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Discussion Paper DP/2020/2

# Business Combinations under Common Control

Comments to be received by 1 September 2021

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# **Business Combinations under Common Control**

*Comments to be received by 1 September 2021*

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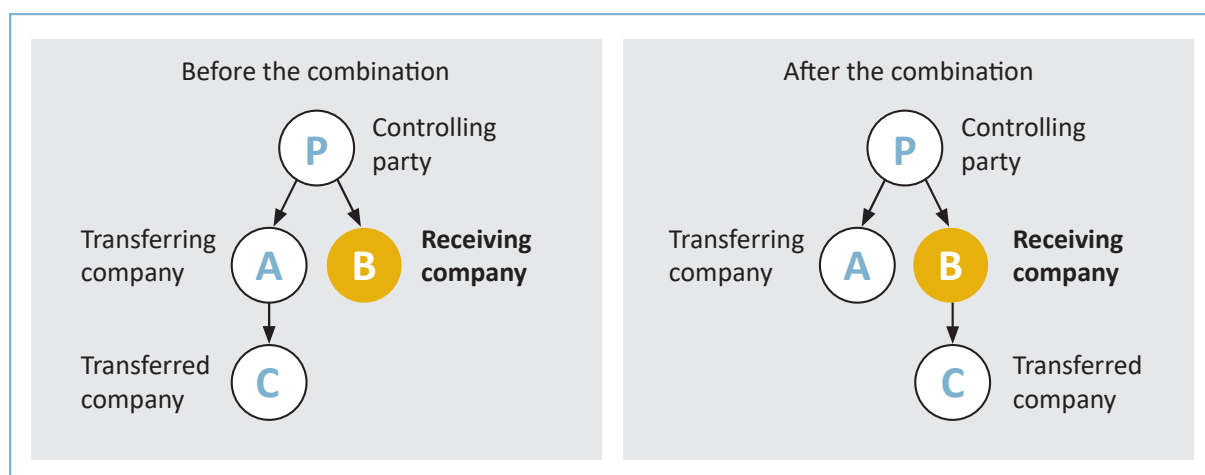
## Introduction and invitation to comment

This Discussion Paper is designed to be accessible to a wide audience. It uses diagrams, colour and, where possible, simple non-technical language. Appendix A sets out the meanings of the terms defined in this Discussion Paper. Defined terms are in **bold type** the first time they appear in each section.

### Why is the Board publishing this Discussion Paper?

IN1 The International Accounting Standards Board (Board) is undertaking a research project on **business combinations under common control**—combinations in which all of the combining companies or **businesses** are ultimately controlled by the same party, both before and after the combination. Diagram IN.1 provides a simple example of a business combination under common control.

**Diagram IN.1—A business combination under common control**



IN2 In the example in Diagram IN.1, control of Company C is transferred from Company A to Company B. All three companies are ultimately controlled by Company P, the **controlling party**, both before and after the transaction. IFRS Standards provide requirements on how companies P, A and C should report this transaction (see paragraph 1.19). However, no IFRS Standard specifically applies to how Company B (the **receiving company**) should report its combination with Company C (the **transferred company**)—such combinations are outside the scope of IFRS 3 *Business Combinations*. In the absence of a specifically applicable IFRS Standard, the receiving company is required to develop its own accounting policy for these transactions.<sup>1</sup>

IN3 The Board is carrying out a research project on business combinations under common control in response to stakeholder feedback that the lack of a specifically applicable IFRS Standard for such combinations has resulted in diversity in practice. Furthermore, companies often provide little information about such combinations. The objective of the project is to explore possible reporting requirements for a receiving company that would reduce that diversity in practice and provide users of the receiving company's financial statements with better information about these combinations.

<sup>1</sup> IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

IN4 This Discussion Paper summarises the results of this research. It sets out the Board’s preliminary views on such possible reporting requirements and seeks feedback on those preliminary views.

## Who will be affected if the preliminary views in this Discussion Paper are implemented?

IN5 If the preliminary views in this Discussion Paper are implemented, they would result in new requirements for business combinations under common control. Any such requirements would apply to the financial statements of the receiving company—the company to which control of one or more companies or businesses has been transferred in the combination. (In Diagram IN.1, the receiving company is Company B.) Typically, those possible reporting requirements would apply to the receiving company’s consolidated financial statements only. However, in some circumstances, those possible reporting requirements would also apply to other types of financial statements prepared by the receiving company (see paragraphs 1.20–1.23 and B.16–B.18).

IN6 If the preliminary views are implemented, diversity in practice would be reduced and the reporting of business combinations under common control by the receiving company would be more transparent and result in more relevant and more comparable information about these combinations.

IN7 The preliminary views would not affect reporting by the controlling party, the **transferring company** or the transferred company (companies P, A and C in Diagram IN.1).

## How did the Board reach its preliminary views?

IN8 In reaching its preliminary views, the Board considered:

- (a) whether and when business combinations under common control are similar to **business combinations** covered by IFRS 3;
- (b) what information would be useful to users of the receiving company’s financial statements;
- (c) whether the benefits of providing particular information would justify the costs of providing it;
- (d) how complex particular approaches would be; and
- (e) whether particular approaches would create opportunities for accounting arbitrage (sometimes called ‘structuring opportunities’).

IN9 In exploring these factors, the Board considered research and feedback from consultations conducted during the project, which included:

- (a) an analysis of the requirements and guidance in IFRS Standards and the *Conceptual Framework for Financial Reporting (Conceptual Framework)*;
- (b) a review of national requirements and recent consultation documents issued by national standard-setters, guidance published by accounting firms, academic papers, reports, articles and other literature;

- (c) consultations with investors and analysts, national standard-setters, regulators, and preparers of financial statements, including consultations with the following bodies that advise the Board: the Capital Markets Advisory Committee, the Accounting Standards Advisory Forum, the Global Preparers Forum and the Emerging Economies Group;
- (d) a desktop review of current reporting practice;<sup>2</sup> and
- (e) a review of corporate credit-rating methodologies of two leading credit-rating agencies.<sup>3</sup>

## What does this Discussion Paper include?

IN10 This Discussion Paper discusses a range of issues that would need to be addressed to set up reporting requirements for business combinations under common control. The Discussion Paper groups these issues into five broad topics, and provides the Board's preliminary views and questions for respondents on each topic. The topics are:

- (a) the project's objective, scope and focus (Section 1);
- (b) selection of the measurement method (Section 2);
- (c) how to apply the **acquisition method** (Section 3);
- (d) how to apply a **book-value method** (Section 4); and
- (e) disclosure requirements (Section 5).

## What are the next steps?

IN11 The views expressed in this Discussion Paper are preliminary and may change. The Board will consider the comments it receives in response to this Discussion Paper before deciding whether to develop an exposure draft containing proposals to implement any or all of its preliminary views.

## Invitation to comment

IN12 The Board invites comments on the Discussion Paper *Business Combinations under Common Control*, particularly on the questions set out in paragraphs IN14–IN19, which are repeated in the related sections of the Discussion Paper. Comments are most helpful if they:

- (a) address the questions as stated;
- (b) indicate the specific paragraphs or preliminary views to which they relate;
- (c) contain a clear rationale;
- (d) identify any wording in the preliminary views that is difficult to translate; and
- (e) include any alternative the Board should consider, if applicable.

IN13 The Board is requesting comments only on matters addressed in this Discussion Paper.

<sup>2</sup> The desktop review covered annual reports published in English from 1 January 2018 to 31 March 2019 in various jurisdictions. The review identified 207 annual reports that disclosed 267 business combinations under common control.

<sup>3</sup> More information about the research and consultations with stakeholders conducted in the project is provided in the staff papers considered by the Board during the development of this Discussion Paper. For example, see February 2020 [Agenda Paper 23B Due process](#) for a summary of consultations with stakeholders (Appendix B), the desktop review of current reporting practice (Appendix C) and the review of academic literature (Appendix D).



## Questions for respondents

### Project scope

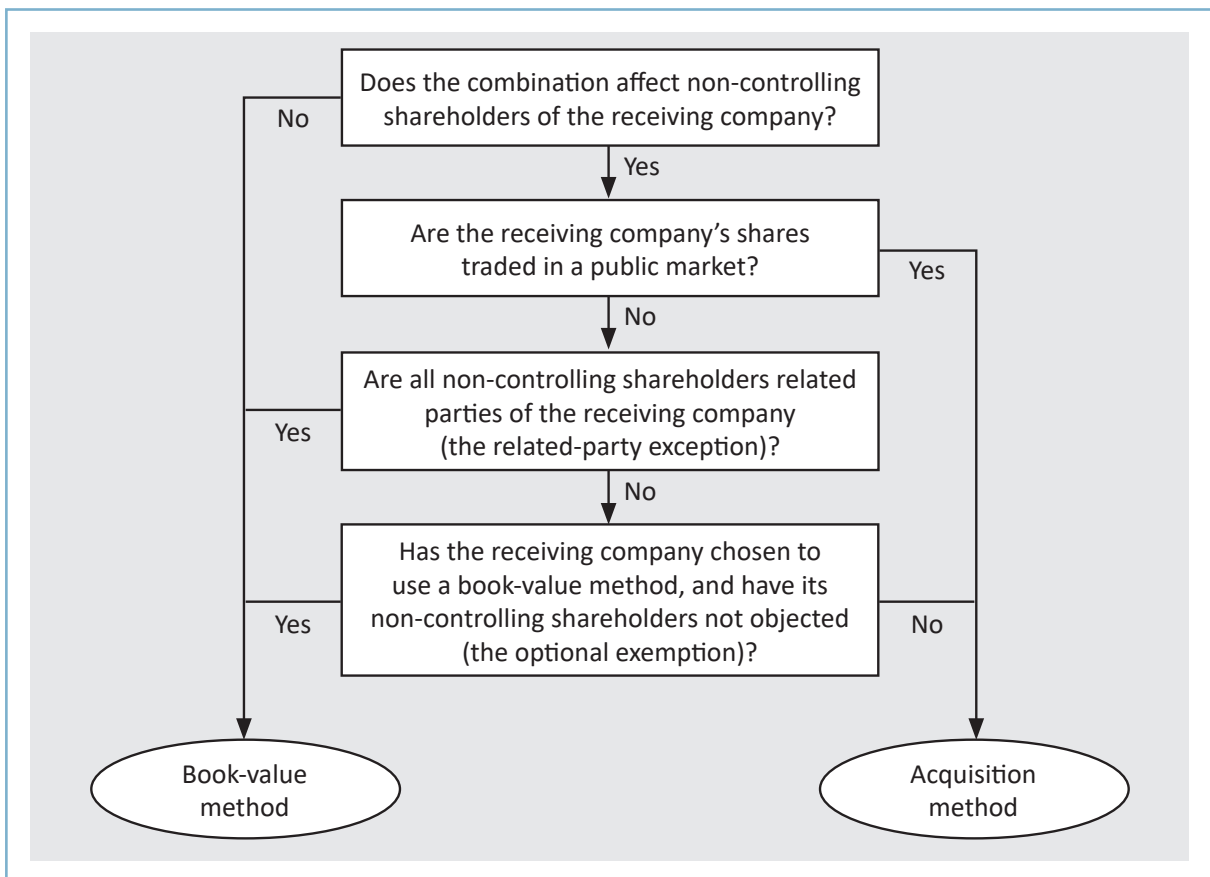
IN14 Section 1 outlines the project’s objective, scope and focus. It explains that the Board’s ultimate goal is to fill a ‘gap’ in IFRS Standards relating to how a receiving company should report a business combination under common control.

Project Scope
<p><b>Question 1</b></p> <p>Paragraphs 1.10–1.23 discuss the Board’s preliminary view that it should develop proposals that cover reporting by the receiving company for all transfers of a business under common control (in the Discussion Paper, collectively called business combinations under common control) even if the transfer:</p> <ul style="list-style-type: none"> <li>(a) is preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies to an external party (that is, a party outside the group); or</li> <li>(b) is conditional on a sale of the combining companies to an external party, such as in an initial public offering.</li> </ul> <p>Do you agree with the Board’s preliminary view on the scope of the proposals it should develop? Why or why not? If you disagree, what transactions do you suggest that the Board consider and why?</p>

### Selecting the measurement method

IN15 Section 2 discusses which measurement methods should apply to business combinations under common control. The Board has reached the preliminary view that neither the acquisition method nor a book-value method should be applied to *all* business combinations under common control. Instead, the acquisition method should be applied to some such combinations and a book-value method should be applied to all other such combinations.

IN16 The Board’s preliminary views on when each method should be used are summarised in Diagram IN.2.

**Diagram IN.2—Summary of the Board’s preliminary views**

## Selecting the measurement method

## Question 2

Paragraphs 2.15–2.34 discuss the Board’s preliminary views that:

- (a) neither the acquisition method nor a book-value method should be applied to *all* business combinations under common control.

Do you agree? Why or why not? If you disagree, which method do you think should be applied to all such combinations and why?

- (b) in principle, the acquisition method should be applied if the business combination under common control affects non-controlling shareholders of the receiving company, subject to the cost–benefit trade-off and other practical considerations discussed in paragraphs 2.35–2.47 (see Question 3).

Do you agree? Why or why not? If you disagree, in your view, when should the acquisition method be applied and why?

- (c) a book-value method should be applied to all other business combinations under common control, including all combinations between wholly-owned companies.

Do you agree? Why or why not? If you disagree, in your view, when should a book-value method be applied and why?

## Selecting the measurement method

## Question 3

Paragraphs 2.35–2.47 discuss the cost–benefit trade-off and other practical considerations for business combinations under common control that affect non-controlling shareholders of the receiving company.

- (a) In the Board’s preliminary view, the acquisition method should be *required* if the receiving company’s shares are traded in a public market.

Do you agree? Why or why not?

- (b) In the Board’s preliminary view, if the receiving company’s shares are privately held:

- (i) the receiving company should be *permitted* to use a book-value method if it has informed all of its non-controlling shareholders that it proposes to use a book-value method and they have not objected (the optional exemption from the acquisition method).

Do you agree with this exemption? Why or why not? Do you believe that the exemption will be workable in practice? If not, in your view, how should such an exemption be designed so that it is workable in practice?

- (ii) the receiving company should be *required* to use a book-value method if all of its non-controlling shareholders are related parties of the company (the related-party exception to the acquisition method).

Do you agree with this exception? Why or why not?

- (c) If you disagree with the optional exemption (Question 3(b)(i)) or the related-party exception (Question 3(b)(ii)), in your view, how should the benefits of applying the acquisition method be balanced against the costs of applying that method for privately held companies?

## Selecting the measurement method

## Question 4

Paragraphs 2.48–2.54 discuss suggestions from some stakeholders that the optional exemption from and the related-party exception to the acquisition method should also apply to publicly traded companies. However, in the Board’s preliminary view, publicly traded receiving companies should always apply the acquisition method.

- (a) Do you agree that the optional exemption from the acquisition method should *not* be available for publicly traded receiving companies? Why or why not? If you disagree, in your view, how should such an exemption be designed so that it is workable in practice?

- (b) Do you agree that the related-party exception to the acquisition method should *not* apply to publicly traded receiving companies? Why or why not?

## Applying the acquisition method

IN17 Section 3 discusses how to apply the acquisition method to business combinations under common control. It explains that, in principle, the receiving company should apply the acquisition method as set out in IFRS 3. However, in some such combinations, the amount of the consideration paid might differ from what would have been paid in an arm's length transaction with an unrelated party. Accordingly, the Board considered whether it should develop special requirements for the receiving company to recognise any such difference as a distribution from equity or contribution to equity.

### Applying the acquisition method

#### Question 5

Paragraphs 3.11–3.20 discuss how to apply the acquisition method to business combinations under common control.

- (a) In the Board's preliminary view, it should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity when applying the acquisition method to a business combination under common control.

Do you agree? Why or why not? If you disagree, what approach for identifying and measuring a distribution from equity do you recommend and why? In particular, do you recommend either of the two approaches discussed in Appendix C or do you have a different recommendation?

- (b) In the Board's preliminary view, it should develop a requirement for the receiving company to recognise any excess fair value of the identifiable acquired assets and liabilities over the consideration paid as a contribution to equity, not as a bargain purchase gain in the statement of profit or loss, when applying the acquisition method to a business combination under common control.

Do you agree? Why or why not? If you disagree, what approach do you recommend and why?

- (c) Do you recommend that the Board develop any other special requirements for the receiving company on how to apply the acquisition method to business combinations under common control? If so, what requirements should be developed and why are any such requirements needed?

## Applying a book-value method

IN18 Section 4 discusses how to apply a book-value method to business combinations under common control. In practice, a variety of book-value methods are used. However, the Board would specify a single book-value method in IFRS Standards. The matters discussed in Section 4 include:

- (a) measuring the assets and liabilities received;
- (b) measuring the consideration paid;
- (c) reporting any difference between the consideration paid and the book value of the assets and liabilities received;
- (d) reporting transaction costs; and
- (e) providing pre-combination information.

## Applying a book-value method

## Question 6

Paragraphs 4.10–4.19 discuss the Board’s preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should measure the assets and liabilities received using the transferred company’s book values.

Do you agree with the Board’s preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

## Applying a book-value method

## Question 7

Paragraphs 4.20–4.43 discuss the Board’s preliminary views that:

- (a) the Board should not prescribe how the receiving company should measure the consideration paid in its own shares when applying a book-value method to a business combination under common control; and
- (b) when applying that method, the receiving company should measure the consideration paid as follows:
  - (i) consideration paid in assets—at the receiving company’s book values of those assets at the combination date; and
  - (ii) consideration paid by incurring or assuming liabilities—at the amount determined on initial recognition of the liability at the combination date applying IFRS Standards.

Do you agree with the Board’s preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

## Applying a book-value method

## Question 8

Paragraphs 4.44–4.50 discuss the Board’s preliminary views that:

- (a) when applying a book-value method to a business combination under common control, the receiving company should recognise within equity any difference between the consideration paid and the book value of the assets and liabilities received; and
- (b) the Board should not prescribe in which component, or components, of equity the receiving company should present that difference.

Do you agree with the Board’s preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

## Applying a book-value method

## Question 9

Paragraphs 4.51–4.56 discuss the Board’s preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should recognise transaction costs as an expense in the period in which they are incurred, except that the costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS Standards.

Do you agree with the Board’s preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

## Applying a book-value method

## Question 10

Paragraphs 4.57–4.65 discuss the Board’s preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should include in its financial statements the assets, liabilities, income and expenses of the transferred company prospectively from the combination date, without restating pre-combination information.

Do you agree with the Board’s preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

## Disclosure requirements

IN19 Section 5 discusses what information the receiving company should disclose about business combinations under common control. It sets out the Board’s preliminary view that all the disclosure requirements in IFRS 3 should apply to combinations to which the acquisition method is applied, including any improvements to those requirements resulting from the Board’s Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*. However, only some of those disclosure requirements are appropriate for combinations to which a book-value method is applied.

## Disclosure requirements

## Question 11

Paragraphs 5.5–5.12 discuss the Board’s preliminary views that for business combinations under common control to which the acquisition method applies:

- (a) the receiving company should be required to comply with the disclosure requirements in IFRS 3 *Business Combinations*, including any improvements to those requirements resulting from the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*; and
- (b) the Board should provide application guidance on how to apply those disclosure requirements together with the disclosure requirements in IAS 24 *Related Party Disclosures* when providing information about these combinations, particularly information about the terms of the combination.

Do you agree with the Board’s preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

**Question 12**

Paragraphs 5.13–5.28 discuss the Board’s preliminary views that for business combinations under common control to which a book-value method applies:

- (a) some, but not all, of the disclosure requirements in IFRS 3 *Business Combinations*, including any improvements to those requirements resulting from the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*, are appropriate (as summarised in paragraphs 5.17 and 5.19);
- (b) the Board should not require the disclosure of pre-combination information; and
- (c) the receiving company should disclose:
  - (i) the amount recognised in equity for any difference between the consideration paid and the book value of the assets and liabilities received; and
  - (ii) the component, or components, of equity that includes this difference.

Do you agree with the Board’s preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

**Deadline**

IN20 The Board will consider all comments received in writing by 1 September 2021.

**How to comment**

IN21 Please submit your comments electronically.

Online <https://www.ifrs.org/projects/open-for-comment/>

By email [commentletters@ifrs.org](mailto:commentletters@ifrs.org)

IN22 Your comments will be on the public record and posted on our website unless you request confidentiality and we grant your request. We do not normally grant such requests unless they are supported by a good reason, for example, commercial confidence. Please see our website for details on this and on how we use your personal data.

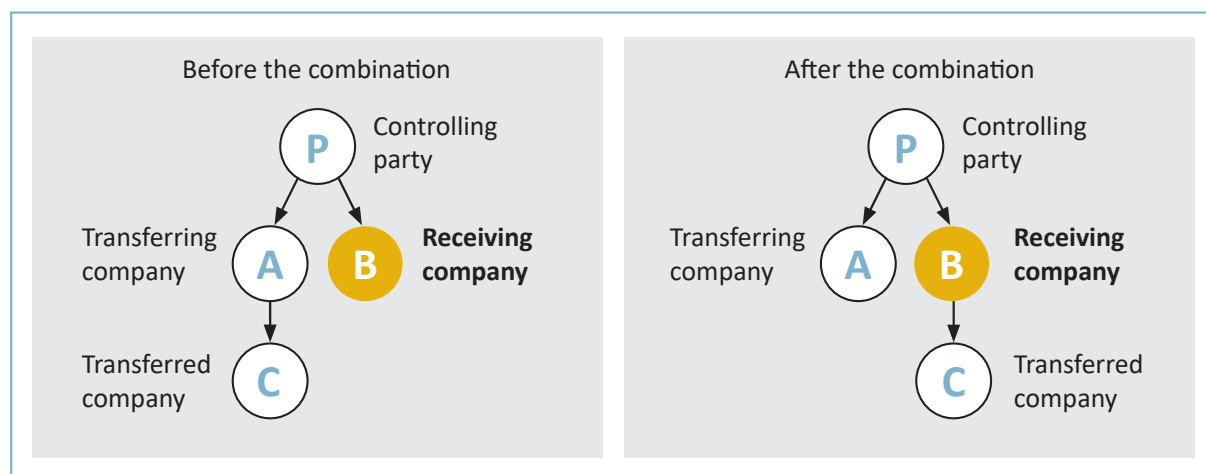
## Section 1—Objective, scope and focus

- 1.1 This section sets out background information for the research project on **business combinations under common control** (paragraphs 1.2–1.8) and discusses:
- the objective of the project (paragraph 1.9);
  - the scope of the project (paragraphs 1.10–1.23);
  - the focus of the project (paragraphs 1.24–1.29); and
  - the interaction between the project and the International Accounting Standards Board’s (Board’s) other projects (paragraph 1.30).

### Background

- 1.2 Accounting requirements for **business combinations**—sometimes called mergers and acquisitions—are set out in IFRS 3 *Business Combinations*. However, the scope of IFRS 3 explicitly excludes business combinations under common control—combinations in which all of the combining companies or **businesses** are ultimately controlled by the same party (or parties), both before and after the combination.
- 1.3 Diagram 1.1 provides a simple example of a business combination under common control.

**Diagram 1.1—A business combination under common control**



- 1.4 In the example in Diagram 1.1, control of Company C is transferred from Company A to Company B. All three companies are ultimately controlled by Company P, the **controlling party**, both before and after the transaction. IFRS Standards provide requirements on how companies P, A and C should report this transaction (see paragraph 1.19). However, no IFRS Standard specifically applies to how Company B (the **receiving company**) should report its combination with Company C (the **transferred company**).
- 1.5 In the absence of a specifically applicable IFRS Standard, the receiving company is required to develop its own accounting policy for business combinations under common control, applying the requirements on selecting accounting policies in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Developing such a policy involves considering the following sources in descending order:



- (a) the requirements in IFRS Standards dealing with similar and related issues. In some cases, because IFRS 3 deals with business combinations, companies apply the requirements of IFRS 3 to report business combinations under common control, despite the scope exclusion in that Standard.
- (b) guidance in the *Conceptual Framework for Financial Reporting (Conceptual Framework)*.
- (c) the most recent pronouncements issued by other standard-setting bodies that meet specified criteria.<sup>4</sup> Some such bodies have issued requirements or guidance on reporting business combinations under common control.

