European Financial Reporting Advisory Group

Organismo Italiano di Contabilità

Discussion Paper: *Accounting for Business Combinations under Common Control*

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Agenda

- Background to the Project
- Summary and Key Issues
- Questions to Constituents
- Next steps

Background

Background to the Project

Why EFRAG and OIC decided to undertake the Project

- IFRS are currently silent on the treatment of Business Combinations under Common Control (BCUCC) as they are scoped out of IFRS 3 *Business Combinations*. In practice, there is no clear consensus on how these transactions should be accounted for in the financial statements of the transferee.
- Underlying the differences in views is the assessment of if BCUCC differs substantially from business combinations under IFRS 3 or not.
- For those reasons EFRAG and the OIC decided to issue this discussion paper, which constitutes the first outcome of the Project. The intention is to stimulate debate about these issues and assist the IASB in developing a practical and workable response to these issues.
- The discussion paper (DP) sets out different point of view in attempt to structure the debate on the topic and does not favour one view over another.

Background to the Project

Key Concerns in developing the Project

- Common “beliefs” in this area: **cost accounting vs fair value accounting**
- **Scope definition**: How to draw the line among so many related issues
- The **“unique” feature** of BCUCC:
  - Purpose of the transaction
  - Absence of market conditions
  - Nature of items being exchanged
- The definition of “**reporting entity**”.

Background to the Project

Key Concerns in developing the Project

- How to satisfy the objective of the financial reporting. That is, the accounting should result in information that is **decision-useful for user**.
  - The information that is likely to be useful to users about such transactions will hinge on **who the user** are and the **types of decisions** they could make as a result of the BCUCC.

- Will user interest be best served by making a **clean break with reported values** of the transferor prior to the combination (that is erasing its financial history and stepping up to fair value at the acquisition date). Alternatively, it may be more useful **to maintain a historical trend** of financial information that results from applying a predecessor basis of accounting.

- How to apply the logic of **IAS 8 hierarchy**: Starting from scratch or focusing preliminarily on possible similarities with other BC under IFRS 3.

Summary and Key issues

Summary and Key issues

a) Scope: initial recognition and measurement in the consolidated financial statements of the transferee. The Project does not address, at this stage, subsequent measurement, separate and individual financial statements, and disclosures.

b) DP suggests that any approach to BCUCC should result in decision-useful information for the users of the financial statements.

c) Rather than starting from 'first principles' the DP follows the logic of the IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors hierarchy.

d) It is not clear from the analysis that IFRS 3 is a 'good fit' for BCUCC as such transactions are not at arm's length and not subject to market forces.

Summary and Key issues

e) Three views are presented:

i. IFRS 3 could be adapted and a meaningful analogy can be drawn but there are variants within this view;

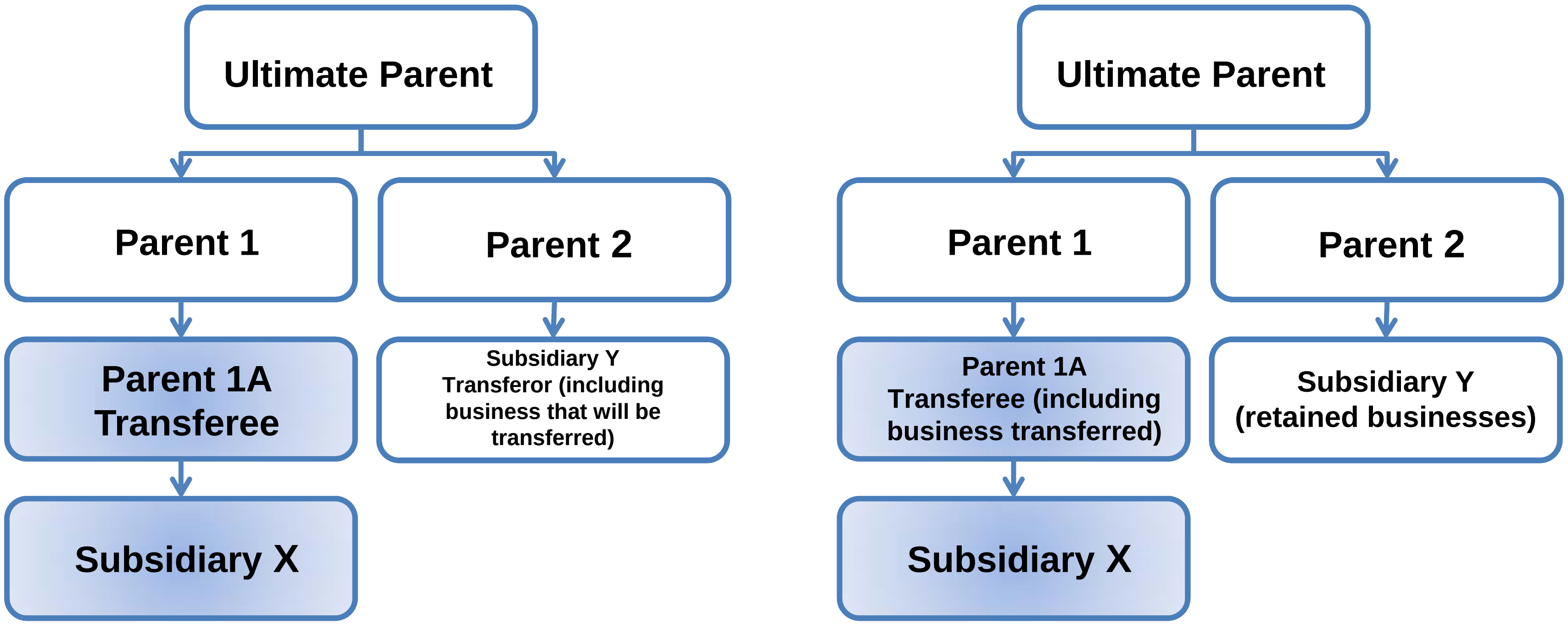
ii. IFRS 3 should never be applied and a predecessor basis or ‘fresh start’ accounting is likely to provide more relevant information; or

