-combination information.
What information to disclose?	• Disclose all information required by IFRS 3. • Provide information about the terms of the combination, including how the transaction price was set.	• Disclose some, but not all, information required by IFRS 3. • Provide information about the difference between the consideration paid and the assets and liabilities received.

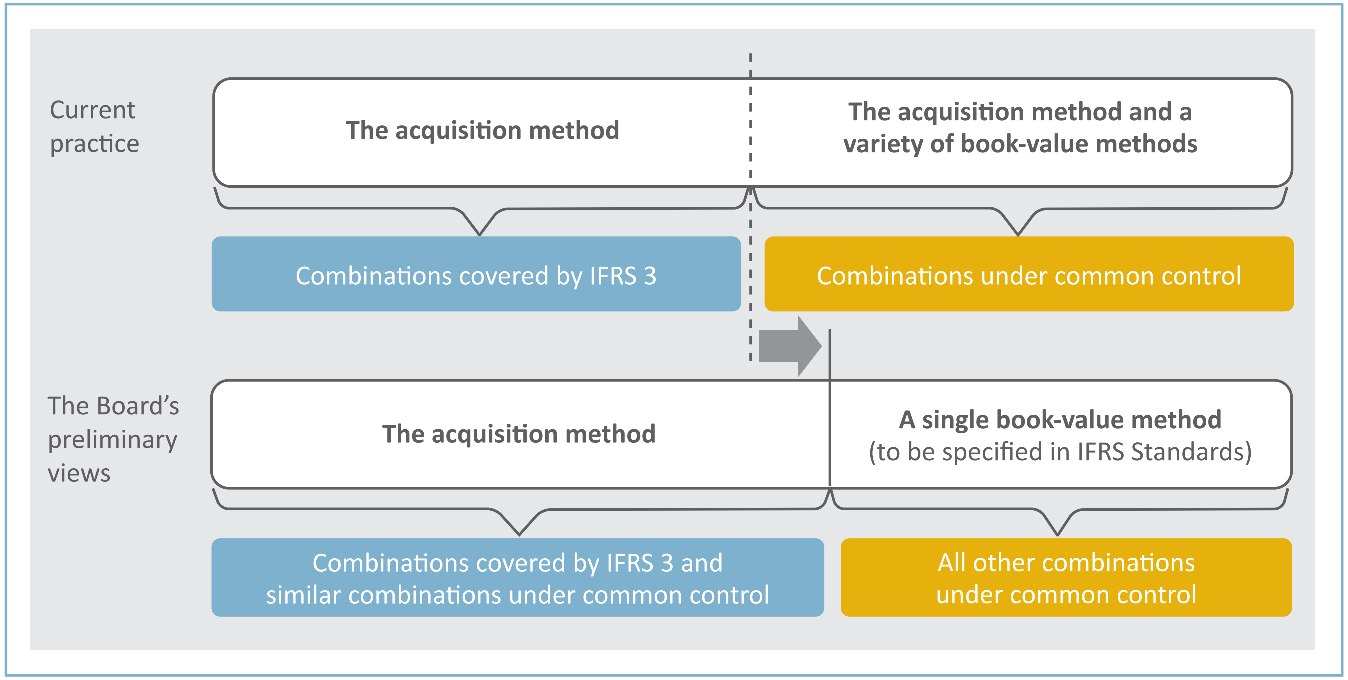
The effects of the Board's preliminary views

If the Board confirms its preliminary views and they are implemented, diversity in practice would be reduced, transparency in reporting would be improved and users of financial statements would receive better information because:

- the acquisition method would be applied both to business combinations covered by IFRS 3 and to similar business combinations under common control when the benefits of applying that method outweigh the costs;
- IFRS Standards would specify which method should be applied in which circumstances, so that companies undertaking similar transactions would apply the same accounting policies; and
- IFRS Standards would specify a single book-value method, thus eliminating the diversity caused by the variety of book-value methods currently used.

The overall effects of the Board's preliminary views are illustrated in Diagram 10.

Diagram 10—The overall effects of implementing the Board's preliminary views



Further information

The deadline for comments on the Discussion Paper is 1 September 2021.

All parties are invited to respond to the questions in the Discussion Paper. The Board will welcome responses even if respondents do not comment on all questions.

To stay up to date with the latest developments in this project and to sign up for email alerts, please visit www.ifrs.org/projects/work-plan/business-combinations-under-common-control/.

This document

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