1.6 Feedback provided to the Board indicates that business combinations under common control occur often in many jurisdictions. That feedback also highlights that the lack of a specifically applicable IFRS Standard has resulted in diversity in practice in preparing financial statements applying IFRS Standards. For example, in some cases companies report these combinations using the **acquisition method** set out in IFRS 3, whereas in other cases companies use a **book-value method**. Also, a variety of book-value methods are used in practice.<sup>5</sup>

1.7 Table 1.1 summarises some of the differences in reporting practice for business combinations under common control, using the simple example in Diagram 1.1.

**Table 1.1—Differences in reporting practice**

	<b>Acquisition method</b>	<b>Book-value method</b>
How does Company B measure the assets and liabilities of Company C received in the combination?	Fair value, with limited exceptions	Book value—various book values are used in practice, for example those reported: <ul style="list-style-type: none"> <li>• by Company C (the transferred company); or</li> <li>• by Company P (the controlling party).</li> </ul>
Does Company B recognise all the identifiable assets and liabilities of Company C received in the combination?	Yes, with limited exceptions	No—only assets and liabilities already recognised before the combination
Does Company B recognise goodwill as a result of the combination?	Yes, unless the combination results in a gain	No
From which date does Company B include in its financial statements the assets, liabilities, income and expenses of Company C?	From the date of the combination	Various approaches are applied—for example, including assets, liabilities, income and expenses of Company C: <ul style="list-style-type: none"> <li>• from the date of the combination; or</li> <li>• from the beginning of the earliest period presented.</li> </ul>

<sup>4</sup> As specified in paragraph 12 of IAS 8.

<sup>5</sup> Various labels are used for book-value methods applied in practice, including the predecessor method, the pooling (or uniting) of interests method and merger accounting. This Discussion Paper uses the term ‘book-value method’ as a collective term for all these methods.

- 1.8 The differences between the two methods—and the diversity in how book-value methods are applied—result in differences in how companies preparing financial statements applying IFRS Standards report similar transactions. Furthermore, companies often provide little information about business combinations under common control. Stakeholders, notably regulators of capital markets, expressed concerns about this diversity in practice when responding to the Board’s 2011 and 2015 agenda consultations. The diversity in practice can make it difficult for users of financial statements to understand how a business combination under common control affected the receiving company and to compare companies that undertake similar transactions.

## Objective of the project

- 1.9 Because of those concerns, the Board began a research project on business combinations under common control. The objective of the project is to explore possible reporting requirements for a receiving company that would reduce diversity in practice and improve the transparency of reporting these combinations. More specifically, the Board aims to provide users of financial statements with better information that is both:
- (a) more relevant—by setting up reporting requirements based on user information needs; and
  - (b) more comparable—by requiring similar transactions to be reported in a similar way.

## Scope of the project

- 1.10 Paragraphs 1.12–1.23 discuss three aspects of the project’s scope:
- (a) which transactions are within the project’s scope (paragraphs 1.12–1.16);
  - (b) which company’s reporting of those transactions is being considered in the project (paragraphs 1.17–1.19); and
  - (c) the types of financial statements in which those transactions are reported (paragraphs 1.20–1.23).
- 1.11 Appendix B elaborates on the discussion in paragraphs 1.12–1.23 using illustrative examples and diagrams.

Which transactions are within the project’s scope?

- 1.12 The research project focuses on business combinations under common control, which are excluded from the scope of IFRS 3. IFRS 3 describes a business combination under common control as:
- a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.<sup>6</sup>

<sup>6</sup> Paragraph B1 of IFRS 3 *Business Combinations*.

- 1.13 A business combination involves the transfer of a business. Accordingly, all transactions being considered in the project involve the transfer of a business under common control. For example, in Diagram 1.1, Company C (the transferred company) must have a business for the transaction to be within the scope of the project. The project is not considering reporting requirements for other types of transactions under common control that do not involve the transfer of a business, for example, transfers of assets (see Examples 1 and 2 in Appendix B). Those transactions are generally addressed by applicable IFRS Standards that do not contain scope exclusions for transactions under common control. Furthermore, the project is not reconsidering reporting requirements for business combinations that are covered by IFRS 3.<sup>7</sup>
- 1.14 For simplicity, this Discussion Paper discusses business combinations under common control that involve the transfer of a company. However, just as is the case for business combinations covered by IFRS 3, business combinations under common control do not necessarily involve the transfer of an entire company. Instead, they could involve a transfer of an unincorporated business (for example, a business operated by an individual person and not within a corporate structure) or of a business that was an unincorporated branch or other part of a company, rather than an entire company.
- 1.15 The project is also considering transactions—sometimes called group restructurings—that involve a transfer of a business under common control but do not meet the definition of a business combination in IFRS 3. For example, some transactions might not meet that definition if they involve transferring a business to a newly established parent company. The Board has reached a preliminary view that it should develop proposals on all transfers of a business under common control, even if the transfer does not meet the definition of a business combination in IFRS 3 (see Example 3 in Appendix B). For simplicity, this Discussion Paper uses the term ‘business combination under common control’ to refer to all such transfers.
- 1.16 In describing business combinations under common control, IFRS 3 requires that common control is ‘not transitory’ but does not provide guidance on that notion. Some stakeholders have raised questions about the meaning of ‘transitory control’, for example, in submissions to the IFRS Interpretations Committee. Those questions arise when considering whether particular combinations are outside the scope of IFRS 3. The Board has not yet considered whether to clarify the meaning of ‘transitory control’ because the outcome of this project could lead to the Board modifying or removing the scope exclusion in IFRS 3. However, in the light of those application questions, the Board has reached the preliminary view that its proposals should cover all transfers of businesses in which all of the combining companies are ultimately controlled by the same party, irrespective of whether the transfer is:
- (a) preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies to an external party (that is, a party outside the group); or
  - (b) conditional on a sale of the combining companies to an external party, such as in an initial public offering (see Example 4 in Appendix B).

### Which company’s reporting?

- 1.17 In undertaking this project, the Board’s goal is to fill a ‘gap’ in IFRS Standards. Accordingly, the project is considering reporting requirements for a receiving company in a business combination under common control. In the example in Diagram 1.1, the receiving company is Company B.

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<sup>7</sup> The Board is conducting another research project on possible improvements to aspects of IFRS 3 (and IAS 36 *Impairment of Assets*), following feedback from the Post-implementation Review of IFRS 3. In that project, the Board published a Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* in March 2020.

- 1.18 The term ‘receiving company’ refers not only to the immediate receiving company in the combination. It also refers to those parent companies (if any) of that immediate receiving company that did not control the transferred company before the combination (see Example 5 in Appendix B).
- 1.19 The project is not considering the reporting requirements for the following other companies involved in the combination illustrated in the example in Diagram 1.1 because IFRS Standards already contain requirements for them:
- (a) Company P (the controlling party)—any effects on Company P are covered by IFRS 10 *Consolidated Financial Statements*;
  - (b) Company C (the transferred company)—the disclosure of information about its new parent (Company B) is covered by IAS 24 *Related Party Disclosures*; and
  - (c) Company A (the **transferring company**)—the loss of control of its subsidiary (Company C) is covered by IFRS 10.

Which types of financial statements?

- 1.20 In general, the project is addressing how a receiving company should report a business combination under common control in its consolidated financial statements.<sup>8</sup> In some cases, the receiving company might not be required to prepare such financial statements. However, consolidated financial statements are required if, for example, the receiving company is **publicly traded** or is preparing to issue its **shares** in a **public market**.
- 1.21 Furthermore, if the combination involves the transfer of an unincorporated business (see paragraph 1.14), the possible reporting requirements developed in this project would also apply in other types of financial statements prepared by the receiving company, such as its separate financial statements.
- 1.22 This Discussion Paper uses the term ‘financial statements’ to refer to all financial statements prepared by the receiving company to which the possible reporting requirements developed in the project would apply (see paragraphs B.16–B.18 in Appendix B).
- 1.23 However, the project is not addressing how a receiving company should report in its separate financial statements an investment in a subsidiary received in a business combination under common control. That topic is addressed by IAS 27 *Separate Financial Statements*.

## Focus of the project

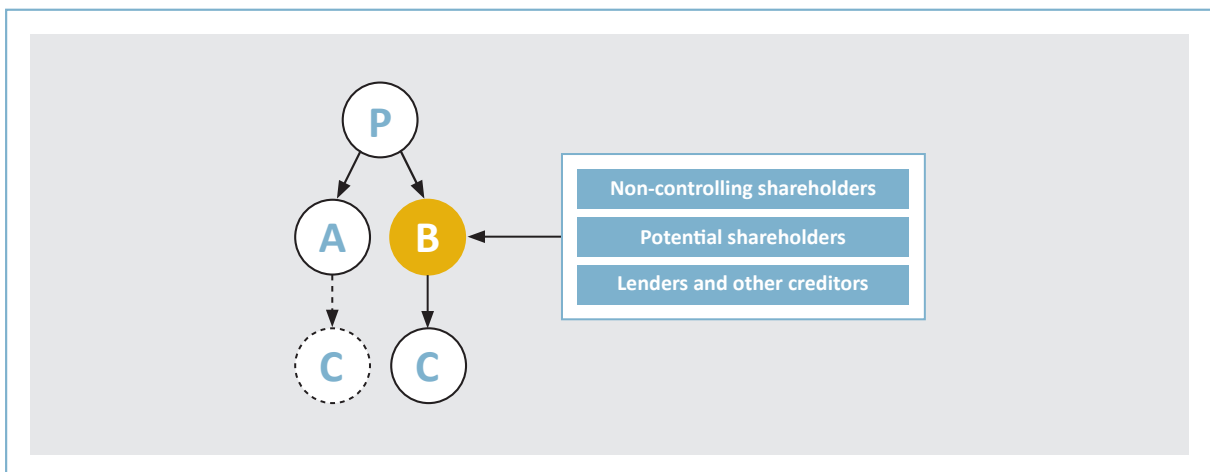
- 1.24 IFRS Standards set reporting requirements for companies that prepare general purpose financial statements. Those financial statements are intended to meet the information needs of the company’s existing and potential shareholders, lenders and other creditors who must rely on those financial statements for much of their information needs because they cannot require the company to provide to them information tailored to their information needs.<sup>9</sup> This Discussion Paper refers to those parties as users of the receiving company’s general purpose financial statements.

<sup>8</sup> In some jurisdictions, the receiving company’s consolidated financial statements are sometimes called sub-consolidated financial statements if the receiving company’s parent company prepares consolidated financial statements for a wider group.

<sup>9</sup> Paragraph 1.5 (including the related footnote 4) of the *Conceptual Framework for Financial Reporting (Conceptual Framework)*.

- 1.25 Existing shareholders of the receiving company in a business combination under common control comprise the controlling party and any **non-controlling shareholders** who own shares in the receiving company at the combination date. However, because the controlling party controls the receiving company, it can obtain the information it needs from the receiving company. One example of such information is information needed to enable the controlling party to prepare its own consolidated financial statements. Another example is information obtained by the controlling party when it exercises its power to direct the activities of the receiving company, such as when the controlling party directs the receiving company to undertake a business combination under common control. In that case, the controlling party would already have information about the combination without using the receiving company's general purpose financial statements. Hence, irrespective of whether the controlling party reviews and analyses those financial statements, that party does not need to rely on those statements for information about the combination.
- 1.26 In contrast, existing non-controlling shareholders, potential shareholders, and existing and potential lenders cannot direct the receiving company to undertake a business combination under common control and are typically not in a position to require the receiving company to provide them with information about that combination. Instead, they must rely on the receiving company's general purpose financial statements for meeting their information needs.
- 1.27 Accordingly, this project does not seek to address the controlling party's information needs—nor the information needs of users of the controlling party's financial statements—although the project might result in the receiving company providing information that is useful to those parties. Rather, this project focuses on the information needs of the receiving company's existing non-controlling shareholders, its potential shareholders and its existing and potential lenders and other creditors who must rely on the receiving company's general purpose financial statements for much of their information needs.
- 1.28 Diagram 1.2 depicts the categories of users of the receiving company's general purpose financial statements whose information needs this project is looking to address.

**Diagram 1.2—Users of the receiving company's financial statements**



- 1.29 A receiving company's non-controlling shareholders, potential shareholders and existing and potential lenders and other creditors may have different information needs. In reaching its preliminary views, the Board considered the common information needs of those users of a receiving company's financial statements.<sup>10</sup>

<sup>10</sup> Paragraph 1.8 of the *Conceptual Framework*.

## Interaction with other projects

- 1.30 The development of possible reporting requirements for business combinations under common control is not expected to affect the Board's other active projects, but some of the Board's other active projects might affect the development of those requirements, namely:
- (a) Goodwill and Impairment—the Board is considering possible improvements to IFRS 3, including improved disclosure requirements. The Board published a Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* in March 2020. That Discussion Paper is open for comments until 31 December 2020. Any amendments to IFRS 3 could affect:
    - (i) those business combinations under common control to which the acquisition method applies; and
    - (ii) disclosures about business combinations under common control.
  - (b) the Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12—one of the Board's preliminary views set out in this Discussion Paper is based on an existing requirement in IFRS 10 (see paragraph 2.47(b)(i)). The Board has not identified a need to examine that requirement in the first phase of the Post-implementation Review of that Standard. However, any subsequent findings in the Post-implementation Review could affect the Board's future conclusions on the issue discussed in paragraphs 2.42–2.44. The Board plans to publish a Request for Information for the Post-implementation Review in the fourth quarter of 2020.

## Question for respondents

Project Scope
<p><b>Question 1</b></p>
<p>Paragraphs 1.10–1.23 discuss the Board's preliminary view that it should develop proposals that cover reporting by the receiving company for all transfers of a business under common control (in the Discussion Paper, collectively called business combinations under common control) even if the transfer:</p> <ul style="list-style-type: none"> <li>(a) is preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies to an external party (that is, a party outside the group); or</li> <li>(b) is conditional on a sale of the combining companies to an external party, such as in an initial public offering.</li> </ul> <p>Do you agree with the Board's preliminary view on the scope of the proposals it should develop? Why or why not? If you disagree, what transactions do you suggest that the Board consider and why?</p>

## Section 2—Selecting the measurement method

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- 2.1 The absence of specific requirements in IFRS Standards for a **receiving company** in **business combinations under common control** has resulted in diversity in practice, as outlined in paragraphs 1.2–1.8. The areas of diverse practice include the selection of the measurement method. The following methods are commonly used: the **acquisition method** and various forms of a **book-value method**. In practice, companies do not use a single consistent principle to determine which method to apply.
- 2.2 One way to reduce diversity in practice would be to require a single method for all **business combinations**, including all business combinations under common control—the acquisition method set out in IFRS 3 *Business Combinations*. As explained in Table 1.1 (see paragraph 1.7), the acquisition method requires measuring identifiable assets and liabilities received in the combination at fair value, and requires the recognition of goodwill.
- 2.3 Another approach, suggested by some stakeholders and often used in practice, would be to require a book-value method for some or all business combinations under common control. As explained in Table 1.1, that method requires measuring assets and liabilities received in the combination at their existing book values.
- 2.4 Some stakeholders have suggested a third method—a ‘fresh start’ method (sometimes called a ‘new basis’ method). That method measures at fair value all assets and liabilities of all of the combining companies, including the receiving company’s own assets and liabilities. However, that method is rarely, if ever, used and received little support during the Board’s initial consultations with stakeholders. Consequently, the fresh start method is not discussed further in this Discussion Paper.
- 2.5 Paragraphs 2.6–2.61 discuss:
- (a) stakeholder input (paragraphs 2.6–2.14);
  - (b) the Board’s main considerations in selecting the measurement method (paragraphs 2.15–2.34);
  - (c) the cost–benefit trade-off and other practical considerations for combinations that affect **non-controlling shareholders** (paragraphs 2.35–2.54);
  - (d) a summary of the Board’s preliminary views (paragraph 2.55); and
  - (e) the effects of implementing the Board’s preliminary views (paragraphs 2.56–2.61).

### Stakeholder input

- 2.6 In consultations conducted in developing this Discussion Paper, stakeholders expressed diverse views on reporting business combinations under common control. Broadly, the views expressed can be summarised as follows:
- (a) View A—business combinations under common control are different from business combinations covered by IFRS 3. Accordingly, the acquisition method should not be applied to any business combinations under common control. Instead, a book-value method should be applied to all such combinations (paragraphs 2.7–2.9).

- (b) View B—business combinations under common control are similar to business combinations covered by IFRS 3 in most, if not all, cases. Accordingly, the acquisition method should normally be applied to business combinations under common control, except perhaps in some cases when the benefits of information produced by that method do not justify the costs of applying it. In those cases, a book-value method should be applied (paragraphs 2.10–2.11).
- (c) View C—some business combinations under common control are similar to business combinations covered by IFRS 3 and others are not similar. Accordingly, neither the acquisition method nor a book-value method should be applied to all business combinations under common control. Instead, the acquisition method should be applied in some cases and a book-value method should be applied in other cases (paragraphs 2.12–2.13).

View A—business combinations under common control are different from business combinations covered by IFRS 3

- 2.7 Some stakeholders take the view that *all* business combinations under common control differ from business combinations covered by IFRS 3. They argue that business combinations under common control lack economic substance because a transfer of a **business** in such a combination does not change ultimate control of that business. Instead, the **controlling party** controls all combining companies both before and after the combination and simply moves its economic resources from one ‘location’ to another within the group. In contrast, in a business combination covered by IFRS 3, if another party controls the acquiring company, ultimate control of the **transferred company** passes to that party.
- 2.8 Accordingly, these stakeholders argue that a book-value method should apply to all business combinations under common control to reflect the controlling party’s continued control of the combining companies. They argue that the acquisition method should not apply to these combinations because, in their view, that method is designed for transactions that involve a change in ultimate control of a business. These stakeholders also argue that a book-value method would:
  - (a) best meet the information needs common to all shareholders, lenders and other creditors of the receiving company, including the controlling party;
  - (b) be less costly to apply than the acquisition method; and
  - (c) be aligned with prevailing practice and with requirements or guidance in many jurisdictions.
- 2.9 These stakeholders further argue that applying the acquisition method to some or all business combinations under common control would not provide the most useful information about those transactions because in their view that method would:
  - (a) involve significant uncertainty in measuring at fair value assets and liabilities received in a related party transaction;
  - (b) result in measuring goodwill at an amount that is not evidenced by a transaction price between independent parties;
  - (c) treat any synergies between the combining companies as newly acquired in the combination, even though some of those synergies may have already existed before the combination; and



- (d) if applied to only some such combinations, decrease comparability between business combinations under common control and create opportunities for accounting arbitrage.

View B—business combinations under common control are similar to business combinations covered by IFRS 3

- 2.10 Some stakeholders take the view that most, if not all, business combinations under common control are similar to business combinations covered by IFRS 3. They note that all business combinations, including all business combinations under common control, involve a transfer of a business. When viewed from the perspective of the receiving company (rather than the perspective of the controlling party), a business combination under common control transfers control of a business to that company, just as occurs in a business combination covered by IFRS 3, and has economic substance for the receiving company. These stakeholders argue that the perspective of the controlling party is irrelevant for the receiving company and for its financial statements, which this project focuses on.
- 2.11 Accordingly, these stakeholders argue that the acquisition method would provide the most useful information about business combinations under common control to users of the receiving company's financial statements. They also argue that applying that method would improve comparability between companies because similar transactions would be reported in a similar way. However, they acknowledge that the benefits of providing that improved information might not always outweigh the costs. Therefore, they argue that the acquisition method should apply to business combinations under common control except when cost-benefit considerations justify using a book-value method.

View C—some business combinations under common control are similar to business combinations covered by IFRS 3 and others are not

- 2.12 Some stakeholders argue that business combinations under common control are not all similar to each other and that different measurement methods may therefore be appropriate in different circumstances. They take the view that some transfers of businesses under common control are similar to business combinations covered by IFRS 3 and that the acquisition method would therefore provide the most useful information in those cases. However, in their view, some other such transfers may not be similar to business combinations covered by IFRS 3 and may, for example, instead result in the pre-existing business continuing its operations in a new legal form. In such cases, they suggest that the acquisition method may not provide the most useful information.
- 2.13 These stakeholders suggest evaluating whether business combinations under common control are similar to business combinations covered by IFRS 3 using one or more criteria, for example:
- (a) whether the receiving company has non-controlling shareholders that are affected by the combination (such as whether those shareholders acquire a significant **ownership interest** in the economic resources transferred in the combination);<sup>11</sup>
  - (b) the pricing of the combination (such as whether the receiving company would have paid a similar amount of consideration in a combination with an unrelated party);

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<sup>11</sup> These stakeholders focus on whether the ultimate ownership interests in the economic resources transferred in a business combination under common control change as a result of the combination. Such a change will typically occur when the receiving company has non-controlling shareholders.

- (c) evidence of fair value (such as whether the fair value of the consideration transferred is based on independent valuations or on other external evidence);
- (d) the decision-making process (such as whether the combining companies initiated the combination and negotiated its terms, or whether the combination was initiated and directed by the controlling party); and
- (e) the purpose of the combination (such as whether its purpose was to benefit the combining companies, or whether it was to benefit the controlling party or other companies in the group).

### Common ground in stakeholders' views

2.14 As explained in paragraphs 2.6–2.13, stakeholders have expressed diverse views on how business combinations under common control should be reported and why. However, although different stakeholders analyse business combinations under common control in different ways, they sometimes come to similar conclusions, albeit for different reasons. Specifically, the following common ground has emerged:

- (a) for combinations that do not affect non-controlling shareholders of a receiving company, many stakeholders who provided feedback during the development of this Discussion Paper generally supported applying a book-value method, even when the combinations affect lenders or other creditors of the receiving company or are undertaken in preparation for a sale of the combining companies, for example, in an initial public offering. Some of those stakeholders, notably investors and analysts who specialise in credit analysis, also expressed the view that the outcome of credit analysis would not depend greatly on whether the acquisition method or a book-value method is applied to combinations under common control. Furthermore, some suggested that if a combination is undertaken in preparation for a sale or listing of wholly-owned combining companies, the information provided to potential shareholders about those companies should not depend on the legal structure chosen for the combination (see Diagram 2.4). Finally, some stakeholders have cost-benefit reasons for supporting a book-value method for combinations that do not affect non-controlling shareholders.
- (b) for combinations that affect non-controlling shareholders of a receiving company, many stakeholders who provided feedback during the development of this Discussion Paper generally supported applying the acquisition method, especially when the extent of non-controlling shareholders' interests in the receiving company is 'substantive'. Those stakeholders argued that use of the acquisition method would provide useful information to those non-controlling shareholders. Some of these stakeholders also expressed a view that the presence of non-controlling shareholders may indicate that the transaction is similar to a business combination covered by IFRS 3. However, some stakeholders disagreed with applying the acquisition method to any business combinations under common control, including those that affect non-controlling shareholders of the receiving company (see paragraphs 2.7–2.9).

## Main considerations in selecting the measurement method

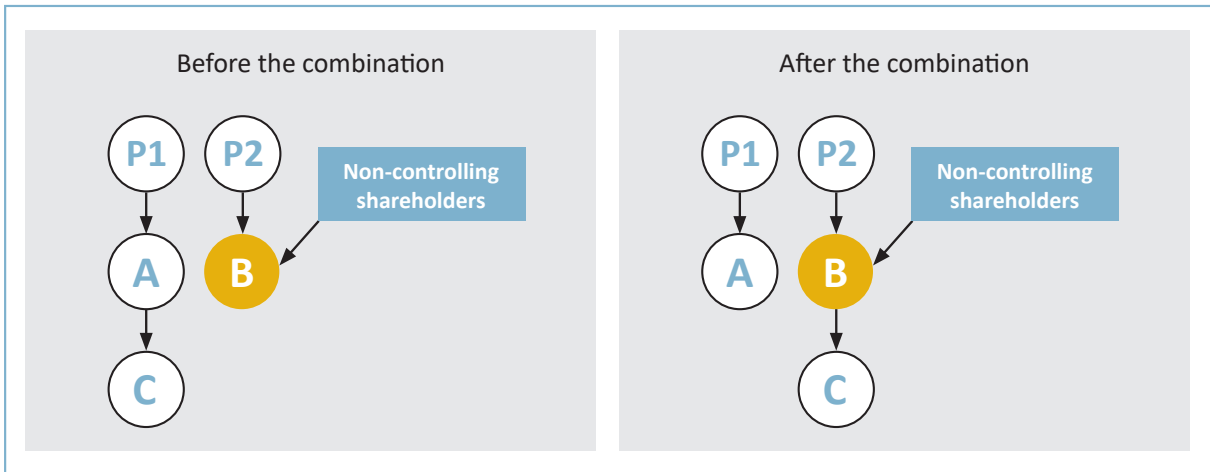
- 2.15 The Board considered the stakeholder input and other research (summarised in paragraphs IN8–IN9) in reaching its preliminary view on which method or methods should be applied to business combinations under common control. In particular, the Board considered:
- (a) whether and when business combinations under common control are similar to business combinations covered by IFRS 3;
  - (b) what information would be most useful to users of the receiving company’s financial statements; and
  - (c) whether the benefits of providing that information would justify the costs of providing it.
- 2.16 The Board does not agree with the view that all business combinations under common control are different from business combinations covered by IFRS 3 and should be accounted for differently. In the Board’s view, although ultimate control of the combining companies does not change in business combinations under common control, that does not mean that such combinations are simply reallocations of economic resources within the group. Instead, such combinations always have economic substance for the receiving company because the receiving company gains control of a business that it did not control before the combination, just as occurs in a business combination covered by IFRS 3.
- 2.17 In addition, some business combinations under common control result in a change in the ultimate ownership interests in the economic resources transferred in the combination, just as occurs in business combinations covered by IFRS 3. Specifically, this occurs when the receiving company has non-controlling shareholders. In those circumstances, those non-controlling shareholders acquire an ownership interest in those economic resources that they did not previously have, whereas the ownership interest of the controlling party in those economic resources is reduced.<sup>12</sup> Hence, such a business combination under common control has a substantive effect on both the receiving company and its shareholders and is not a mere reallocation of economic resources within the group.
- 2.18 The Board next considered whether to require companies to evaluate how similar a business combination under common control is to business combinations covered by IFRS 3 in order to determine what information should be provided about that combination. In the Board’s view, it would be difficult to provide a workable set of indicators for companies to use in making such an evaluation. Also, the Board’s view is that such an evaluation would be subjective and that requiring companies to make such an evaluation may not help reduce diversity in practice. Thus, the Board has reached the view that it should not base the selection of the measurement method on such an evaluation by the receiving company.
- 2.19 The Board also considers that some of the indicators suggested by stakeholders—for example, the purpose of the combination or the process for deciding the terms of the combination—would not change the conclusion about what information would be most useful to users of the receiving company’s financial statements. The Board acknowledges that the pricing of some business combinations under common control can differ from the pricing of business combinations covered by IFRS 3 (see paragraph 2.28) and that evidence of fair value may not always be readily available in a business combination under common control. However, in the Board’s view, those considerations relate to the mechanics of how the selected measurement method should be applied rather than to the selection of the measurement method (Section 3 discusses those considerations). Instead, the Board focussed on changes in ownership interests in the economic resources transferred in business combinations under common control, as discussed in paragraphs 2.20–2.34.

<sup>12</sup> The effect of the combination on the controlling party will also depend on whether non-controlling shareholders are present in the transferring company.

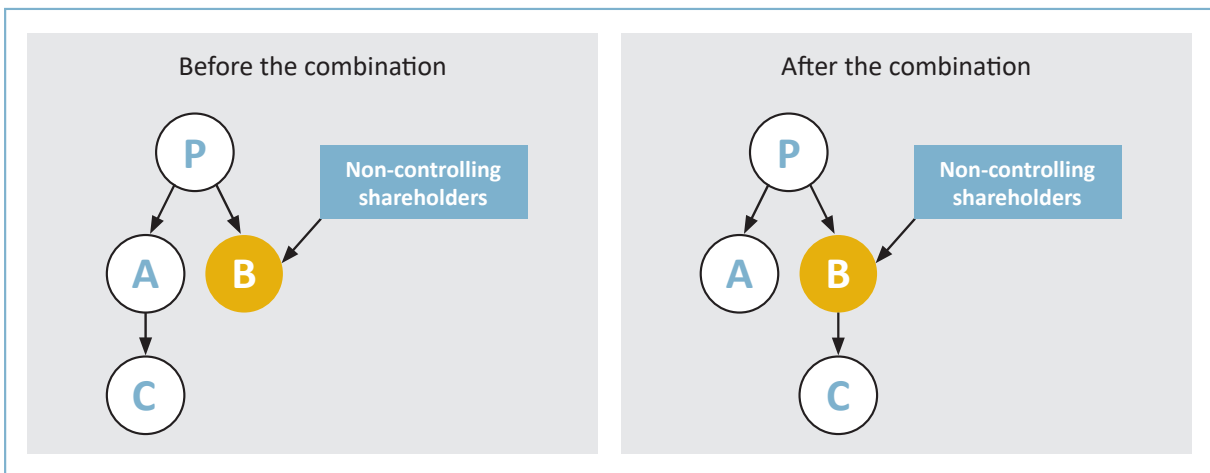
Combinations that affect non-controlling shareholders

2.20 As discussed in paragraph 2.17, when non-controlling shareholders of the receiving company acquire an ownership interest in the economic resources transferred in a business combination under common control, the combination has a substantive effect not only on the receiving company itself but also on its shareholders. The Board considers that a transfer to non-controlling shareholders of the receiving company of an ownership interest in the economic resources of the transferred company has a pervasive effect on the evaluation of how similar the combination is to a business combination covered by IFRS 3. Specifically, the Board’s view is that if such a transfer occurs, that transaction is similar to business combinations covered by IFRS 3. That similarity is illustrated in Diagrams 2.1 and 2.2. In both scenarios, Company B, the receiving company, gains control of Company C, the transferred company, which it did not control before. Furthermore, in both scenarios, non-controlling shareholders of Company B acquire an ownership interest in the economic resources of Company C, regardless of whether ultimate control of Company C changes. Both combinations result in a substantive change in the ownership interests in the economic resources of the transferred company.

**Diagram 2.1—Business combination covered by IFRS 3**



**Diagram 2.2—Business combination under common control**

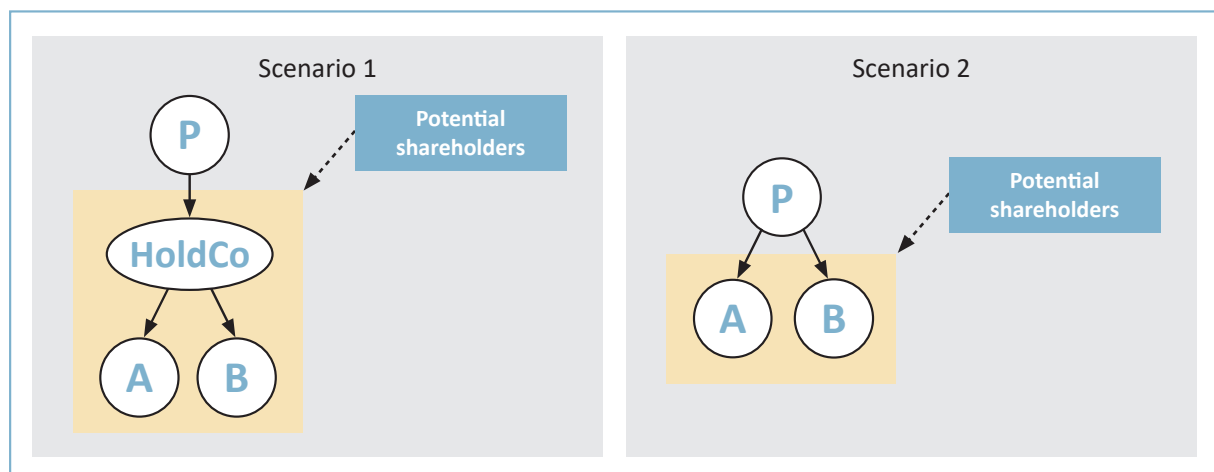


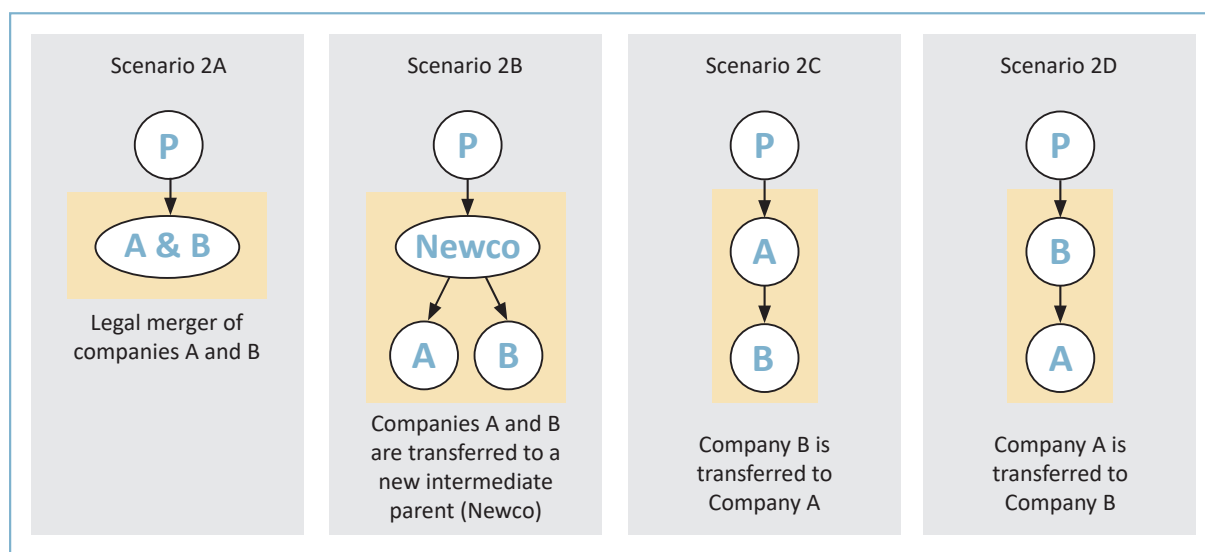
- 2.21 Furthermore, if a business combination under common control affects non-controlling shareholders of the receiving company, the composition of users who rely on that company's financial statements for meeting their information needs about the combination is also similar to the composition of users in a business combination covered by IFRS 3. Specifically, for both types of business combinations, they comprise those non-controlling shareholders, potential shareholders and lenders and other creditors of the receiving company.
- 2.22 Therefore, because both the combination itself is similar to a business combination covered by IFRS 3 (paragraph 2.20) and the composition of users of the receiving company's financial statements is similar in both cases (paragraph 2.21), the common information needs of those users in such combinations are also similar.
- 2.23 Accordingly, in the Board's preliminary view, in principle, the acquisition method should be applied to business combinations under common control that affect non-controlling shareholders of the receiving company, subject to the cost-benefit trade-off and other practical considerations (discussed in paragraphs 2.35–2.47).

### Combinations that do not affect non-controlling shareholders

- 2.24 In contrast, if the receiving company does not have non-controlling shareholders (such as in a business combination under common control involving wholly-owned companies), not only is there no change in the ultimate control of the combining companies, but also no change in the ultimate ownership interests in the economic resources transferred in the combination. In such circumstances, questions may arise about how similar the combination is to business combinations covered by IFRS 3 and whether the acquisition method should be applied.
- 2.25 Combinations between wholly-owned companies are illustrated in Diagrams 2.3 and 2.4, using an example of a controlling party, Company P, that wishes to sell its wholly-owned subsidiaries, companies A and B, in an initial public offering. In Scenario 1, Company P owns and controls Company A and Company B via an intermediate holding company, HoldCo. Accordingly, Company P could sell its subsidiaries by selling HoldCo. In contrast, in Scenario 2, Company P owns and controls its subsidiaries directly. In this case, Company P might first need to restructure its subsidiaries. Company P could do that in various ways, as illustrated in Diagram 2.4.

**Diagram 2.3—Group structure before initial public offering**



**Diagram 2.4—Group restructuring in preparation for an initial public offering**

- 2.26 If the acquisition method was applied to the group restructuring illustrated in Diagram 2.4, one of the combining companies would need to be identified as the ‘acquirer’—either Company A or Company B or, in Scenario 2B, possibly Newco.<sup>13</sup> Identifying the acquirer determines which measurement bases are applied to the assets and liabilities of the combining companies, and thus would usually have a fundamental and pervasive effect on what information is provided to potential public shareholders. The assets and liabilities of the company identified as the acquirer continue to be measured at their existing book values, whereas the assets and liabilities of the other combining company (or companies, in Scenario 2B) are measured at fair value. However, from the viewpoint of those shareholders, they would be investing in the same economic resources in all scenarios, as illustrated by the shaded areas in Diagrams 2.3 and 2.4. In contrast, a book-value method would produce similar information in all those scenarios, regardless of whether and how the controlling party restructures its subsidiaries in preparation for the initial public offering.
- 2.27 Furthermore, identifying the acquirer in a business combination under common control involving wholly-owned companies like the group restructuring illustrated in Diagram 2.4 might be difficult. That difficulty arises because, when applying the acquisition method, the legal structure of the combination does not necessarily determine which company is the acquirer. Instead, IFRS 3 provides application guidance on identifying the acquirer. Some of that guidance considers the effects of the combination on the shareholders of the combining companies.<sup>14</sup> However, such effects would not arise for combining companies that are wholly-owned by the controlling party. In such cases, it might be difficult to identify the acquirer in a way that results in useful information. In contrast, if non-controlling shareholders acquire an ownership interest in the economic resources transferred in the combination, the guidance in IFRS 3 could help identify the acquirer.

<sup>13</sup> When a new company is formed to effect a business combination, in some cases paragraph B18 of IFRS 3 does not permit the new company to be identified as the acquirer. In those cases, either Company A or Company B must be identified as the acquirer.

<sup>14</sup> Paragraphs B15(a) and B15(b) of IFRS 3.

- 2.28 Another difficulty with applying the acquisition method when the receiving company does not have non-controlling shareholders is that the consideration paid might differ from the consideration that would have been paid to an unrelated party. For example, in the group restructuring illustrated in Diagram 2.4, the controlling party, Company P, might direct the combining companies to transact at the book value of the assets and liabilities of the transferred company. However, as discussed further in Section 3, the measurement of goodwill applying the acquisition method is based on the premise that the amount of the consideration paid is determined in an arm's length negotiation and depends on the fair value of the acquired business and the price for any synergies expected from the combination. As a result, goodwill is measured at an amount that is expected to reflect the fair value of the pre-existing goodwill in the acquired business and the price for the synergies expected from the combination. In contrast, if business combinations under common control are not priced at arm's length, applying the acquisition method might measure goodwill at an arbitrary amount that does not provide useful information.
- 2.29 As also discussed further in Section 3, such a scenario is less likely to arise in a business combination under common control that affects non-controlling shareholders of the receiving company. The research for this project indicates that in such combinations, the consideration paid would typically approximate the consideration that would have been paid between unrelated parties, because many jurisdictions have regulations that are designed to protect non-controlling shareholders. However, those regulations would not apply if a transaction does not affect non-controlling shareholders.
- 2.30 Furthermore, when a business combination under common control does not affect non-controlling shareholders of the receiving company, questions arise about which method would produce sufficient benefits for users of the receiving company's financial statements to justify the costs of applying that method.
- 2.31 Cost is a pervasive constraint on the information that can be provided by financial reporting. It is important that the costs of reporting particular information are justified by the benefits of reporting that information.<sup>15</sup> If a business combination under common control does not affect non-controlling shareholders of the receiving company, that company's only existing shareholder is the controlling party and, as discussed in paragraph 2.24, the combination does not change that party's control of the combining companies nor its ownership interest in them. Also, as discussed in paragraph 1.25, because the controlling party controls the receiving company, it does not need to rely on that company's general purpose financial statements to meet its information needs.

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<sup>15</sup> Paragraph 2.39 of the *Conceptual Framework*.

- 2.32 Some question, therefore, whether the costs of applying the acquisition method to these combinations would be justified. Feedback received from stakeholders in the project indicates that a book-value method is typically less costly to apply and would provide useful information:
- (a) to potential shareholders of the receiving company. This is because a book-value method provides potential shareholders with similar information about the combined economic resources in all scenarios, regardless of whether a combination under common control is undertaken in preparation for a sale to potential shareholders and regardless of how the combination is legally structured (as discussed in paragraphs 2.25–2.26 and illustrated in Diagrams 2.3 and 2.4).
  - (b) to lenders and other creditors of the receiving company. This is because their economic interest in the receiving company is typically limited to receiving payments of principal and interest. Thus, lenders and other creditors need information about the receiving company's cash flows and debt commitments in order to assess the company's ability to service its existing debt and to raise new debt. That information is largely unaffected by whether the acquisition method or a book-value method is used to account for a business combination under common control. In addition, although information about fair values of particular assets received in such a combination can be useful to lenders and other creditors in some cases, the outcome of their analysis would not depend greatly on whether they receive that information.
- 2.33 Accordingly, in the Board's preliminary view, a book-value method should be applied to business combinations under common control that do not affect non-controlling shareholders of the receiving company, including all combinations between wholly-owned companies.

#### Selecting the measurement method

##### The Board's preliminary views

- 2.34 The Board's preliminary views are that:
- (a) neither the acquisition method nor a book-value method should be applied to *all* business combinations under common control;
  - (b) in principle, the acquisition method should be applied if the business combination under common control affects non-controlling shareholders of the receiving company, subject to the cost–benefit trade-off and other practical considerations (discussed in paragraphs 2.35–2.47); and
  - (c) a book-value method should be applied to all other business combinations under common control, including all combinations between wholly-owned companies.

## The cost–benefit trade-off and other practical considerations for combinations that affect non-controlling shareholders

- 2.35 Having reached the preliminary view that, in principle, the acquisition method should be applied to business combinations under common control that affect non-controlling shareholders of the receiving company, the Board next considered whether that method should be applied to *all* or only to *some* such combinations.



- 2.36 Some stakeholders consulted in the project suggested that the acquisition method should be applied only if non-controlling shareholders hold a ‘substantive’ ownership interest in the receiving company and that a book-value method should be applied in all other cases. Some of those stakeholders argued that the acquisition method would be more costly to apply than a book-value method. They expressed concerns that the costs of applying the acquisition method may not be justified by the benefits of the information provided by that method when non-controlling shareholders have only a ‘small’ ownership interest in the receiving company. Some stakeholders also suggested that those costs may not be justified when all non-controlling shareholders are **related parties** of the receiving company, who may not need to rely on the company’s financial statements to meet their information needs.
- 2.37 Some stakeholders also expressed concerns about opportunities for accounting arbitrage. They noted that the acquisition method would require a receiving company to recognise goodwill and other intangible assets, and to measure assets at fair value, when IFRS Standards would not permit doing so if the receiving company had always owned the transferred business. They suggested that requiring the acquisition method for all business combinations under common control that affect non-controlling shareholders would allow a receiving company to structure a combination in a particular way to achieve those accounting outcomes.
- 2.38 Accordingly, the Board considered whether, in some circumstances, applying the acquisition method to combinations that affect non-controlling shareholders might not produce benefits that justify the costs of applying that method, or might create opportunities for accounting arbitrage. The Board first considered whether it should set a quantitative threshold specifying that the acquisition method should not be applied if the extent of the ownership interest of non-controlling shareholders is below that threshold. However, the Board has rejected such an approach because a quantitative threshold would be arbitrary and would lack a conceptual basis. In addition, it could give rise to further concerns about opportunities for accounting arbitrage. Accordingly, the Board next considered qualitative factors.
- 2.39 First, the Board has reached the preliminary view that the acquisition method should be applied to business combinations under common control if the receiving company’s **shares** are traded in a **public market**. The Board noted that minimum listing requirements or capital markets regulations for public trading in many jurisdictions typically prevent the listing of shares when the ownership interest of non-controlling shareholders in the company is insignificant. Accordingly, a condition based on trading in a public market would not itself impose an arbitrary quantitative threshold, but would apply quantitative considerations indirectly without being arbitrary. In the Board’s view, such a condition is objective and easy to apply, and would not create opportunities for accounting arbitrage. Furthermore, a similar condition is already used in IFRS Standards to determine which information must be provided in some specified cases.<sup>16</sup>
- 2.40 Second, the Board considered how to weigh the benefits of applying the acquisition method against the costs if the receiving company’s shares are not **publicly traded**, and whether and when a book-value method should instead be applied to combinations that affect non-controlling shareholders in such companies. The Board has reached the preliminary view that for **privately held** companies (that is, companies whose shares are not publicly traded) there should be:

<sup>16</sup> See paragraph 4(a)(ii) of IFRS 10 *Consolidated Financial Statements*, paragraph 2(b)(i) of IFRS 8 *Operating Segments* and paragraph 2(b)(i) of IAS 33 *Earnings per Share*. These Standards describe a public market as a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets.

- (a) an optional exemption from the acquisition method—the receiving company should be *permitted* to use a book-value method rather than the acquisition method, if it has informed all of its non-controlling shareholders that it proposes to use a book-value method and they have not objected (see paragraphs 2.41–2.44) (the optional exemption from the acquisition method); and
  - (b) an exception to the acquisition method—the receiving company should be *required* to use a book-value method rather than the acquisition method if all of its non-controlling shareholders are related parties of the company, as defined in IAS 24 *Related Party Disclosures* (see paragraph 2.45) (the related-party exception to the acquisition method).
- 2.41 The Board considers that for privately held companies, the benefits of information provided by the acquisition method may not outweigh the costs of providing that information. For example, the benefits might not outweigh the costs if non-controlling shareholders of a privately held company:
- (a) do not hold a significant ownership interest in the company;
  - (b) do not need to rely on the company’s financial statements to meet their information needs (for example, if the terms and conditions of agreements between the company and the private shareholders give them a right to obtain information); or
  - (c) do not routinely rely on analysis of detailed financial information, performed either by themselves or by financial intermediaries.
- 2.42 Therefore, the Board has reached the view that it should allow privately held companies to ‘opt out’ from the acquisition method and to apply a book-value method instead, on condition that all of its non-controlling shareholders have been informed about the use of a book-value method for a combination and have not objected to its use. This condition is based on one already used in IFRS Standards for exempting privately held companies from some requirements in specified circumstances when, in the Board’s view, the costs of applying those requirements may outweigh the benefits of doing so.<sup>17</sup>
- 2.43 The condition would not require any action from non-controlling shareholders unless they object to the use of a book-value method. The Board’s view is that designing the condition in this way would lead to a more appropriate trade-off between benefits and costs than requiring companies to seek explicit consent for the use of a book-value method. This is because when non-controlling shareholders are largely indifferent about which information they receive, they are unlikely to respond to a request about which method to use. However, the Board has also reached the view that it should allow non-controlling shareholders to require the use of the acquisition method so they receive fair value information when it is important to them.
- 2.44 Practical questions may arise about applying such an exemption, for example, about how and when the company should notify its non-controlling shareholders or how long those shareholders should be given to raise any objections. However, such a condition is already used in IFRS Standards. Accordingly, the Board expects that such an exemption would be workable in practice, especially for a small number of concentrated and stable shareholdings in a privately held company.

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<sup>17</sup> See paragraph 4 of IFRS 10 and paragraph 17 of IAS 28.

- 2.45 The Board has also reached the preliminary view that a privately held receiving company should not be permitted to use the acquisition method if all of its non-controlling shareholders are related parties of the company, as defined in IAS 24. The Board's reason is that the receiving company's related parties might not need to rely on its general purpose financial statements to meet their information needs. Hence, the benefits of applying the acquisition method in those cases might not justify the costs. In addition, requiring a book-value method in those cases would prevent opportunities to structure a combination by issuing shares to related parties for the sole purpose of qualifying for the acquisition method.
- 2.46 The Board's preliminary views on when the acquisition method should be applied to combinations that affect non-controlling shareholders and when a book-value method should be applied to such combinations are all based on conditions already used in IFRS Standards. The Board considers that an approach relying on conditions already used would generally involve less complexity than introducing into IFRS Standards new conditions that have not been applied in practice.

## Selecting the measurement method

### The Board's preliminary views

2.47 For business combinations under common control that affect non-controlling shareholders of the receiving company, the Board's preliminary views are that:

- (a) if the receiving company's shares are traded in a public market, the receiving company should be *required* to apply the acquisition method; and
- (b) if the receiving company's shares are privately held:
  - (i) the receiving company should be *permitted* to use a book-value method if it has informed all of its non-controlling shareholders that it proposes to use a book-value method and they have not objected (the optional exemption from the acquisition method); and
  - (ii) the receiving company should be *required* to use a book-value method if all of its non-controlling shareholders are related parties of the company (the related-party exception to the acquisition method).

2.48 In reaching the preliminary views expressed in paragraph 2.47, the Board considered whether the optional exemption and the related-party exception should apply not only to privately held companies, but also to publicly traded companies.

2.49 First, some stakeholders suggested that, even for a publicly traded receiving company, the benefits of information provided to non-controlling shareholders by the acquisition method may not be enough to justify the costs if those non-controlling shareholders do not object to receiving information about book values of assets and liabilities of the transferred company instead of fair value information. In considering this suggestion, the Board noted that for publicly traded companies such an exemption:

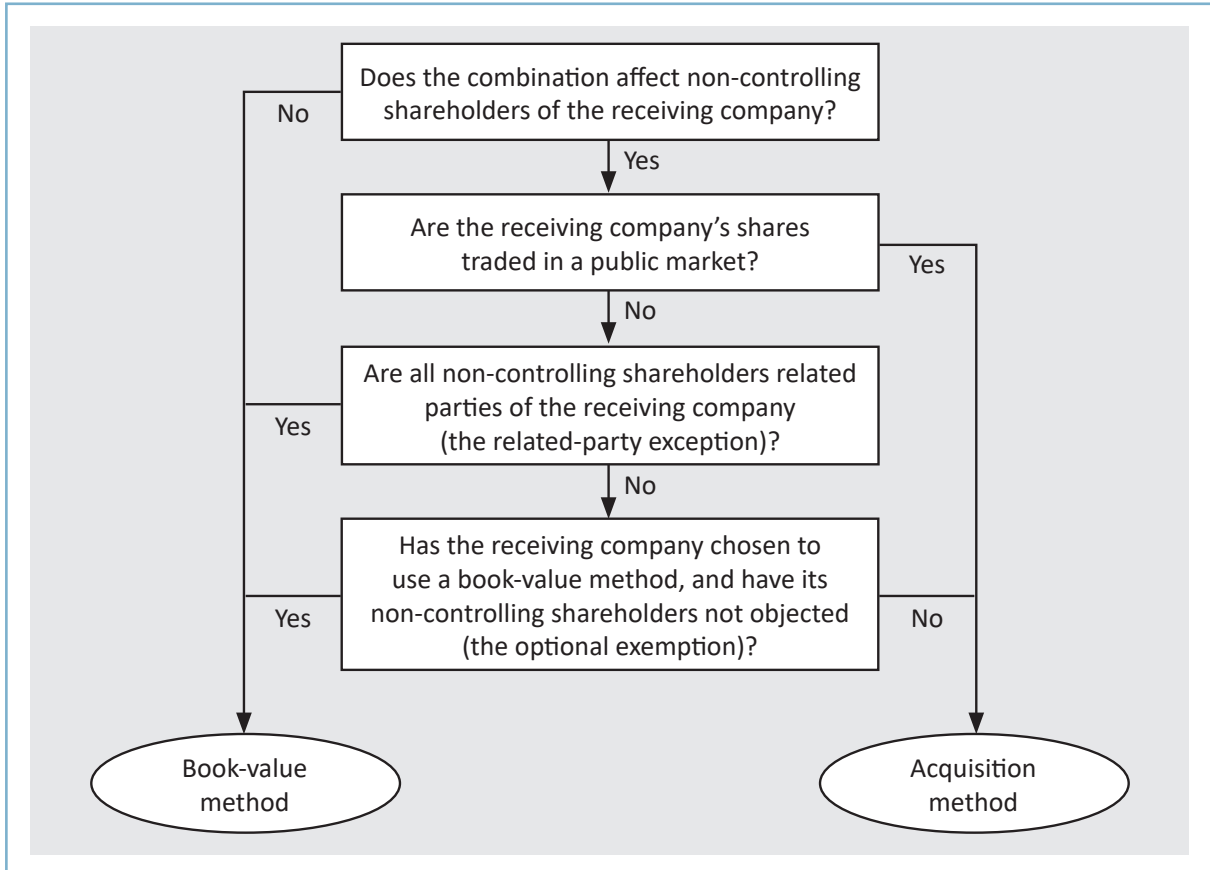
- (a) might be more difficult to apply (see paragraph 2.50); and
- (b) might be more difficult to justify on cost-benefit grounds (see paragraph 2.51).

- 2.50 The optional exemption might be more difficult to apply for publicly traded companies because such companies often have many shareholders, with frequent changes in share ownership, whereas privately held companies are likely to have a more stable and concentrated ownership structure. Accordingly, the practical challenges discussed in paragraph 2.44 for privately held companies could be much more difficult to overcome for publicly traded companies.
- 2.51 The optional exemption might also be more difficult to justify on cost-benefit grounds for publicly traded companies because:
- (a) non-controlling shareholders in a publicly traded receiving company are likely to hold, in aggregate, a significant ownership interest in that company (paragraph 2.39) and would need to rely on its financial statements for much of their information needs—unlike non-controlling shareholders in a privately held receiving company who:
    - (i) might not hold a significant ownership interest in that company;
    - (ii) might not need to rely on the company’s financial statements to meet their information needs; or
    - (iii) might not routinely analyse detailed financial information (paragraph 2.41).
  - (b) share ownership in publicly traded companies is likely to change more often than in a privately held company. As a result, the non-controlling shareholders in a publicly traded company who will use the information about the combination might not be the same as the shareholders who were consulted when the receiving company proposed to use a book-value method, and their response might have been different. This possibility also exists for privately held companies, but it is less likely to be the case for those companies because their holdings are generally less liquid and those companies are therefore more likely to have a stable ownership base.
- 2.52 For those reasons, the Board has reached the view that if it wished to extend the optional exemption from the acquisition method to publicly traded companies, that exemption might need to be designed in a different way than the exemption for privately held companies in order for it to achieve appropriate accounting outcomes and be workable in practice.
- 2.53 Second, some stakeholders suggested that the related-party exception to the acquisition method should also apply to publicly traded companies. In other words, a publicly traded receiving company would be required to use the book-value method if all its non-controlling shareholders are related parties of the company. In considering this suggestion, the Board noted that listing requirements or capital market regulations often limit how many shares of a publicly traded company can be held by parties that are considered to be related to the company. Accordingly, the Board expects it would be unusual for all the non-controlling shareholders of a publicly traded receiving company to be related parties of that company. Hence, extending the related-party exception to publicly traded companies may have little practical effect.
- 2.54 Although the Board is not proposing to extend the optional exemption from or the related-party exception to the acquisition method to publicly traded companies, the Board is requesting feedback from stakeholders about whether (and, if so, how) such extensions should be made.

## Summary of the Board’s preliminary views

2.55 The Board’s preliminary views on which method to use and when are summarised in Diagram 2.5.

**Diagram 2.5—Summary of the Board’s preliminary views**



## The effects of implementing the Board’s preliminary views

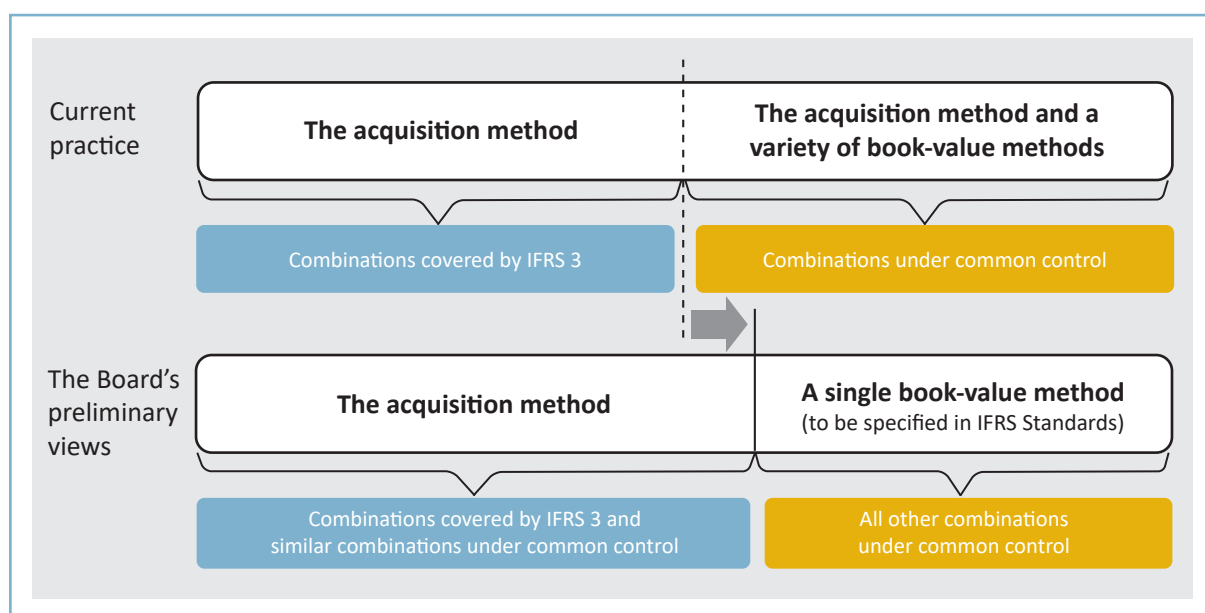
2.56 If the Board’s preliminary views are implemented, the acquisition method would apply to business combinations under common control in specified circumstances and a book-value method would apply in all other cases. Some stakeholders suggested that applying a single method—for example, a book-value method—to all business combinations under common control would more effectively reduce diversity in practice and improve comparability in reporting such combinations than the approach outlined in the Board’s preliminary views. In addition, some stakeholders argued that applying a book-value method to all business combinations under common control would result in less complexity, be less costly and provide fewer opportunities for accounting arbitrage than the Board’s approach.

2.57 However, the Board considers that an approach based on its preliminary views would meet the project’s objective of reducing diversity in practice, improving transparency of reporting and providing better information about business combinations under common control—that is, information that is both more relevant and more comparable—while taking appropriate account of the cost–benefit trade-off. In particular:

- (a) diversity in practice would be reduced by specifying:
  - (i) which method should be applied in which circumstances so companies undertaking similar combinations would apply the same accounting policies.
  - (ii) how a book-value method should be applied, thus eliminating the diversity in practice caused by the variety of book-value methods used.
- (b) the acquisition method would be applied both to business combinations covered by IFRS 3 and to business combinations under common control that are similar to business combinations covered by IFRS 3 when the benefits of applying that method outweigh the costs. As a result, users of the receiving company’s financial statements would receive more relevant and more comparable information about business combinations under common control and the transparency of reporting these combinations will be improved.

2.58 Those overall effects of implementing the Board’s preliminary views are illustrated in Diagram 2.6.<sup>18</sup>

**Diagram 2.6—The overall effects of implementing the Board’s preliminary views**



<sup>18</sup> Diagram 2.6 is designed to illustrate the overall effects of implementing the Board’s preliminary views. It is not intended to illustrate the likely scale of the change to current practice.

- 2.59 In contrast, requiring a book-value method for all business combinations under common control would result in companies reporting transactions that are similar to transactions covered by IFRS 3 applying a method that is different from the method required by IFRS 3. Hence, if the Board pursued such an approach, users of the receiving company's financial statements would receive information that is less relevant and less comparable.
- 2.60 Furthermore, the Board's view is that requiring one of two specified methods and specifying when each should be used would not introduce undue complexity for either preparers or users of financial statements because both methods are already in use. Besides, the criteria developed by the Board for determining which method should be applied are objective and are all based on conditions already used in IFRS Standards. In fact, the Board's view is that complexity would be reduced because companies would be subject to the requirements in IFRS Standards instead of having to develop their own accounting policy.
- 2.61 Finally, because IFRS 3 already requires the acquisition method for business combinations within its scope, if the Board decided to pursue a single measurement method for all business combinations that would mean extending the scope of the acquisition method to all business combinations under common control. Although such an approach might appear simpler, many of the Board's stakeholders consulted during the project do not support it and, on the basis of the Board's analysis set out in this section, the Board concurs with that view.

## Questions for respondents

### Selecting the measurement method

#### Question 2

Paragraphs 2.15–2.34 discuss the Board's preliminary views that:

- (a) neither the acquisition method nor a book-value method should be applied to *all* business combinations under common control.
- Do you agree? Why or why not? If you disagree, which method do you think should be applied to all such combinations and why?
- (b) in principle, the acquisition method should be applied if the business combination under common control affects non-controlling shareholders of the receiving company, subject to the cost-benefit trade-off and other practical considerations discussed in paragraphs 2.35–2.47 (see Question 3).
- Do you agree? Why or why not? If you disagree, in your view, when should the acquisition method be applied and why?
- (c) a book-value method should be applied to all other business combinations under common control, including all combinations between wholly-owned companies.
- Do you agree? Why or why not? If you disagree, in your view, when should a book-value method be applied and why?

## Selecting the measurement method

## Question 3

Paragraphs 2.35–2.47 discuss the cost–benefit trade-off and other practical considerations for business combinations under common control that affect non-controlling shareholders of the receiving company.

- (a) In the Board’s preliminary view, the acquisition method should be *required* if the receiving company’s shares are traded in a public market.

Do you agree? Why or why not?

- (b) In the Board’s preliminary view, if the receiving company’s shares are privately held:

- (i) the receiving company should be *permitted* to use a book-value method if it has informed all of its non-controlling shareholders that it proposes to use a book-value method and they have not objected (the optional exemption from the acquisition method).

Do you agree with this exemption? Why or why not? Do you believe that the exemption will be workable in practice? If not, in your view, how should such an exemption be designed so that it is workable in practice?

- (ii) the receiving company should be *required* to use a book-value method if all of its non-controlling shareholders are related parties of the company (the related-party exception to the acquisition method).

Do you agree with this exception? Why or why not?

- (c) If you disagree with the optional exemption (Question 3(b)(i)) or the related-party exception (Question 3(b)(ii)), in your view, how should the benefits of applying the acquisition method be balanced against the costs of applying that method for privately held companies?

## Selecting the measurement method

## Question 4

Paragraphs 2.48–2.54 discuss suggestions from some stakeholders that the optional exemption from and the related-party exception to the acquisition method should also apply to publicly traded companies. However, in the Board’s preliminary view, publicly traded receiving companies should always apply the acquisition method.

- (a) Do you agree that the optional exemption from the acquisition method should *not* be available for publicly traded receiving companies? Why or why not? If you disagree, in your view, how should such an exemption be designed so that it is workable in practice?

- (b) Do you agree that the related-party exception to the acquisition method should *not* apply to publicly traded receiving companies? Why or why not?



## Section 3—Applying the acquisition method

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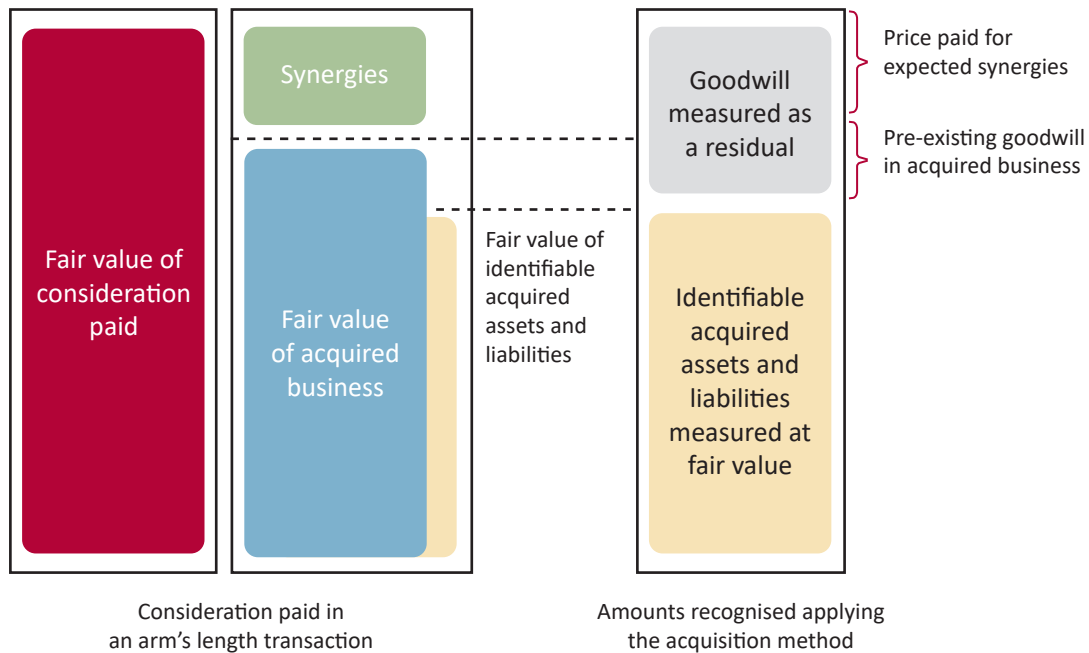
- 3.1 Section 2 discusses the Board’s preliminary view that the **acquisition method** set out in IFRS 3 *Business Combinations* should be applied to **business combinations under common control** that affect **non-controlling shareholders** of the **receiving company** (with an exemption and an exception, as set out in paragraph 2.47). This section discusses whether the Board would need to develop any special requirements on how to apply that method to such combinations.
- 3.2 The reasons for the Board’s preliminary views discussed in Section 2 on when to apply the acquisition method include the following:
- (a) these combinations are similar to **business combinations** covered by IFRS 3; and
  - (b) the composition of users of information about these combinations—and hence their common information needs and cost–benefit considerations—are similar to those in business combinations covered by IFRS 3.
- 3.3 Accordingly, in principle, the acquisition method should be applied as set out in IFRS 3. However, business combinations under common control may contain one feature that is not present in business combinations covered by IFRS 3. Specifically, the consideration paid in business combinations under common control might be directed by the **controlling party** and therefore might differ from an arm’s length price that would have been negotiated between unrelated parties in a business combination covered by IFRS 3.
- 3.4 However, the measurement of goodwill applying the acquisition method is based on the premise that the amount of the consideration paid is determined in an arm’s length negotiation and depends on:
- (a) the fair value of the acquired **business**; and
  - (b) the price paid for any synergies expected from the combination.<sup>19</sup>
- 3.5 More specifically, as explained in Table 1.1 (see paragraph 1.7), applying the acquisition method, an acquirer recognises the identifiable assets and liabilities acquired in the business combination and measures them at fair value. The acquirer also recognises goodwill and measures it as a residual amount: the excess of the fair value of the consideration paid over the fair value of the identifiable acquired assets and liabilities.<sup>20</sup> As a result, goodwill is measured at an amount that is expected to reflect the fair value of the pre-existing goodwill in the acquired business and the price paid for any synergies expected from the combination.<sup>21</sup> These key features of the acquisition method are illustrated in Diagram 3.1.

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<sup>19</sup> Paragraph BC316 of the Basis for Conclusions to IFRS 3.

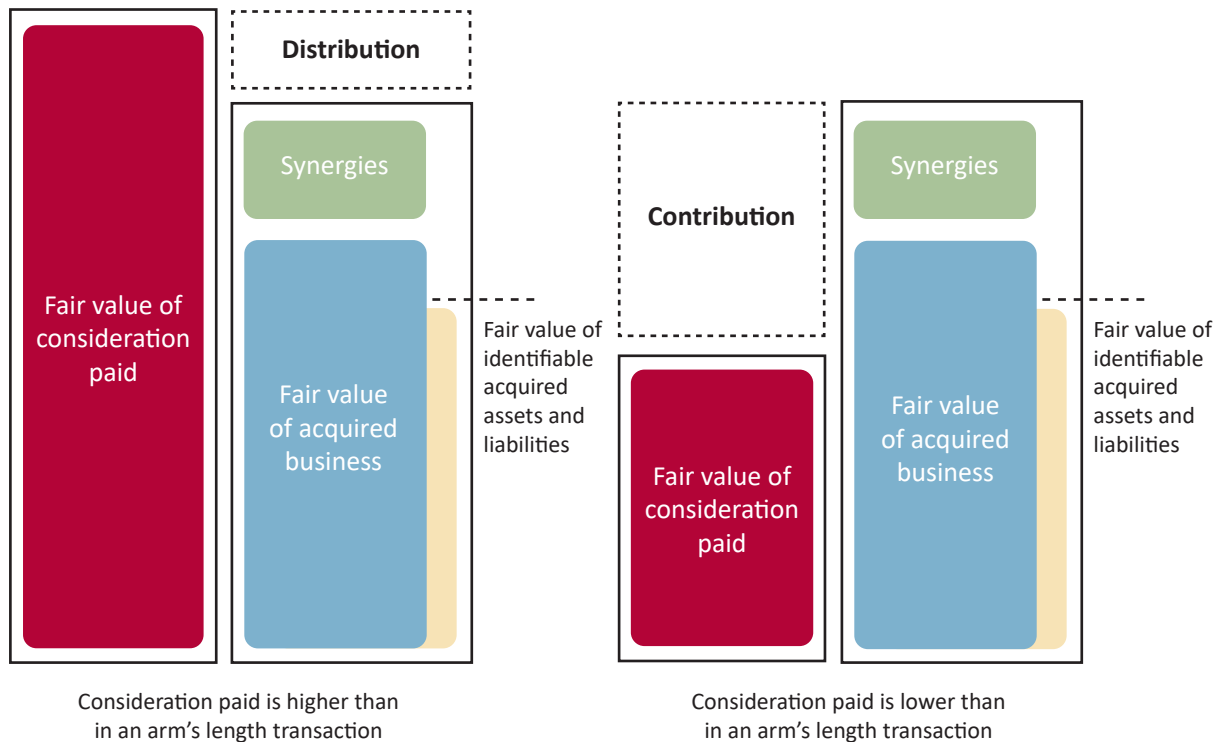
<sup>20</sup> Paragraph 3.5 summarises requirements explained more precisely in paragraph 32 of IFRS 3.

<sup>21</sup> As illustrated in Diagram 3.1, the fair value of the pre-existing goodwill in the acquired business is the excess of the fair value of the acquired business as a whole over the aggregate fair value of its identifiable assets and liabilities. Expected synergies relate to the benefits that arise from combining the acquired business with the acquirer’s business and are unique to each combination.

**Diagram 3.1—Key features of the acquisition method**

3.6 However, in a business combination under common control, the receiving company and the **transferring company** might not have been involved in deciding how much consideration is paid. Instead, the controlling party might have determined the amount of consideration. Any difference between that amount and the amount that would have been paid to an unrelated party in an arm's length transaction indicates that the combination includes an additional component—a transaction with the owners acting in their capacity as owners. Specifically, as illustrated in Diagram 3.2:

- if the consideration paid is higher, that excess constitutes a distribution from equity by the receiving company to the transferring company, and ultimately to the controlling party; and
- if the consideration paid is lower, that difference constitutes a contribution to equity of the receiving company from the transferring company, and ultimately from the controlling party.

**Diagram 3.2—Distribution from equity or contribution to equity**

- 3.7 Applying IAS 1 *Presentation of Financial Statements*, transactions with owners in their capacity as owners should be reported in the receiving company's statement of changes in equity.<sup>22</sup>
- 3.8 Accordingly, the Board considered whether it should develop special requirements for the receiving company, when applying the acquisition method to a business combination under common control, to identify and recognise:
- (a) distributions from equity (paragraphs 3.11–3.16); and
  - (b) contributions to equity (paragraphs 3.17–3.20).
- 3.9 The Board has not identified a need to consider any other special requirements on how to apply the acquisition method to business combinations under common control.
- 3.10 Paragraphs 5.8–5.12 discuss whether the Board should develop disclosure requirements for business combinations under common control in addition to those required by IFRS 3, for example, disclosures about the terms of these combinations.

<sup>22</sup> Paragraph 106 of IAS 1 *Presentation of Financial Statements*.

## Distributions from equity

- 3.11 If the Board were to require the receiving company to identify and recognise a distribution from equity in a business combination under common control, the Board would need to specify how to measure any such distributions. The Board considered a similar issue when it developed IFRS 3: whether to provide special requirements for business combinations in which a buyer ‘overpays’ for the acquisition. No such requirements are included in IFRS 3, because the Board concluded that, in practice, an overpayment is unlikely to be detectable or known at the acquisition date and that the overpayment would be difficult, if not impossible, to quantify. Accordingly, if an overpayment occurs, it is initially included in goodwill recognised in a business combination and is addressed through subsequent testing of goodwill for impairment.<sup>23</sup>
- 3.12 In the Board’s view, similar difficulties would arise in identifying and measuring a distribution to the controlling party in a business combination under common control. Appendix C discusses such difficulties.
- 3.13 The Board also considered whether a distribution from equity would be likely to occur in practice in business combinations under common control that affect non-controlling shareholders of the receiving company. In effect, any such distribution would transfer wealth from those non-controlling shareholders to the transferring company, and ultimately to the controlling party. Research for this project and stakeholder input suggest that distributions to the controlling party are unlikely to occur in such combinations. Such distributions are unlikely to occur because many jurisdictions have legal requirements and regulations that are designed to protect the interests of non-controlling shareholders.
- 3.14 For the reasons discussed in paragraphs 3.12–3.13, the Board has reached the preliminary view that it should not develop a requirement for the receiving company to identify, measure and recognise a distribution to the controlling party applying the acquisition method. Accordingly, in the unlikely event that an overpayment occurs in a business combination under common control that affects non-controlling shareholders, it would be initially included in goodwill and addressed through subsequent testing of goodwill for impairment, just as occurs in a business combination covered by IFRS 3. Many stakeholders who provided their views on this matter during the development of this Discussion Paper (see paragraph IN9), notably investors and analysts, agreed with that conclusion.
- 3.15 However, investors and analysts also emphasised that they need information about the economics of the combination to help them make their own assessment of whether the consideration paid includes an overpayment. Disclosure requirements when applying the acquisition method to business combinations under common control are discussed further in Section 5 (see paragraphs 5.5–5.12). In particular, that section explains that in another active project—Goodwill and Impairment—the Board is considering possible improvements to IFRS 3, including improved disclosure requirements designed to help investors and analysts understand whether the price paid in a business combination was reasonable.<sup>24</sup> Any such improved disclosures would also provide useful information about the consideration paid in a business combination under common control to which the acquisition method is applied.

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<sup>23</sup> Paragraph BC382 of the Basis for Conclusions to IFRS 3.

<sup>24</sup> See Section 2 of the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*, published in March 2020.

### The Board's preliminary view

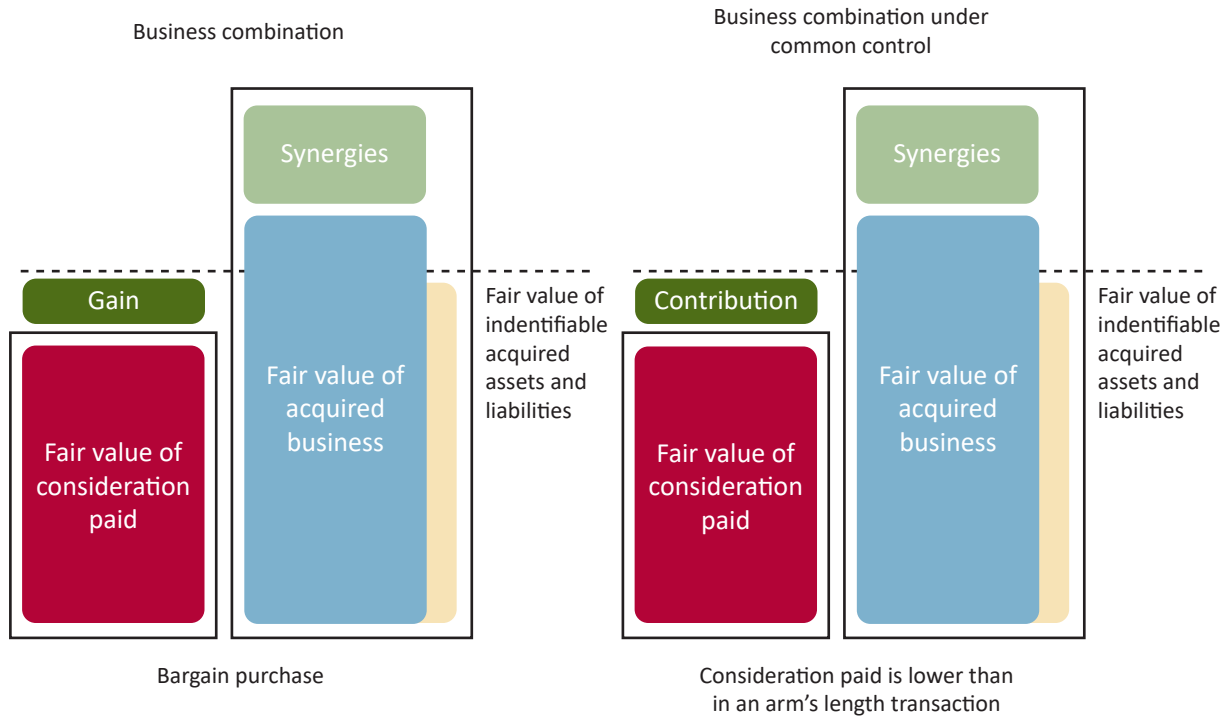
- 3.16 The Board has reached the preliminary view that it should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity when applying the acquisition method to a business combination under common control.

## Contributions to equity

- 3.17 The Board also considered whether the receiving company should be required to recognise a contribution to equity when applying the acquisition method to a business combination under common control. The Board first considered whether such a contribution would be likely to occur if such a combination affects non-controlling shareholders of the receiving company. The legal protections discussed in paragraph 3.13 might not apply in this situation, because any such contribution would transfer wealth from the controlling party to the non-controlling shareholders of the receiving company and so would not adversely affect those shareholders. Nevertheless, the controlling party is unlikely to allow a transfer of wealth to non-controlling shareholders. Therefore, the Board has reached the view that such contributions are also unlikely to occur in practice.
- 3.18 However, in the unlikely event that a contribution did occur, the question arises whether it could be identified and measured and, if so, whether it should be recognised. As illustrated in Diagram 3.2, in a business combination under common control, economically the amount of any contribution to equity equals the excess of the consideration that would have been negotiated between unrelated parties in an arm's length transaction over the consideration actually paid. In an arm's length transaction between unrelated parties, the amount of consideration is expected to reflect the fair value of the acquired business and the price paid for any synergies expected from the combination (as discussed in paragraph 3.4). However, that amount would be difficult, if not impossible, to measure in practice. Hence, measuring the full amount of the contribution (as indicated by the dashed box in Diagram 3.2) would not be workable in practice.
- 3.19 The Board next considered whether any portion of the contribution could be identified and measured. In considering that question, the Board analysed the requirements of IFRS 3 for bargain purchase gains. A bargain purchase gain arises if the fair value of the consideration paid is below the fair value of identifiable assets and liabilities acquired in a business combination, as illustrated in Diagram 3.3. The Standard explains that a bargain purchase gain might happen occasionally, for example, in a forced sale in which the seller is acting under compulsion.<sup>25</sup> IFRS 3 requires such a gain to be recognised in the statement of profit or loss. However, based on the discussion in paragraph 3.6, in a business combination under common control, any excess fair value of the identifiable acquired assets and liabilities over the consideration paid constitutes a contribution to equity and therefore should be reported as a change in the receiving company's equity. Accordingly, the Board has reached the preliminary view that it should develop a requirement for the receiving company in a business combination under common control to recognise any excess of the fair value of the identifiable acquired assets and liabilities over the consideration paid as a contribution to equity, rather than as a gain in the statement of profit or loss. The measurement of a contribution is illustrated in Diagram 3.3.

<sup>25</sup> Paragraph 35 of IFRS 3.

**Diagram 3.3—Measuring a bargain purchase gain and a contribution to equity**



Applying the acquisition method

The Board's preliminary view

3.20 The Board has reached the preliminary view that it should develop a requirement for the receiving company to recognise any excess fair value of the identifiable acquired assets and liabilities over the consideration paid as a contribution to equity, not as a bargain purchase gain in the statement of profit or loss, when applying the acquisition method to a business combination under common control.

## Question for respondents

### Applying the acquisition method

#### Question 5

Paragraphs 3.11–3.20 discuss how to apply the acquisition method to business combinations under common control.

- (a) In the Board’s preliminary view, it should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity when applying the acquisition method to a business combination under common control.

Do you agree? Why or why not? If you disagree, what approach for identifying and measuring a distribution from equity do you recommend and why? In particular, do you recommend either of the two approaches discussed in Appendix C or do you have a different recommendation?

- (b) In the Board’s preliminary view, it should develop a requirement for the receiving company to recognise any excess fair value of the identifiable acquired assets and liabilities over the consideration paid as a contribution to equity, not as a bargain purchase gain in the statement of profit or loss, when applying the acquisition method to a business combination under common control.

Do you agree? Why or why not? If you disagree, what approach do you recommend and why?

- (c) Do you recommend that the Board develop any other special requirements for the receiving company on how to apply the acquisition method to business combinations under common control? If so, what requirements should be developed and why are any such requirements needed?

## Section 4—Applying a book-value method

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- 4.1 Section 2 discusses the Board’s preliminary view that a **book-value method** should be applied to:
- (a) all **business combinations under common control** that do not affect **non-controlling shareholders** of the **receiving company**—including combinations that affect potential shareholders or lenders or other creditors of the receiving company; and
  - (b) some business combinations under common control that affect non-controlling shareholders of a **privately held** receiving company in specified circumstances (see paragraph 2.47(b)).
- 4.2 This section discusses the Board’s preliminary views on how a book-value method should be applied to such combinations.
- 4.3 IFRS Standards do not refer to any book-value methods and do not specify how such a method should be applied. As discussed in paragraph 1.6, a variety of book-value methods are used in practice. In particular, the variations relate to:
- (a) measuring the assets and liabilities received—the receiving company uses either the **transferred company’s** book values or the **controlling party’s** book values to measure those assets and liabilities.<sup>26</sup>
  - (b) providing pre-combination information—the receiving company includes the transferred company’s assets, liabilities, income and expenses in its financial statements:
    - (i) either prospectively from the date of the combination,<sup>27</sup> without restating pre-combination information; or
    - (ii) retrospectively from the beginning of the earliest period presented as if the receiving company and transferred company had always been combined, with pre-combination information restated.<sup>28</sup>
- 4.4 Paragraphs 4.6–4.65 discuss:
- (a) input from stakeholders (paragraphs 4.6–4.9);
  - (b) how to measure the assets and liabilities received (paragraphs 4.10–4.19);
  - (c) how to measure the consideration paid (paragraphs 4.20–4.43);
  - (d) how to report any difference between the consideration paid and the book value of the assets and liabilities received (paragraphs 4.44–4.50);
  - (e) how to report transaction costs (paragraphs 4.51–4.56); and
  - (f) how to provide pre-combination information (paragraphs 4.57–4.65).

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<sup>26</sup> In some cases, the transferring company’s book values are used.

<sup>27</sup> The date on which control of a company (or business) is transferred to the receiving company.

<sup>28</sup> In practice, retrospective restatement might apply only from the beginning of the reporting period or only from the date when the combining companies first came under common control by the controlling party.



- 4.5 This section focuses on the key features of a book-value method. The Board will consider the comments received on this Discussion Paper in deciding whether to confirm its preliminary views and develop detailed proposals on how the receiving company should apply a book-value method. Such future detailed proposals might address, for example, how to determine the book values of the assets and liabilities received when those book values are not readily available.

## Stakeholder input

- 4.6 Stakeholder views on *how* a receiving company should apply a book-value method are often linked to their views on *when* and *why* the receiving company should apply that method (summarised in paragraphs 2.6–2.13). Paragraphs 4.7–4.9 discuss how stakeholder views on those topics are interrelated.

View A—business combinations under common control are different from business combinations covered by IFRS 3

- 4.7 As discussed in paragraphs 2.7–2.9, some stakeholders argue that a book-value method should be applied to all business combinations under common control. They argue that all such combinations are different from **business combinations** covered by IFRS 3 *Business Combinations*. These stakeholders view business combinations under common control from the perspective of the controlling party, which controls all combining companies both before and after the combination. In their view, the controlling party simply moves its economic resources from one ‘location’ to another within the group. To reflect the controlling party’s continuing control of the combining companies, these stakeholders typically advocate:
- (a) measuring the assets and liabilities received using the controlling party’s book values; and
  - (b) including the transferred company’s assets, liabilities, income and expenses in the receiving company’s financial statements retrospectively from the beginning of the earliest period presented as if the receiving company and transferred company had always been combined, with pre-combination information restated.

View B—business combinations under common control are similar to business combinations covered by IFRS 3

- 4.8 As discussed in paragraphs 2.10–2.11, some stakeholders argue that most, if not all, business combinations under common control are similar to business combinations covered by IFRS 3. These stakeholders view business combinations under common control from the perspective of the receiving company (rather than the perspective of the controlling party). However, they agree with using a book-value method in some cases for cost-benefit reasons and, in effect, view that method as a series of practical expedients that simplify the **acquisition method** and avoid, for example, the need to determine the fair value of assets and liabilities received. For these reasons, these stakeholders typically express the following views on how to apply a book-value method:
- (a) measuring the assets and liabilities received:
    - (i) some favour using the transferred company’s book values because that approach adopts the perspective of the combining companies rather than the controlling party’s perspective.
    - (ii) others favour using the controlling party’s book values because in some cases those values may be more up to date (see paragraph 4.11).

- (b) providing pre-combination information—they advocate including the transferred company’s assets, liabilities, income and expenses in the receiving company’s financial statements prospectively from the date of combination, which is consistent with the requirements in IFRS 3. Such a prospective approach does not restate pre-combination information.

View C—some business combinations under common control are similar to business combinations covered by IFRS 3 and others are not

4.9 As discussed in paragraphs 2.12–2.13, some stakeholders argue that business combinations under common control are not all similar to each other. In their view, some such combinations are similar to business combinations covered by IFRS 3 and other such combinations may not be similar. For the latter combinations, in their view, a book-value method should be used. These stakeholders express the following views on how to apply that method:

- (a) measuring the assets and liabilities received:
  - (i) some favour using the transferred company’s book values because such an approach treats the receiving company and the transferred company on the same basis and produces an outcome that is similar to **combined financial statements**.
  - (ii) others favour using the controlling party’s book values, for cost-benefit reasons. They suggest that using those book values may simplify internal reporting within the group and hence reduce the cost of reporting.
- (b) providing pre-combination information:
  - (i) some favour including the transferred company’s assets, liabilities, income and expenses in the receiving company’s financial statements retrospectively from the beginning of the earliest period presented, as if the receiving company and the transferred company had always been combined, with pre-combination information restated. In their view, this approach is consistent with the concept of combined financial statements (see paragraph 4.59) and provides useful information about the combined company.
  - (ii) others favour including the transferred company’s assets, liabilities, income and expenses in the receiving company’s financial statements prospectively from the date of the combination, without restating pre-combination information. They agree that pre-combination information for all combining companies could be useful. However, they argue that such information would be both subjective and costly to provide. In addition, they point out that such an approach would depict a combined company that in fact did not exist before the combination.

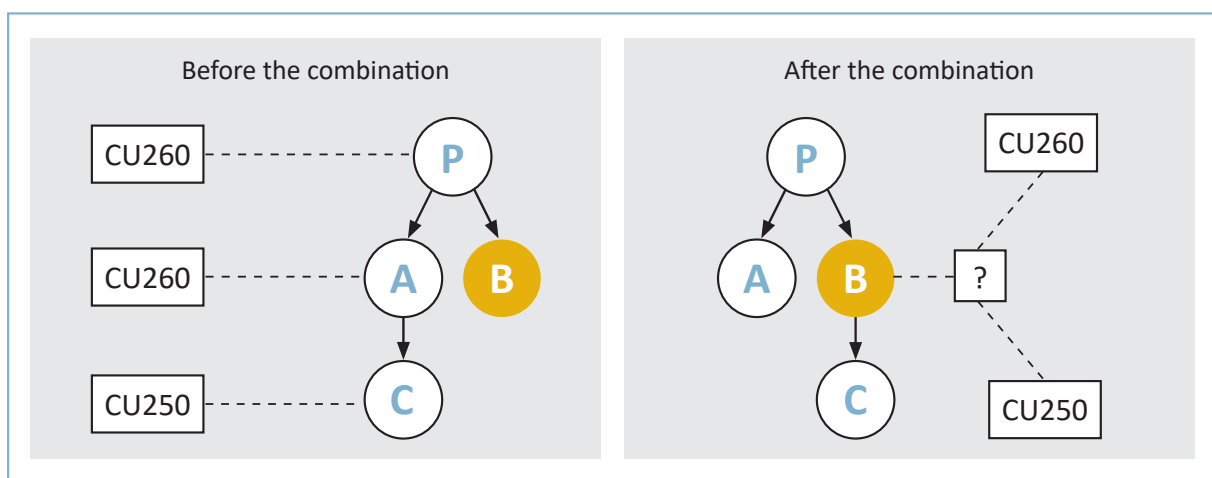
## Measuring the assets and liabilities received

4.10 The Board considered whether the receiving company should measure the assets and liabilities received at the transferred company’s book values or at the controlling party’s book values.<sup>29</sup> 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 had previously been acquired from an external party (that is, a party outside the group), especially if that external acquisition was recent.

<sup>29</sup> Regardless of the approach used, the book values of the assets and liabilities received might need to be adjusted to align them with the receiving company’s accounting policies.

4.11 A difference between the transferred company's book values and the controlling party's book values is illustrated in the example in Diagram 4.1. In that example, Company P controls and wholly owns companies A, B and C. In the past, Company A acquired Company C from an external party. Applying the acquisition method, the assets and liabilities of Company C were measured at fair value at the acquisition date both by Company A, the immediate acquirer, and by Company P, the controlling party. Subsequently, Company C is transferred from Company A to Company B.<sup>30</sup> At the time of this business combination under common control, the book value of Company C's assets and liabilities in its financial statements is CU250,<sup>31</sup> and the book value of those assets and liabilities in both Company A's and Company P's consolidated financial statements is CU260.<sup>32</sup> The latter book value reflects a more recent valuation of Company C's assets and liabilities that was performed at the time when Company A acquired that company from the external party.

**Diagram 4.1—Book values in a business combination under common control**



4.12 In the example in Diagram 4.1, using the controlling party's book values to measure the assets and liabilities received in the business combination under common control would:

- (a) provide information based on a more recent valuation of the assets and liabilities of Company C, the transferred company. However, the controlling party's book values would typically not reflect the fair value of those assets and liabilities at the date of the business combination under common control, especially if the prior external acquisition occurred a long time ago.
- (b) be, arguably, inconsistent with the *Conceptual Framework for Financial Reporting (Conceptual Framework)* which focuses on information about transactions and events from the perspective of the company that prepares the financial statements—in this case, the receiving company.<sup>33</sup> From that perspective, the book values recorded by the controlling party, arguably, have no relation to the combination between Company B, the receiving company, and Company C, the transferred company, because the controlling party is not a party to that combination.

<sup>30</sup> In describing business combinations under common control, IFRS 3 requires that common control is not transitory. As discussed in paragraph 1.16, the Board has not yet considered whether to retain the notion of 'transitory control' and whether to clarify its meaning.

<sup>31</sup> In this Discussion Paper, monetary amounts are denominated in 'currency units' (CU).

<sup>32</sup> The amounts of CU250 and CU260 are both aggregate net amounts that comprise: (a) the total book value of the assets; minus (b) the total book value of the liabilities.

<sup>33</sup> Paragraph 3.8 of the *Conceptual Framework*.

- (c) treat the assets and liabilities of the combining companies, Company B and Company C, on a different basis. That is, following the combination, the assets and liabilities of Company B, the receiving company, would continue to be measured at the book values reported by that company whereas the assets and liabilities of Company C, the transferred company, would be measured at the book values reported by the controlling party. Such an approach means that different information would be provided about the assets and liabilities of the combining companies, depending on how the combination is structured (that is, depending on whether Company C is transferred to Company B or vice versa).
- 4.13 In contrast, using the transferred company's book values to measure the assets and liabilities received in the business combination under common control would:
- (a) provide uninterrupted historical information about Company C, the transferred company, that is useful in analysing trends;
  - (b) present the combination from the perspective of the combining companies, Company B and Company C, rather than from the perspective of the controlling party; and
  - (c) treat the assets and liabilities of the combining companies, Company B and Company C, on the same basis. That is, following the combination, each company's assets and liabilities would continue to be measured at the book values previously reported by that company. Such an approach would provide similar information about the assets and liabilities of the combining companies, irrespective of how the combination is structured (that is, irrespective of whether Company C is transferred to Company B or vice versa).
- 4.14 The Board considers that using the transferred company's book values, rather than the controlling party's book values, would be more consistent with the Board's reasons for requiring or permitting a book-value method in specified circumstances. Specifically, as discussed in paragraphs 2.24–2.27 and illustrated in Diagrams 2.3 and 2.4, using a book-value method for business combinations under common control that do not affect non-controlling shareholders would:
- (a) provide useful information to potential shareholders of the combining companies because the information produced by that method does not depend on how the combination is legally structured; and
  - (b) avoid the difficulties that would arise if the acquisition method was applied because a book-value method does not rely on identifying the 'acquirer' in order to provide useful information.
- 4.15 Extending this logic to *how* a book-value method should be applied suggests that the assets and liabilities of each combining company should be treated on the same basis. That is, each company's assets and liabilities should continue to be measured at the book values previously reported by that company—instead of using different approaches for measuring the assets and liabilities of the combining companies depending on how the combination is legally structured.

- 4.16 The Board also considered the other arguments summarised in paragraphs 4.12–4.13 for using the transferred company’s book values or the controlling party’s book values. The Board acknowledged that, in principle, both information about more recent valuations (discussed in paragraph 4.12(a)) and uninterrupted historical information for analysing trends (discussed in paragraph 4.13(a)) could be useful to users of financial statements. However, the Board’s view is that from a conceptual standpoint, using the transferred company’s book values is more appropriate than using the controlling party’s book values because the controlling party is not a party to the combination of the receiving company with the transferred company.
- 4.17 From a practical perspective, the Board noted that whether the transferred company’s book values or the controlling party’s book values are less costly to use would depend on the facts and circumstances of each combination. For example, one factor that would affect the costs of applying a book-value method is whether the transferred company or the controlling party has prepared its financial statements applying IFRS Standards.
- 4.18 On the basis of the above analysis, the Board has reached the preliminary view that using the transferred company’s book values would be likely to provide the most useful information to users of the receiving company’s financial statements at a cost justified by the benefits of that information.

#### Applying a book-value method

##### The Board's preliminary view

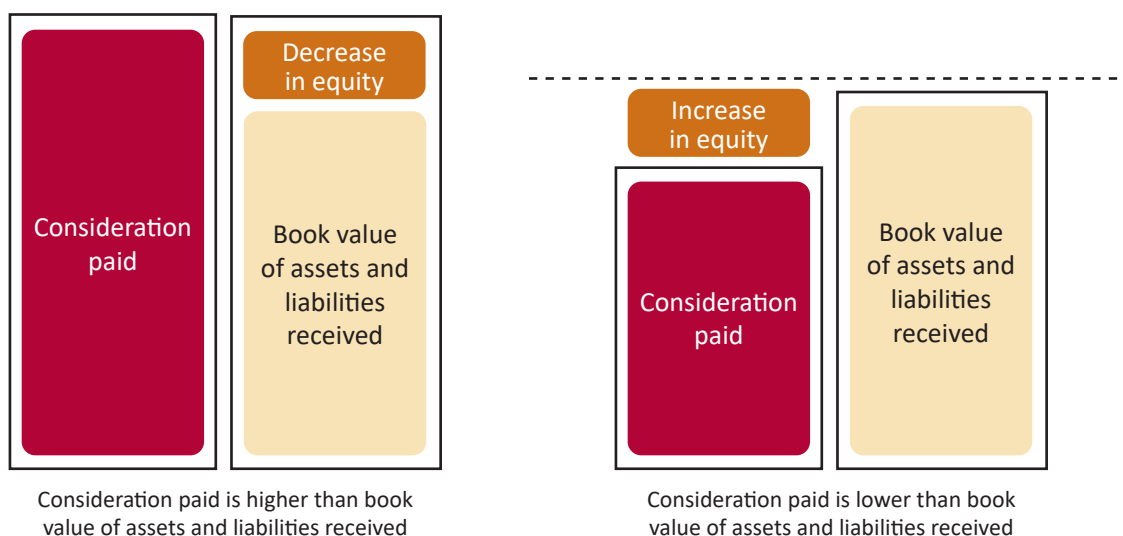
- 4.19 The Board has reached the preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should measure the assets and liabilities received using the transferred company’s book values.

## Measuring the consideration paid

- 4.20 The consideration paid in a business combination under common control can take various forms. Research for this project indicates that the consideration is usually paid in cash or in the receiving company’s own **shares**, but sometimes in non-cash assets or by incurring or assuming liabilities.
- 4.21 That research also indicates that when a book-value method is applied in practice, the consideration paid is measured either at fair value or at book value or, in the case of the consideration paid in own shares, at their par value or a nominal value. Accordingly, the Board considered how the receiving company should measure the consideration paid:
- (a) in own shares (paragraphs 4.25–4.28);
  - (b) in assets (paragraphs 4.29–4.36); and
  - (c) by incurring or assuming liabilities (paragraphs 4.37–4.42).

- 4.22 As discussed in paragraph 3.5, the acquisition method generally measures both the consideration paid and the identifiable acquired assets and liabilities at fair value. Any difference between the fair value of the consideration and the fair value of those assets and liabilities is recognised as goodwill or, in unusual cases, as a gain on a bargain purchase. As also discussed in that paragraph, the acquisition method measures goodwill at an amount that is expected to reflect the fair value of the pre-existing goodwill in the acquired **business** and the price paid for any synergies expected from the combination (see Diagram 3.1 for the illustration of the key features of the acquisition method).
- 4.23 However, as discussed in paragraphs 4.10–4.19, a book-value method measures the assets and liabilities received at their book values rather than their fair values. In addition, book-value methods applied to business combinations under common control in practice typically do not recognise goodwill or a gain. Instead, any difference between the consideration paid and the book value of the assets and liabilities received is typically recognised as a decrease or an increase within the receiving company's equity and, as discussed in paragraphs 4.44–4.50, the Board concurs with such an approach. Accordingly, the reasons for requiring fair value measurement of the consideration paid when applying the acquisition method do not apply to a book-value method.
- 4.24 The interaction between the key features of a book-value method, discussed in paragraph 4.23, is illustrated in Diagram 4.2.

**Diagram 4.2—The key features of a book-value method**



### Consideration paid in own shares

- 4.25 The Board considered whether it should specify how the receiving company should measure the consideration paid in its own shares—for example, at their fair value or at their par value or a nominal value.

- 4.26 As explained in paragraph 4.23, there is an interaction between the question of how to measure the consideration paid and the question of how to report any difference between that consideration and the book value of the assets and liabilities received. In the Board's view, discussed in paragraphs 4.44–4.50, that difference should be recognised within equity. If that difference is recognised within equity, the measurement of the consideration paid in own shares would not affect the receiving company's assets, liabilities, income or expenses or its total equity, but could affect the amounts reported for particular components of the receiving company's equity.
- 4.27 The potential effects on the receiving company's financial statements of the measurement of the consideration paid in the receiving company's own shares are shown in Diagram 4.3. Continuing with the example presented in Diagram 4.1, Company B, the receiving company, issues 100 shares in consideration for Company C, the transferred company. Par value of Company B's shares is CU2 per share and their fair value at the combination date is CU2.7 per share. The book value of Company C's assets and liabilities in its financial statements at the combination date is CU250. The measurement approach for the consideration paid by issuing Company B's own shares could affect the amounts reported for particular components of Company B's equity, as illustrated in Diagram 4.3.

**Diagram 4.3—Measuring consideration paid in own shares**

<i>(all amounts are in CU)</i>	Issued shares at par value	Issued shares at fair value
<b>Company B's equity</b>		
Issued shares	200	270
Difference between the consideration paid and the book value of the assets and liabilities received	50	(20)
<b>Net increase in equity</b>	<u><u>250</u></u>	<u><u>250</u></u>

- 4.28 The reporting of components within a reporting company's equity and the measurement of issued shares for the purpose of that reporting are often affected by national requirements and regulations, and are generally not prescribed in IFRS Standards. For those reasons, the Board has reached a preliminary view that it should not prescribe how to measure the consideration paid in the receiving company's own shares.

#### Consideration paid in assets

- 4.29 The Board next considered how the receiving company should measure the consideration paid in assets—at the fair value of those assets or at their book value in the receiving company's financial statements at the date of combination. If the consideration is paid in cash, its fair value would also be its book value so both measurement approaches would produce the same outcome. However, if the consideration is paid in assets other than cash, the measurement of the consideration would affect whether the receiving company recognises a gain or loss on disposal of those assets in the statement of profit or loss, as follows:
- (a) if the consideration paid is measured at the book value of those assets, no gain or loss would be recognised.
  - (b) if the consideration paid is measured at the fair value of those assets, the receiving company would recognise a gain or loss on disposal of those assets if their book values differ from their fair values.

- 4.30 In addition, the measurement of the consideration paid in assets could affect the amounts reported for particular components of the receiving company's equity, just as occurs when the consideration is paid in the receiving company's own shares (as discussed in paragraph 4.27).
- 4.31 The potential effects on the receiving company's financial statements of measuring the consideration paid in assets other than cash at the fair value or at the book value of those assets are illustrated in Diagram 4.4. Continuing with the example presented in Diagram 4.1, Company B, the receiving company, transfers non-cash assets in consideration for Company C, the transferred company. The book value of those assets in Company B's financial statements at the combination date is CU220 and their fair value is CU270. The book value of Company C's assets and liabilities in its financial statements at the combination date is CU250. Depending on how the consideration paid by transferring non-cash assets is measured, Company B would or would not report a gain on disposal of those assets in the statement of profit or loss. In addition, the amounts reported for particular components of Company B's equity could also vary.

**Diagram 4.4—Measuring the consideration paid in assets**

<i>(all amounts are in CU)</i>	Assets transferred at book value	Assets transferred at fair value
<b>Company B's statement of profit or loss</b>		
Gain on disposal	–	50
<b>Company B's equity</b>		
Retained earnings or other appropriate component of equity	–	50
Difference between the consideration paid and the book value of the assets and liabilities received	30	(20)
<b>Net effect on equity</b>	<b>30</b>	<b>30</b>

- 4.32 As explained in paragraph 4.28, the Board does not generally prescribe the reporting of components within a reporting company's equity because this matter is often affected by national requirements and regulations. However, because the measurement of the consideration paid in assets other than cash would affect the amounts recognised in the receiving company's statement of profit or loss, the Board considered whether this form of consideration should be measured at the fair value of those assets or at their book value.
- 4.33 It could be argued that measuring the consideration paid in assets at the book value of those assets rather than at their fair value would result in different accounting outcomes depending on the structure of the transaction. For example, if the receiving company first sells the assets at their fair value, and then uses the cash proceeds as the consideration in the business combination under common control, it recognises a gain or loss on disposal of those assets in the statement of profit or loss. Alternatively, if the receiving company uses those assets as the consideration in the combination and measures the consideration at the book value of those assets, it will not recognise a gain or loss on disposal. This argument suggests that the consideration paid in assets should be measured at the fair value of those assets, which would result in similar information about the disposal of the assets, regardless of how that disposal occurred.



- 4.34 However, measuring the consideration paid in assets at their fair values could be costly and could involve significant measurement uncertainty. In contrast, such challenges would not arise if the assets are sold for cash and those cash proceeds are used as the consideration paid in the combination. It could also be argued that measuring the consideration paid in assets at their book values, rather than at their fair values, would be more consistent with measuring the assets and liabilities received at their book values. Such an approach would, arguably, be more appropriate if a business combination under common control is viewed as a single transaction—an exchange of the consideration for the business—rather than two separate transactions—a disposal of assets and an acquisition of a business.
- 4.35 Furthermore, information about the gain or loss on disposal may be of limited use to users of the receiving company's financial statements in business combinations under common control to which a book-value method would be applied. Under the Board's preliminary views set out in Section 2, such combinations would typically affect lenders and other creditors of the receiving company. As explained in paragraph 2.32(b), lenders and other creditors need information about the receiving company's cash flows and debt commitments, so they can assess the company's ability to service its existing debt and to raise new debt. That assessment would not depend greatly on information about a gain or loss on disposal of an asset.
- 4.36 Having considered the arguments discussed in paragraphs 4.33–4.35, the Board has reached the view that the benefits of measuring the consideration paid in assets at the fair value of those assets may not outweigh the costs of doing so. Therefore, the Board has reached the preliminary view that the receiving company should measure the consideration paid in assets at the receiving company's book values of those assets at the combination date.

#### Consideration paid by incurring or assuming liabilities

- 4.37 Finally, the Board considered how the receiving company should measure the consideration paid by incurring a liability to the **transferring company** or by assuming a liability of the transferring company to another party.
- 4.38 This form of consideration paid—and the related liability—could be measured at:
- (a) the fair value of the liability at the combination date; or
  - (b) the amount determined on initial recognition of the liability at the combination date applying IFRS Standards.
- 4.39 The Board considered the potential effects of those measurement approaches on the receiving company's financial statements. The measurement approach would affect:
- (a) the initial measurement of the liability; and
  - (b) the amount recognised within the receiving company's equity for any difference between the consideration paid and the book value of the assets and liabilities received.
- 4.40 However, in some cases, for example for financial liabilities, the applicable IFRS Standard would require measuring the liability on initial recognition at fair value. In those cases, both measurement approaches would produce the same outcome.

- 4.41 Except for the effects discussed in paragraphs 4.39–4.40, the measurement approach for the consideration paid by incurring or assuming a liability would not have any other effects on the receiving company’s financial statements at the combination date. Moreover, as stated in paragraphs 4.28 and 4.36, the Board has reached preliminary views that would not require the receiving company to measure other forms of consideration paid at fair value when applying a book-value method.
- 4.42 Accordingly, the Board has not identified convincing reasons to require the consideration paid by incurring or assuming liabilities to always be measured at fair value. Instead, the Board has reached a preliminary view that such consideration should be measured at the amount determined on initial recognition of the liability at the combination date applying IFRS Standards. As stated in paragraph 4.40, in some cases the applicable IFRS Standard would require measuring the liability at fair value.

#### Applying a book-value method

##### The Board's preliminary views

- 4.43 The Board's preliminary views are that:
- (a) the Board should not prescribe how the receiving company should measure the consideration paid in own shares when applying a book-value method to a business combination under common control; and
  - (b) when applying that method, the receiving company should measure the consideration paid as follows:
    - (i) consideration paid in assets—at the receiving company’s book values of those assets at the combination date; and
    - (ii) consideration paid by incurring or assuming liabilities—at the amount determined on initial recognition of the liability at the combination date applying IFRS Standards.

## Reporting the difference between the consideration paid and assets and liabilities received

- 4.44 As discussed in paragraph 4.23, research for this project indicates that, in practice, when applying a book-value method, any difference between the consideration paid and the book value of the assets and liabilities received in a business combination under common control is typically recognised within the receiving company’s equity.
- 4.45 The Board considered whether it should require that approach or a different approach. Under IFRS Standards, changes in equity arise from one of two sources—from transactions with owners in their capacity as owners (such as a contribution of equity or a distribution of dividends to shareholders) or as a result of the company’s financial performance for the period. Economically, not all of the difference that may arise when applying a book-value method necessarily constitutes a contribution to, or distribution from, the receiving company’s equity, nor does all of it necessarily represent income or an expense. Instead, that difference may include one or more of the following components:

- (a) any difference between the consideration paid and what would have been paid to an unrelated party in an arm's length transaction. As discussed in paragraph 3.6, such a difference constitutes a contribution to or a distribution from the receiving company's equity.
  - (b) unrecognised goodwill, comprising the pre-existing goodwill in the transferred company and any synergies arising as a result of the combination. Applying a book-value method, such goodwill is not recognised because (among other reasons) the consideration paid in some business combinations under common control may not approximate the fair value of the acquired business together with the price for the expected synergies (see paragraphs 2.28–2.29). Accordingly, recognising goodwill in those circumstances might result in measuring goodwill at an arbitrary amount that does not provide useful information.
  - (c) other factors, such as measurement differences arising from measuring assets and liabilities received at their book values rather than their fair values and the effects of how the consideration paid is measured under a book-value method (discussed in paragraphs 4.20–4.43).
- 4.46 An approach that requires the difference described in paragraph 4.45 to be segregated into components could be costly and complex to apply. For example, determining whether any of that difference relates to differences between the book values and fair values of the assets and liabilities received would require the receiving company to determine those fair values. Moreover, as discussed in paragraphs 3.11–3.12, the Board has reached the view that a requirement to identify and measure components within the difference between the consideration paid and the fair value of the identifiable acquired assets and liabilities applying the acquisition method would be difficult, if not impossible, to apply in practice—those challenges would also arise if the Board were to require the receiving company to segregate the difference arising applying a book-value method into components. Finally, segregating that difference into components and recognising those components separately would, in effect, remove the differences between a book-value method and the acquisition method. Such an outcome would negate the Board's preliminary view, discussed in Section 2, that a book-value method should be applied to particular business combinations under common control.
- 4.47 Accordingly, the Board has reached the view that the receiving company should not be required to segregate into components any such difference arising when applying a book-value method. The Board has also reached the view that recognising that difference in the receiving company's equity is more appropriate than recognising it as an asset, liability, income or expense. The Board's reasons include that, in accordance with the Board's preliminary views set out in Section 2, a book-value method would be applied to business combinations under common control which might not be subject to any regulations applicable to related party transactions (see paragraphs 2.28–2.29) and which might therefore include a contribution to or distribution from the receiving company's equity (see paragraph 4.45(a)).
- 4.48 The Board next considered whether it should prescribe within which component of equity a receiving company should present any difference arising when applying a book-value method. In practice, locations for presenting this difference include:
- (a) reserves, for example, a special reserve (such as 'reorganisation reserve') or in general reserves;
  - (b) retained earnings or a similar component of equity; or
  - (c) share premium, additional paid-in-capital or a similar component of equity.

4.49 As discussed in paragraph 4.28, IFRS Standards generally do not prescribe within which component of equity particular amounts should be presented. Often, the presentation of components of equity depends on national laws, regulations or other requirements in particular jurisdictions. Accordingly, the Board has reached the preliminary view that it should not prescribe within which component of equity the receiving company should present any difference between the consideration paid and the book value of the assets and liabilities received.

#### Applying a book-value method

#### The Board's preliminary views

4.50 The Board's preliminary views are that:

- (a) when applying a book-value method to a business combination under common control, the receiving company should recognise within equity any difference between the consideration paid and the book value of the assets and liabilities received; and
- (b) the Board should not prescribe in which component, or components, of equity the receiving company should present that difference.

## Reporting transaction costs

4.51 In undertaking business combinations under common control, companies might incur transaction costs, such as advisory, legal, accounting, valuation and other professional fees and the costs of issuing shares or debt instruments.

4.52 In developing its preliminary view on how such transaction costs should be treated under a book-value method, the Board considered:

- (a) the requirements of IFRS 3 and the rationale for those requirements; and
- (b) reporting practices applying a book-value method.

4.53 Under the acquisition method, transaction costs are recognised as expenses in the statement of profit or loss in the period in which they are incurred, with one exception. That exception is for the costs of issuing shares or debt instruments, which are accounted for in accordance with the applicable IFRS Standards.<sup>34</sup>

4.54 In developing IFRS 3, the Board concluded that transaction costs incurred to effect a business combination are not part of the exchange between the buyer and the seller of the business. Rather, they are separate transactions in which the buyer pays for services received. Accordingly, the costs of those services received and consumed during the period should be recognised as expenses (except for costs to issue shares or debt instruments).<sup>35</sup> In practice, book-value methods typically use the same approach for transaction costs.

4.55 The Board has identified no reason for a book-value method to treat transaction costs differently from the approach required by IFRS 3. The approach required by IFRS 3 is also generally used in practice when applying a book-value method.

<sup>34</sup> IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments*.

<sup>35</sup> Paragraphs BC365–BC370 of the Basis for Conclusions to IFRS 3.

### The Board's preliminary view

4.56 The Board has reached the preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should recognise transaction costs as an expense in the period in which they are incurred, except that the costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS Standards.

## Providing pre-combination information

- 4.57 As discussed in paragraph 4.3, in some cases when applying a book-value method, companies combine the assets, liabilities, income and expenses of the transferred company retrospectively. In other words, the receiving company's financial statements are prepared as if the combining companies had always been combined, with pre-combination information restated to include the transferred company's assets, liabilities, income and expenses from the beginning of the earliest period presented. In other cases, companies combine those items prospectively, that is, from the date of the combination, as is required for business combinations covered by IFRS 3. The prospective approach does not require the receiving company to restate pre-combination information.
- 4.58 As discussed in paragraphs 4.14–4.15, in developing its preliminary views on how a book-value method should be applied, the Board considered the reasons for its preliminary view on when a book-value method should be applied to business combinations under common control. Specifically, as discussed in paragraphs 2.24–2.27 and illustrated in Diagrams 2.3 and 2.4, using a book-value method for business combinations under common control that do not affect non-controlling shareholders would:
- (a) provide useful information to potential shareholders of the combining companies because the information produced by that method does not depend on how the combination is legally structured; and
  - (b) avoid the difficulties that would arise if the acquisition method was applied because a book-value method does not rely on identifying the 'acquirer' in order to provide useful information.
- 4.59 Extending this logic to *how* a book-value method should be applied in relation to pre-combination information suggests that pre-combination information should be prepared in a way that does not depend on how the combination is legally structured. That is, the receiving company should combine the transferred company's assets, liabilities, income and expenses retrospectively, so the receiving company's financial statements are prepared as if the combining companies had always been combined. Such an approach would result in the same information being provided, regardless of how the combination is legally structured. Also, such an approach would be similar to the concept of combined financial statements discussed in the *Conceptual Framework*, which implies a retrospective approach.<sup>36</sup>

<sup>36</sup> Paragraph 3.12 of the *Conceptual Framework*.

- 4.60 However, in discussing this issue, many users of financial statements and other stakeholders did not agree with using a retrospective approach in the primary financial statements. As explained in paragraph 4.9(b)(ii), although they agreed that pre-combination information for all combining companies could be useful, they expressed a view that such a retrospective approach would provide a picture of a group in a period when that group did not exist. Some stakeholders call such information ‘pro forma’ (or hypothetical) information and consider it inappropriate to include such information in primary financial statements. Some stakeholders also expressed concerns that preparing such information may involve significant judgement and uncertainty. Finally, some stakeholders pointed out that historical information about each of the combining companies would typically be required by capital market regulations if the combination is undertaken in preparation for an initial public offering.
- 4.61 From a practical perspective, the Board noted that the retrospective approach would be more costly to apply than a prospective approach. Furthermore, the two approaches would provide different information only in the financial statements for the period in which the combination occurs (including when presenting comparative information) and in the financial statements for the following period (only when presenting comparative information). The differences between the approaches would not cause differences in the financial statements for later periods.
- 4.62 After considering the stakeholder input and analysis summarised in paragraphs 4.57–4.61, the Board has reached the view that the benefits of information provided by a retrospective approach may be limited and may not outweigh the costs of providing that information. Accordingly, the Board has reached the preliminary view that the receiving company should combine the transferred company’s assets, liabilities, income and expenses prospectively from the combination date. (However, that preliminary view would not preclude requiring the receiving company to disclose pre-combination information in the notes to its financial statements. That issue is discussed in paragraphs 5.23–5.25.)
- 4.63 The Board next considered whether it should provide application guidance on identifying the receiving company for accounting purposes or whether the legal structure of the transaction should determine this in all cases. This question arises because a prospective approach provides pre-combination information for the receiving company only. For example, Diagram 2.4 in Section 2 illustrates a combination of two wholly-owned subsidiaries in preparation for an initial public offering. Because the combination could be structured in various ways, the question is whether only the legal structure of the transaction should always determine which company is the receiving company for accounting purposes. An alternative approach might be to develop application guidance on identifying which company is the receiving company for accounting purposes. As explained in paragraph 2.27, IFRS 3 already provides application guidance on identifying the acquirer for accounting purposes when applying the acquisition method, such as in reverse acquisitions. However, as explained in paragraph 2.27, that guidance may not help with identifying which company is the receiving company in the circumstances when a book-value method would be applied.

4.64 As discussed in paragraph 4.58(b), one of the Board’s reasons for its preliminary view that a book-value method should be applied to business combinations under common control that do not affect non-controlling shareholders is the difficulty of identifying the acquirer in a way that would provide useful information (see paragraphs 2.26–2.27). A similar difficulty would be likely to arise if the Board were to require companies to look beyond the legal structure of the combination when applying a book-value method and to consider other facts and circumstances to identify the receiving company for accounting purposes. Also, when using a book-value method, identifying the receiving company does not affect the recognition and measurement of the assets, liabilities, income and expenses at the combination date or subsequently—as explained in paragraph 4.61, only pre-combination information is affected. Accordingly, in the Board’s view, the costs of requiring companies to look beyond the legal structure of the combination to identify the receiving company when applying a book-value method are likely to outweigh the benefits of the information provided by such an approach. Hence, the Board has reached the view that it should not develop application guidance on identifying the receiving company when applying a book-value method that considers factors other than the legal structure of the transaction.

#### Applying a book-value method

##### The Board's preliminary view

4.65 The Board has reached the preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should include in its financial statements the assets, liabilities, income and expenses of the transferred company prospectively from the combination date, without restating pre-combination information.

## Questions for respondents

#### Applying a book-value method

##### Question 6

Paragraphs 4.10–4.19 discuss the Board’s preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should measure the assets and liabilities received using the transferred company’s book values.

Do you agree with the Board’s preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

## Applying a book-value method

## Question 7

Paragraphs 4.20–4.43 discuss the Board’s preliminary views that:

- (a) the Board should not prescribe how the receiving company should measure the consideration paid in its own shares when applying a book-value method to a business combination under common control; and
- (b) when applying that method, the receiving company should measure the consideration paid as follows:
  - (i) consideration paid in assets—at the receiving company’s book values of those assets at the combination date; and
  - (ii) consideration paid by incurring or assuming liabilities—at the amount determined on initial recognition of the liability at the combination date applying IFRS Standards.

Do you agree with the Board’s preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

## Applying a book-value method

## Question 8

Paragraphs 4.44–4.50 discuss the Board’s preliminary views that:

- (a) when applying a book-value method to a business combination under common control, the receiving company should recognise within equity any difference between the consideration paid and the book value of the assets and liabilities received; and
- (b) the Board should not prescribe in which component, or components, of equity the receiving company should present that difference.

Do you agree with the Board’s preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

## Applying a book-value method

## Question 9

Paragraphs 4.51–4.56 discuss the Board’s preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should recognise transaction costs as an expense in the period in which they are incurred, except that the costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS Standards.

Do you agree with the Board’s preliminary view? Why or why not? If you disagree, what approach do you suggest and why?



**Question 10**

Paragraphs 4.57–4.65 discuss the Board’s preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should include in its financial statements the assets, liabilities, income and expenses of the transferred company prospectively from the combination date, without restating pre-combination information.

Do you agree with the Board’s preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

## Section 5—Disclosure requirements

- 5.1 This section discusses what information the Board should require **receiving companies** to disclose in the notes about **business combinations under common control** to improve the transparency of reporting these combinations. In practice, companies often provide little information, particularly when applying a **book-value method**.
- 5.2 When developing its preliminary views on disclosure, the Board considered:
- its preliminary views on when and how the **acquisition method** and a book-value method should apply to business combinations under common control;
  - the disclosure requirements in IFRS 3 *Business Combinations*, together with possible improvements to those requirements, as discussed in the Board's Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* (IFRS 3 Discussion Paper);<sup>37</sup> and
  - the fact that business combinations under common control are related party transactions, which means that in some cases the terms of such combinations might differ from those of an arm's length transaction.
- 5.3 Paragraphs 5.5–5.28 discuss:
- disclosure when applying the acquisition method (paragraphs 5.5–5.12); and
  - disclosure when applying a book-value method (paragraphs 5.13–5.28).
- 5.4 The Board's discussion on disclosure is necessarily preliminary, because:
- decisions on disclosure in the context of a particular method are linked to decisions about when and how that method applies, and the Board's preliminary views expressed in Sections 2–4 might change after considering feedback on this Discussion Paper;
  - the Board's preliminary views set out in its IFRS 3 Discussion Paper might change after it considers feedback on that Discussion Paper; and
  - the Board has not yet fully developed the book-value method it would require.

### Disclosure when applying the acquisition method

- 5.5 Section 2 discusses the Board's preliminary view that the acquisition method should be applied to business combinations under common control that affect **non-controlling shareholders** of the **receiving company** (with an exemption and an exception, as set out in paragraph 2.47). One of the Board's reasons for its preliminary view is that business combinations under common control that affect non-controlling shareholders of the receiving company are similar to **business combinations** covered by IFRS 3. Furthermore, the composition of users of the receiving company's financial statements is similar in both cases. Hence, as discussed in paragraph 2.22, the common information needs of those users in such business combinations are also similar. Therefore, the Board's preliminary view is that, in principle, the disclosure requirements in IFRS 3, together with possible improvements to those requirements set out in the IFRS 3 Discussion Paper, should also apply to business combinations under common control when the acquisition method is used.

<sup>37</sup> This Discussion Paper was published in March 2020 and is open for comments until 31 December 2020.

- 5.6 Requiring the same disclosures about those business combinations under common control as are required for business combinations covered by IFRS 3 would be consistent with the practice of some companies that apply the disclosure requirements in IFRS 3 to business combinations under common control reported using the acquisition method.
- 5.7 In addition to developing its overall approach to establishing disclosure requirements for these combinations, the Board considered each of the disclosure requirements in IFRS 3 and each possible improvement to those requirements discussed in the IFRS 3 Discussion Paper. The Board has found no reason to exclude any of those requirements or any of those improvements for business combinations under common control when the acquisition method is used.
- 5.8 The Board also considered whether additional information should be required for those combinations. In particular, a feature of business combinations under common control is that such combinations may not be priced at arm's length, because they involve **related parties**. Therefore, as discussed in paragraph 3.3, the amount of the consideration paid might differ from the amount that would have been paid to an unrelated party in an arm's length transaction. Hence, the Board considered whether it should require additional disclosure about the terms of these combinations to help users of the financial statements understand how the amount of the consideration paid was determined and whether it was reasonable (see paragraph 3.15).
- 5.9 The Board's preliminary views on possible improvements to the IFRS 3 disclosure requirements discussed in the IFRS 3 Discussion Paper would help address the issue discussed in paragraph 5.8. These possible improvements include the disclosure of additional information to help users of the financial statements assess whether the price paid in a business combination was reasonable, such as information about expected synergies.<sup>38</sup> The Board considers that such information would also be useful to users of the receiving company's financial statements in a business combination under common control reported applying the acquisition method.
- 5.10 Furthermore, IAS 24 *Related Party Disclosures* applies to business combinations under common control. In particular, that Standard requires the disclosure of information about the nature of the related party relationship, the amount of the consideration paid and any outstanding balances.<sup>39</sup> IAS 24 also states that disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such terms can be substantiated.
- 5.11 The Board considered whether those requirements in IAS 24 are sufficient to require the receiving company to provide users of its financial statements with the information they need about the terms of a business combination under common control. The Board noted that those requirements would need to be applied together with the requirements in IFRS 3 (including any improved requirements resulting from the IFRS 3 Discussion Paper) when disclosing information about business combinations under common control, for example, information about the terms of those combinations. The Board has reached the preliminary view that it should provide application guidance to help companies apply those disclosure requirements to such combinations. For example, that guidance could explain that companies should disclose information about the governance process over the terms of the combination, such as whether those terms were supported by an independent appraisal or were subject to an approval process involving shareholders or the governing body of the receiving company.

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<sup>38</sup> See Section 2 of the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* (IFRS 3 Discussion Paper) for more information (for example, paragraphs 2.53–2.68).

<sup>39</sup> Paragraph 18 of IAS 24.

### The Board's preliminary views

- 5.12 The Board's preliminary views are that for business combinations under common control to which the acquisition method applies:
- (a) the receiving company should be required to comply with the disclosure requirements in IFRS 3 *Business Combinations*, including any improvements to those requirements resulting from the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*; and
  - (b) the Board should provide application guidance on how to apply those disclosure requirements together with the disclosure requirements in IAS 24 *Related Party Disclosures* when providing information about those combinations, particularly information about the terms of the combination.

## Disclosure when applying a book-value method

- 5.13 Section 2 discusses the Board's preliminary views that a book-value method should apply to all business combinations under common control that do not affect non-controlling shareholders of the receiving company, and some combinations that affect such shareholders in specified circumstances (see paragraphs 2.34 and 2.47). The Board has reached the view that those combinations may not be similar to business combinations covered by IFRS 3 (see paragraphs 2.24–2.29). For example, those combinations involve no change in ultimate **ownership interests** in the economic resources transferred in the combination. Furthermore, if there are no non-controlling shareholders in the receiving company, the composition of users that rely on the receiving company's financial statements for their information needs is also different from business combinations covered by IFRS 3. Specifically, those users only include potential shareholders and existing and potential lenders and other creditors. As a result, the common information needs of those users in such business combinations under common control may also differ from user information needs in business combinations covered by IFRS 3. In addition, the cost-benefit considerations may also be different in those cases.
- 5.14 Section 4 discusses the Board's preliminary views on how a book-value method should be applied to business combinations under common control, in particular, how to measure the assets and liabilities received and the consideration paid, and what pre-combination information should be provided.
- 5.15 The matters discussed in Sections 2 and 4 affect what information the Board should require companies to disclose about those business combinations under common control to which a book-value method would be applied. Specifically, those matters affect the nature and extent of the information necessary to meet common user information needs, as well as whether the benefits of disclosing particular information outweigh the associated costs.
- 5.16 In identifying possible disclosure requirements for such combinations when a book-value method applies, the Board considered the disclosure requirements in IFRS 3 as a starting point. However, in the Board's view, because of the differences in both common user information needs and the cost-benefit trade-off, as well as the differences between how a book-value method and the acquisition method would be applied, only some of the disclosure requirements in IFRS 3 would be appropriate when a book-value method applies.

- 5.17 The Board has reached the preliminary view that the requirement in IFRS 3 for companies to provide information to help users of financial statements evaluate the nature and financial effect of the combination is appropriate for business combinations under common control.<sup>40</sup> The Board has also reached the preliminary view that the related possible requirement discussed in the IFRS 3 Discussion Paper, for companies to provide information to help users understand the benefits expected from the combination, is also appropriate for these combinations.
- 5.18 However, the specific information needed to meet these requirements might differ from the information needed for business combinations covered by IFRS 3. For example, the benefits expected from the combination might include synergies and other benefits for the **controlling party** and the group it controls. Information about those other benefits might be necessary for users of the receiving company's financial statements to understand the nature and effect of the combination.
- 5.19 The Board has also reached the preliminary view that when a book-value method is used, companies should be required to disclose:
- (a) the name and a description of the **transferred company**, the combination date, the percentage of voting equity interests transferred to the receiving company, the primary reasons for the combination and a description of how the receiving company obtained control (paragraphs B64(a)–(d) of IFRS 3);
  - (b) the recognised amounts of each major class of assets received 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 related preliminary view discussed in the IFRS 3 Discussion Paper);
  - (c) the carrying amount of any non-controlling interest in the transferred company (paragraph B64(o) of IFRS 3);
  - (d) aggregate information for individually immaterial combinations that are material collectively (paragraph B65 of IFRS 3);
  - (e) information about combinations that occur after the end of the reporting period but before the financial statements are authorised for issue (paragraph B66 of IFRS 3);
  - (f) the amount and an explanation of any gain or loss recognised in the current reporting period that relates to assets and liabilities received in a business combination under common control that occurred in the current or previous reporting period, if such disclosure is relevant to understanding the receiving company's financial statements (paragraph B67(e) of IFRS 3); and
  - (g) whatever additional information is necessary to meet the disclosure requirements discussed in paragraph 5.17 (paragraph 63 of IFRS 3).
- 5.20 However, in the Board's preliminary view, other disclosures required by IFRS 3 should not be required for business combinations under common control to which a book-value method is applied. For example, the Board's view is that it should not require disclosure of the combination-date fair value of the consideration transferred, such as the fair value of non-monetary assets transferred (paragraph B64(f) of IFRS 3). The Board's preliminary views on measuring the consideration transferred when applying a book-value method would not require fair value measurement (see paragraphs 4.20–4.43) and, in the Board's view, the costs of disclosing such information would outweigh the benefits.

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<sup>40</sup> Paragraph 59 of IFRS 3.

5.21 Table 5.1 summarises those disclosure requirements set out in IFRS 3 (including possible improvements to those requirements discussed in the IFRS 3 Discussion Paper) which, in the Board’s preliminary view, should not be required for business combinations under common control to which a book-value method applies. Table 5.1 also notes the main reason for the Board’s view on each requirement (although more than one reason applies in some cases).

**Table 5.1—IFRS 3 disclosures that should not be required when a book-value method is applied**

Main reason for the Board’s preliminary view	Disclosure requirement
These combinations may not be similar to combinations covered by IFRS 3	Strategic rationale, management’s objectives for the acquisition and subsequent performance of the acquisition (preliminary view discussed in the IFRS 3 Discussion Paper relating to paragraph B64(d) of IFRS 3)
	Description, timing and estimated amount of expected synergies (preliminary view discussed in the IFRS 3 Discussion Paper relating to paragraph B64(e) of IFRS 3)
The book-value method differs from the acquisition method	Description of factors that make up acquired goodwill and reconciliation of its carrying amount at the beginning and at the end of the reporting period (paragraphs B64(e) and B67(d) of IFRS 3)
	Description and estimate of financial effects of contingent liabilities recognised (paragraphs B64(j) and B67(c) of IFRS 3)
	Amount of gain recognised in a bargain purchase (paragraph B64(n) of IFRS 3)
The costs of providing the information outweigh the benefits	Fair value of the consideration transferred and of each major class of consideration at the acquisition date (paragraph B64(f) of IFRS 3)
	Fair value and gross contractual amount of acquired receivables (paragraph B64(h) of IFRS 3)
	Amount of goodwill deductible for tax purposes (paragraph B64(k) of IFRS 3)
	Pro forma information for the current period as though the acquisition had occurred at the beginning of the annual reporting period (paragraph B64(q) of IFRS 3 and the related preliminary view discussed in the IFRS 3 Discussion Paper)
The Board has not yet discussed all aspects of a book-value method and the disclosure relates to a matter not yet considered	Amount at the acquisition date (and subsequent changes in that amount) and description of contingent consideration and indemnification assets (paragraphs B64(g) and B67(b) of IFRS 3)
	Description and amount recognised for separate transactions (paragraphs B64(l) and B64(m) of IFRS 3)
	Fair value of the equity interest in the acquiree in a business combination achieved in stages (paragraph B64(p) of IFRS 3)
	Information to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods (paragraphs 61, 62 and B67(a) of IFRS 3)

- 5.22 In addition to considering the disclosure requirements in IFRS 3 and the possible improvements to those requirements, the Board considered whether it should specify any other disclosure requirements for business combinations under common control when a book-value method applies.
- 5.23 In particular, the Board considered whether it should require disclosure of pre-combination information. Section 4 explains that the Board reached the preliminary view that the assets, liabilities, income and expenses of the transferred company should be combined with those of the receiving company prospectively, from the combination date, without restating pre-combination information. However, that preliminary view would not preclude requiring the receiving company to disclose pre-combination information in the notes to its financial statements.
- 5.24 For example, the Board could require a complete set of pre-combination information for all the combining companies, such as a full or condensed set of **combined financial statements**. Alternatively, the Board could require limited pre-combination information, such as the revenue and profit or loss of the combined company for the current reporting period, as if the combination had occurred at the beginning of the reporting period (as required by paragraph B64(q)(ii) of IFRS 3). (The IFRS 3 Discussion Paper discusses possible improvements to this requirement, such as adding a requirement to disclose cash flows from operating activities.)
- 5.25 In considering whether it should require disclosure of pre-combination information, the Board noted feedback from users of financial statements that such information could be useful, for example, in performing trend analysis. However, some stakeholders (including preparers of financial statements) argued that this information is costly to prepare, for example, when it would be necessary to align accounting policies of the combining companies retrospectively rather than prospectively. On balance, in the Board's view, the benefits of the disclosure of pre-combination information in the circumstances when a book-value method is applied would not outweigh the costs of doing so. Accordingly, the Board has reached the preliminary view that it should not require the disclosure of pre-combination information.
- 5.26 The Board next considered its preliminary view, as discussed in paragraphs 4.44–4.50, that when a book-value method applies:
- (a) any difference between the amount of the consideration paid and the book value of the assets and liabilities received should be recognised within the receiving company's equity; and
  - (b) the Board would not prescribe the component, or components, of equity within which that difference should be presented.
- 5.27 In the Board's view, information about that difference would be useful to users of the receiving company's financial statements. Accordingly, the Board has reached the preliminary view that the receiving company should disclose the amount recognised in equity for any difference between the consideration paid and the book value of the assets and liabilities received, together with the component, or components, of equity that includes this difference.

### The Board's preliminary views

5.28 The Board's preliminary views are that for business combinations under common control to which a book-value method applies:

- (a) some, but not all, of the disclosure requirements in IFRS 3 *Business Combinations*, including any improvements to those requirements resulting from the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*, are appropriate (as summarised in paragraphs 5.17 and 5.19);
- (b) the Board should not require the disclosure of pre-combination information; and
- (c) the receiving company should disclose:
  - (i) the amount recognised in equity for any difference between the consideration paid and the book value of the assets and liabilities received; and
  - (ii) the component, or components, of equity that includes this difference.

## Questions for respondents

### Question 11

Paragraphs 5.5–5.12 discuss the Board's preliminary views that for business combinations under common control to which the acquisition method applies:

- (a) the receiving company should be required to comply with the disclosure requirements in IFRS 3 *Business Combinations*, including any improvements to those requirements resulting from the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*; and
- (b) the Board should provide application guidance on how to apply those disclosure requirements together with the disclosure requirements in IAS 24 *Related Party Disclosures* when providing information about these combinations, particularly information about the terms of the combination.

Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?



**Question 12**

Paragraphs 5.13–5.28 discuss the Board’s preliminary views that for business combinations under common control to which a book-value method applies:

- (a) some, but not all, of the disclosure requirements in IFRS 3 *Business Combinations*, including any improvements to those requirements resulting from the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*, are appropriate (as summarised in paragraphs 5.17 and 5.19);
- (b) the Board should not require the disclosure of pre-combination information; and
- (c) the receiving company should disclose:
  - (i) the amount recognised in equity for any difference between the consideration paid and the book value of the assets and liabilities received; and
  - (ii) the component, or components, of equity that includes this difference.

Do you agree with the Board’s preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

## Appendix A—Terms used in this Discussion Paper

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In general, this Discussion Paper uses simple, non-technical language (as discussed in the Introduction). However, the following terms are used in this Discussion Paper with meanings specified in this appendix.

<b>acquisition method</b>	The method required in IFRS 3 <i>Business Combinations</i> to account for business combinations within the scope of that Standard.
<b>book-value method</b>	<p>A method in which a receiving company measures assets and liabilities received in a business combination under common control using the book values (carrying amounts) of those assets and liabilities determined by applying IFRS Standards.</p> <p>A variety of book-value methods are used in practice and various labels are used for those methods, including the predecessor method, the pooling (or uniting) of interests method or merger accounting. This Discussion Paper uses the term ‘book-value method’ as a collective term for all these methods.</p>
<b>business</b>	An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating income from ordinary activities. <sup>41</sup>
<b>business combination</b>	A transaction or other event in which an acquirer obtains control of one or more businesses. Business combinations are sometimes called mergers or acquisitions. <sup>42</sup>
<b>business combination under common control</b>	<p>A business combination in which all of the combining companies or businesses are ultimately controlled by the same party, both before and after the combination.<sup>43</sup></p> <p>For simplicity, this Discussion Paper uses this term to refer to all transactions within the scope of the project (as described in paragraphs 1.12–1.16), irrespective of whether those transactions meet the definition of a business combination in IFRS 3.</p>
<b>combined financial statements</b>	The financial statements of a reporting entity that comprises two or more entities that are not all linked by a parent-subsidary relationship. <sup>44</sup> The <i>IFRS for SMEs</i> <sup>®</sup> Standard describes an approach to preparing combined financial statements (for example, intercompany transactions and balances are eliminated). <sup>45</sup>

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<sup>41</sup> Appendix A of IFRS 3.

<sup>42</sup> Appendix A of IFRS 3.

<sup>43</sup> Paragraphs B1–B4 of IFRS 3.

<sup>44</sup> Paragraph 3.12 of the *Conceptual Framework*.

<sup>45</sup> Paragraph 9.29 of the *IFRS for SMEs* Standard.

<b>controlling party</b>	<p>The party or parties that control all of the combining companies both before and after a business combination under common control. IFRS 3 explains that in these combinations, the controlling party could be a company, an individual or, in specified circumstances, a group of individuals.<sup>46</sup> For simplicity, this Discussion Paper uses examples of business combinations under common control in which the controlling party is a company, rather than an individual or a group of individuals. For example, in Diagram 1.1, the controlling party is Company P.</p> <p>In some combinations, there may exist more than one party that controls all of the combining companies both before and after the combination. For example, if Company P in Diagram 1.1 was controlled by another party—say Company U—then both companies U and P would be a ‘controlling party’ because both companies would control companies A, B and C. In this case, Company U would be the ultimate controlling party.</p>
<b>non-controlling shareholders</b>	<p>Shareholders other than the controlling party (sometimes called minority shareholders). For example, in Diagram 2.2, if 70% of shares in Company B, the receiving company, are held by the controlling party and the other 30% of its shares are held by other parties, those other parties are non-controlling shareholders in Company B.</p> <p>For simplicity, this Discussion Paper uses the term ‘shareholders’ to refer to all holders of the company’s equity instruments, as defined in IAS 32 <i>Financial Instruments: Presentation</i>, and the term ‘shares’ to refer to all those equity instruments (also see the definition of the term ‘shares’).</p>
<b>ownership interest</b>	<p>An economic interest held in a company by its shareholders. This Discussion Paper uses the term ‘ownership interest’ broadly to refer not only to the shareholders’ legal interest in the company’s shares, but also to their economic interest in the economic resources of that company and of its subsidiaries.</p>
<b>privately held</b>	<p>Shares that are not traded in a public market or a company whose shares are not traded in a public market.</p>
<b>public market</b>	<p>A domestic or foreign stock exchange or an over-the-counter market, including local and regional markets.<sup>47</sup></p>
<b>publicly traded</b>	<p>Shares that are traded in a public market or a company whose shares are traded in a public market.</p>
<b>related party</b>	<p>A related party as defined in IAS 24 <i>Related Party Disclosures</i>.<sup>48</sup></p>
<b>receiving company</b>	<p>The company to which control of a company (or business) is transferred in a business combination under common control. For example, in Diagram 1.1, Company B is the receiving company. The term ‘receiving company’ refers not only to the immediate receiving company but also to those parent companies (if any) of that immediate receiving company that did not control the transferred company before the combination.</p>

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<sup>46</sup> Paragraphs B2 and B3 of IFRS 3.

<sup>47</sup> Paragraph 4(a)(ii) of IFRS 10 *Consolidated Financial Statements*, paragraph 2(b)(i) of IFRS 8 *Operating Segments* and paragraph 2(b)(i) of IAS 33 *Earnings per Share*.

<sup>48</sup> Paragraph 9 of IAS 24.

<b>shares</b>	Equity instruments, as defined in IAS 32, issued by the receiving company. For simplicity, this Discussion Paper focuses on receiving companies with simple capital structures, comprising only ordinary shares that meet the definition of an equity instrument and simple debt instruments that meet the definition of a liability. In the next phase of the project, the Board will consider the implications of more complex instruments.
<b>transferred company</b>	The company (or business) that is transferred from one company to another in a business combination under common control. For example, in Diagram 1.1, Company C is the transferred company.
<b>transferring company</b>	The company that loses control of one or more companies (or businesses) in a business combination under common control. For example, in Diagram 1.1, Company A is the transferring company. The term ‘transferring company’ refers not only to the immediate transferring company, but also to those parent companies (if any) of that immediate transferring company that also lose control of the transferred company as a result of the combination.

## Appendix B—Scope of the project

- B.1 Paragraphs 1.10–1.23 of Section 1 discuss the scope of the project. This appendix elaborates on:
- which transactions are within the project’s scope (paragraphs B.2–B.12);
  - which company’s reporting of those transactions is considered in the project (paragraphs B.13–B.15); and
  - in which types of financial statements those transactions are reported (paragraphs B.16–B.18).

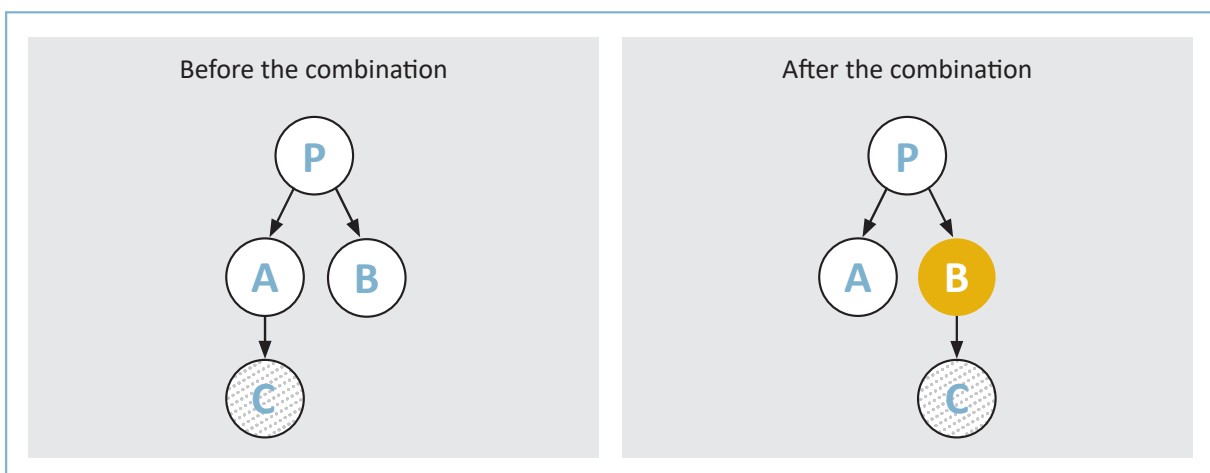
### Which transactions are within the project’s scope?

- B.2 Paragraph 1.13 explains that the project is not considering reporting requirements for transactions involving companies under common control that do not involve the transfer of a **business**, for example, transfers of assets. Examples 1 and 2 illustrate transactions that are outside the scope of the project.
- B.3 Paragraphs 1.15–1.16 explain the Board’s preliminary view that it should develop proposals for reporting by the **receiving company** of all transfers of a business under common control, irrespective of whether the transfer:
- is preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies to an external party (that is, a party outside the group); or
  - is conditional on a sale of the combining companies to an external party, such as in an initial public offering.
- B.4 Examples 3 and 4 illustrate transactions that are within the project’s scope.

Example 1—A transfer of a company that does not have a business

- B.5 In Example 1, control of Company C is transferred from Company A to Company B. All three companies are ultimately controlled by Company P. However, Company C does not have a business—it has no business activities and its only asset is vacant land.

**Diagram B.1—A transfer of a company that does not have a business**

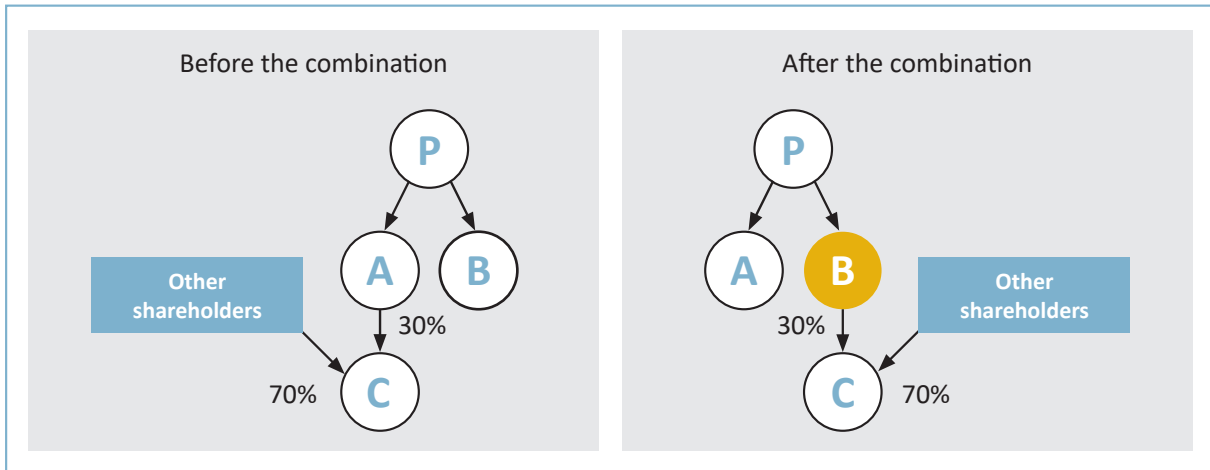


B.6 In this transaction, the transfer of Company C to Company B results in Company B receiving an asset, not a business. Therefore, this transaction is outside the scope of the project.

Example 2—A transfer of an associate

B.7 In Example 2, Company A has an investment in an associate, Company C. Company A transfers its investment in Company C to Company B. Companies A and B are controlled by Company P.

Diagram B.2—A transfer of an associate

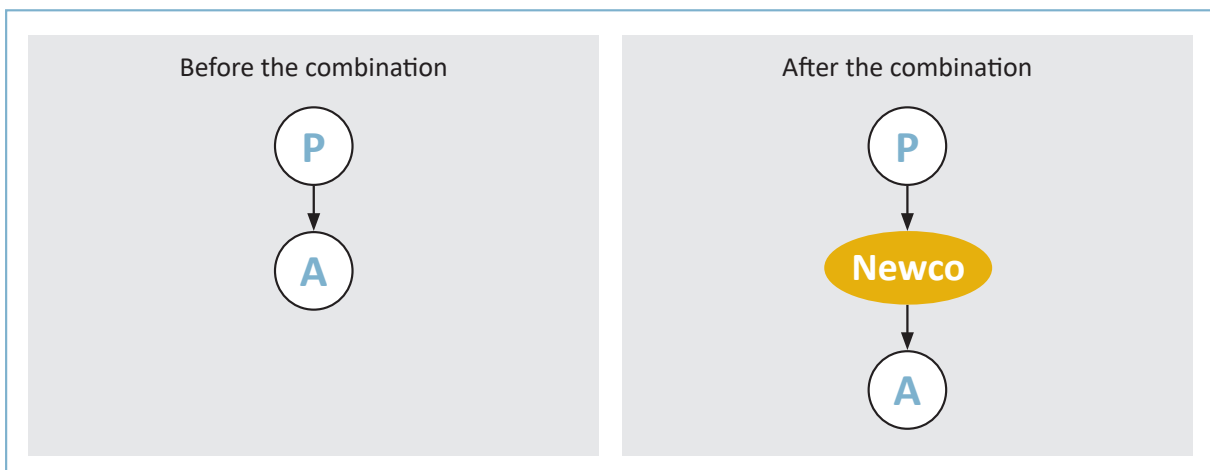


B.8 In this transaction, Company B receives an asset—an investment in an associate, Company C—not a business. Therefore, this transaction is outside the scope of the project.

Example 3—A transfer of a business that may not meet the definition of a business combination

B.9 In Example 3, Company A is controlled by Company P. Company P forms a new company, Newco, and transfers control of Company A to Newco.

Diagram B.3—A transfer of a business that may not meet the definition of a business combination

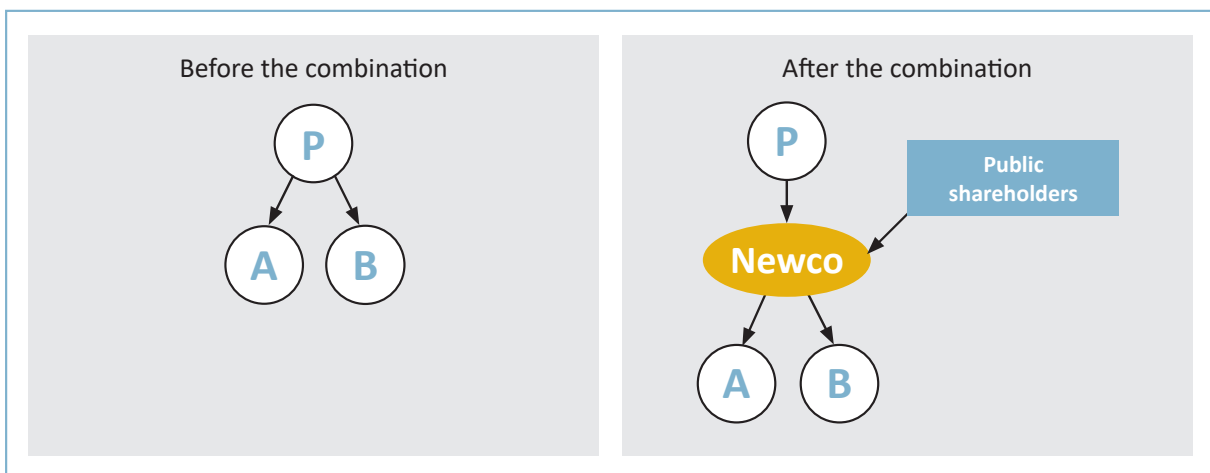


B.10 IFRS 3 *Business Combinations* defines a **business combination** as a transaction or other event in which an acquirer obtains control of one or more businesses.<sup>49</sup> Paragraph B18 of IFRS 3 limits the circumstances when a new company formed to effect a business combination can be identified as the acquirer. If Newco cannot be identified as the acquirer in the ‘combination’ of Newco and Company A, the only other possible ‘acquirer’ in that ‘combination’ would be Company A—that is, the transaction would be viewed as Company A acquiring Newco (rather than the other way around). However, because Newco is a newly established company, it could be just a legal shell that does not have a business. If Newco does not have a business, the transaction would not meet the definition of a business combination. Nevertheless, the transaction involves a transfer of a business, Company A, under common control. Therefore, applying the Board’s preliminary view, the transaction is within the scope of the project.

Example 4—A combination that is conditional on an external sale in an initial public offering

B.11 In Example 4, companies A and B are controlled by Company P. In preparation for an initial public offering, Company P forms a new company, Newco. Control of Companies A and B is transferred to Newco, but that transfer is conditional on the success of the initial public offering of **shares** in Newco. If that offer is successful, Company P will lose control of Newco, Company A and Company B.

**Diagram B.4—A combination that is conditional on an external sale in an initial public offering**



B.12 In this situation, questions might arise about whether Company P’s control of Newco is ‘transitory’ and, therefore, whether the combination of Newco with companies A and B is a **business combination under common control** as described in IFRS 3. Nevertheless, applying the Board’s preliminary view, the combination is within the scope of the project.

<sup>49</sup> Appendix A of IFRS 3.

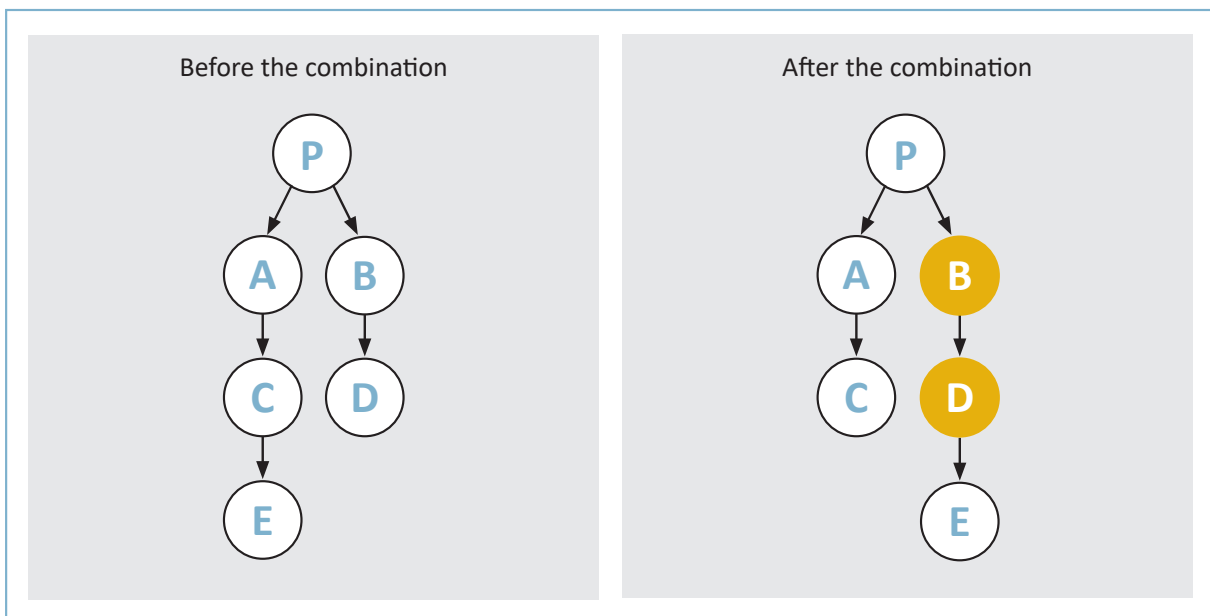
## Which company's reporting?

B.13 Paragraphs 1.17–1.19 explain that the project is considering possible reporting requirements for a receiving company in a business combination under common control. However, the term 'receiving company' refers not only to the immediate receiving company in the combination. It also refers to those parent companies (if any) of that immediate receiving company that did not control the **transferred company** before the combination. Example 5 illustrates a business combination under common control in which there is more than one receiving company.

Example 5—A combination with more than one receiving company

B.14 In Example 5, companies A, B, C, D and E are all ultimately controlled by Company P. Control of Company E is transferred from Company C to Company D. After the combination, Company E's immediate parent is Company D, whose immediate parent is Company B.

**Diagram B.5—A combination with more than one receiving company**



B.15 Companies B and D are both receiving companies in the combination because the combination resulted in both companies gaining control of Company E—Company D now controls Company E as its immediate parent, and Company B now controls Company E through its control of Company D. Accordingly, possible reporting requirements explored by the Board in this project would apply to both companies B and D. They would not apply to any of the other companies.

## Which types of financial statements?

B.16 Paragraphs 1.20–1.23 explain which types of financial statements prepared by the receiving company would be subject to possible reporting requirements explored by the Board in this project.



- B.17 Specifically, for the transfer of a company, those possible reporting requirements:
- (a) would apply to the receiving company's consolidated financial statements.
  - (b) would *not* apply to the receiving company's separate financial statements. As discussed in paragraph 1.23, the project is not addressing how the receiving company should report in its separate financial statements an investment in a subsidiary received in a business combination under common control.
- B.18 Furthermore, if the combination involves the transfer of an unincorporated business, those possible reporting requirements would apply as follows:
- (a) if the receiving company has subsidiaries, those requirements would apply to both consolidated and separate financial statements of the receiving company.
  - (b) if the receiving company does not have any subsidiaries, but has an investment in an associate or a joint venture, those requirements would apply to both individual and separate financial statements of the receiving company.
  - (c) if the receiving company does not have any subsidiaries, associates or joint ventures, those requirements would apply to the individual financial statements of the receiving company.<sup>50</sup>

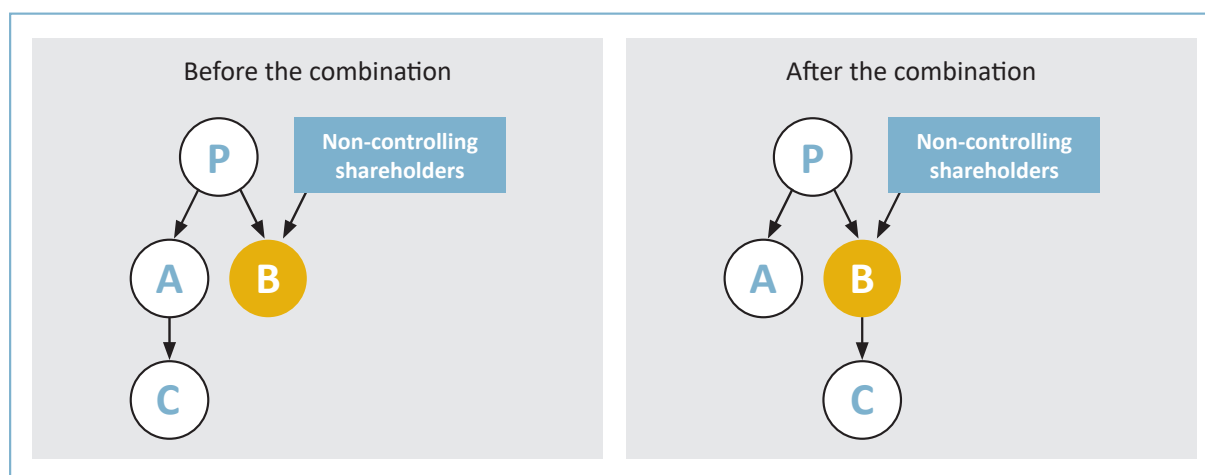
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<sup>50</sup> Separate financial statements are those that report a company's investments in subsidiaries, joint ventures and associates at cost or by applying one of the other methods permitted by IAS 27 *Separate Financial Statements*. The term 'individual financial statements' is sometimes used to refer to the financial statements of a company with no subsidiaries.

## Appendix C—Measuring distributions from equity

- C.1 Section 3 sets out the Board’s preliminary view that it should not develop a requirement for the **receiving company** to identify, measure and recognise a distribution from equity when applying the **acquisition method** to a **business combination under common control**.
- C.2 If the Board were, nevertheless, to require the receiving company to identify and recognise a distribution, it would need to consider how the receiving company should measure that distribution. This appendix discusses two possible approaches:
- measuring a distribution as the excess of the fair value of the consideration transferred over the fair value of the acquired **business** (the fair-value-based approach) (paragraphs C.6–C.8); and
  - measuring a distribution by applying the requirements on testing goodwill for impairment in IAS 36 *Impairment of Assets* (the impairment-based approach) (paragraphs C.9–C.10).
- C.3 This Appendix uses a simple example of a business combination under common control illustrated in Diagram C.1 to explain how those possible approaches would apply.

**Diagram C.1—A business combination under common control**



- C.4 In the example in Diagram C.1, control of Company C is transferred from Company A to Company B. Suppose that:
- the fair value of Company C’s identifiable assets and liabilities is CU90;<sup>51</sup>
  - the fair value of Company C’s business is CU100; and
  - the fair value of the consideration paid by Company B is CU130 (see Diagram C.2).

<sup>51</sup> The amount of CU90 is an aggregate net amount that comprises: (a) the total fair value of the assets; minus (b) the total fair value of the liabilities.

- C.5 Applying the acquisition method, the receiving company, Company B, will measure goodwill as a residual amount—the excess of the fair value of the consideration paid over the fair value of the identifiable acquired assets and liabilities.<sup>52</sup> In this example, this residual amount is CU40 (CU130 minus CU90). If the consideration paid of CU130 includes a distribution from equity, a requirement to measure that distribution would entail finding a way to divide the excess consideration of CU40 between that distribution and goodwill. Paragraphs C.6–C.10 outline two possible approaches considered by the Board. Paragraph C.11 includes a diagram that summarises these two approaches.

## The fair-value-based approach

- C.6 The fair-value-based approach would require the receiving company, Company B, to measure:
- (a) a distribution from equity as the excess of the fair value of the consideration paid (CU130) over the fair value of the acquired business (CU100). That excess is CU30 in the example in Diagram C.1; and
  - (b) goodwill at the excess of the fair value of the acquired business (CU100) over the fair value of the identifiable acquired assets and liabilities (CU90). That excess is CU10 in the example in Diagram C.1.
- C.7 As discussed in paragraph 3.5, in a **business combination** between unrelated parties, goodwill reflects both:
- (a) the fair value of the pre-existing goodwill in the acquired business; and
  - (b) the price paid for any synergies expected from the combination.
- C.8 In contrast, the fair-value-based approach would limit the initial measurement of goodwill to the first element—the fair value of the pre-existing goodwill in the acquired business. The receiving company would therefore, in effect, include the price paid for any synergies expected from the combination in measuring the distribution from equity, not in measuring goodwill. Accordingly, this approach would understate goodwill and overstate the distribution from equity if the consideration paid includes a price paid for expected synergies (see Diagram C.2). Also, this approach would typically involve significant measurement uncertainty and be costly to apply, because it would require the receiving company to measure the fair value of the acquired business.

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<sup>52</sup> Paragraph C.5 summarises requirements explained more precisely in paragraph 32 of IFRS 3.

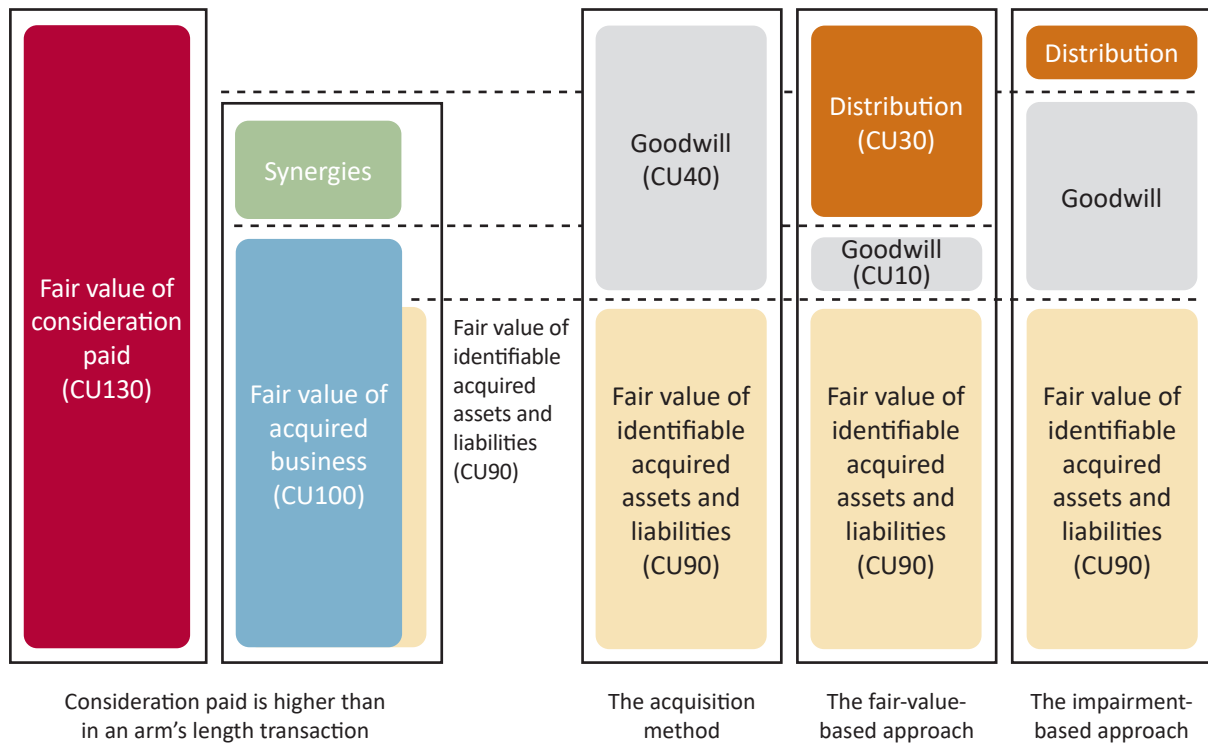
## The impairment-based approach

- C.9 The impairment-based approach would build on the requirements in IAS 36 on testing goodwill for impairment. Hence, unlike the fair-value-based approach, this approach would not introduce a new type of measurement or require the receiving company to measure the fair value of the acquired business. Instead, it would use the goodwill impairment test as a means of allocating the excess consideration paid in a business combination under common control over the fair value of the identifiable acquired assets and liabilities (CU40 in the example in Diagram C.1) between goodwill and a distribution from equity. The impairment-based approach would require the receiving company, Company B, to:
- (a) apply the goodwill impairment test at the combination date;
  - (b) measure goodwill at the recoverable amount calculated in the impairment test; and
  - (c) treat any excess goodwill over that recoverable amount as a distribution from equity rather than as an impairment loss.
- C.10 However, this approach might not allow the receiving company to identify appropriately which portion of the consideration paid is a distribution from equity rather than goodwill. This portion is difficult to identify because the goodwill impairment test requires allocating goodwill to cash-generating units and does not measure the recoverable amount of goodwill directly.<sup>53</sup> If the recoverable amount of the cash-generating unit containing an allocation of goodwill exceeds the book value of that unit, no impairment loss and no distribution from equity would be identified and recognised, even if goodwill is in fact not recoverable (see Diagram C.2).

## Summary of the two approaches

- C.11 Diagram C.2 illustrates how the fair-value-based approach and the impairment-based approach would work in theory. It assumes that:
- (a) the consideration paid is higher than the consideration that would have been paid in an arm's length transaction between unrelated parties;
  - (b) the fair value of the acquired business can be estimated without significant measurement uncertainty; and
  - (c) the goodwill impairment test is able to measure the excess of the consideration paid over the sum of (i) the fair value of the acquired business, and (ii) the price that would have been paid for expected synergies in an arm's length transaction between unrelated parties.

<sup>53</sup> In the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*, the Board expressed the preliminary view that significantly improving the effectiveness of the impairment test for goodwill at a reasonable cost is not feasible.

**Diagram C.2—Possible approaches to measuring a distribution from equity**

C.12 As discussed in Section 3, the Board has reached the preliminary view that it should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity when applying the acquisition method to a business combination under common control. The Board did not discuss which, if any, of the two approaches discussed in paragraphs C.6–C.10 it should propose if it were to require companies to recognise a distribution from equity.



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