iii. the recognition and measurement principles should be driven by how the transaction impacts the decisions of users – that could result in an accounting outcome consistent with i or ii.

Summary and Key issues

Fact Pattern

Before | **ASSET DEAL** | **After**



Potential Ways to account for BCUCC

Consideration of the three Views:

- **View one**: IFRS 3 can always be applied by analogy
  - ✓ Variant one: the recognition and measurement principle in IFRS 3 should equally apply to BCUCC.
  - ✓ Variant two: goodwill should not be recognised in the balance sheet of the transferee.
  - ✓ Variant three: goodwill and intangible assets should not be recognised in the balance sheet of the transferee.

- **View two**: It is not appropriate to analogise to IFRS 3

- **View three**: The analogy to IFRS 3 may apply however it may be difficult to conclude that applying an accounting outcome based on IFRS 3 would be relevant and faithfully represent a BCUCC.

Questions

Questions to Constituents

General Concerns and Approaches taken by preparers in practice
1.1 Do you think that the concerns (about BCUCC) have been accurately described in relation to the issue arising from accounting for BCUCC transactions? If not, please could you suggest other significant concerns that have not been addressed? 1.2 In your experience what approaches are typically applied by preparers in practice for BCUCC transactions and what justification is provided to support their application of these approaches?

Questions to Constituents

Scope definition – Separate financial statements – Disclosures
2.1 Are there any issues not included in the scope of the DP that, in your view, need to be addressed in developing an approach to accounting for BCUCC in the consolidated financial statements of the transferee? 2.2 Do you believe that there are any specific issues to be addressed in the initial recognition and measurement of BCUCC in the separate and individual financial statements? If so, please explain what those issues are and how they should be addressed? 2.3 Are there any specific issue you think need to be addressed when considering what information about BCUCC should be disclosed in the notes to the financial statements of the transferee?

Questions to Constituents

User Information needs – Entity and Proprietary Perspective – IAS 8 approach - IFRS 3 analogy

3.1 Do you agree that an important step is to understand the information needs of users in the financial reporting of a BCUCC transaction? If not, how else would you set out an approach that satisfies the objective of financial reporting ?

3.2 It is noted above that the analysis in this DP is taken from the perspective of the transferee (entity perspective) as opposed to the perspective of the owners (proprietary perspective). Do you agree that, to be consistent with existing IFRS, the entity perspective should be dominant when considering BCUCC? If not, why not?

3.3 Do you agree with applying the 'logic' of the IAS 8 hierarchy in developing an approach to accounting for BCUCC transactions? If not, what alternative would you propose and how would you reconcile that approach with existing IFRS?

3.4 Do you agree that if and when an analogy to IFRS 3 is considered to apply, it is appropriate to assume that fair value at initial recognition provides information that is more decision-useful than values based on previously recognised amounts or any other measurement attribute? If not, please explain why?

3.5 Do you agree that if the analogy to IFRS 3 does not apply, defining an appropriate measurement attribute should be guided by an analysis of the information needs of users? If not, why not

Questions to Constituents

Main features of BCUCC – Similarities and Differences with BC – Entity or Proprietary Perspective – Acquirer identification

4.1 Do you agree with the main features of a BCUCC identified above? If not, what other features would you highlight? It is noted above that BCUCC can be substantially different in nature from business combinations between unrelated parties.

4.2 Do you agree that a BCUCC can be different to a business combination under IFRS 3? If so, describe examples you have encountered in practice that verifies this. If not, please explain why?

4.3 Do you agree with the analysis that has been performed in relation to the information needs of users? If not, why not?

4.4 Do you think that with BCUCC it may be difficult in some circumstances to identify an acquirer (View A) or do you believe that an acquirer can always be identified (View B)?

4.5 If you believe that an acquirer can always be identified in a BCUCC, do you think that an analogy to IFRS 3 is not valid because the ultimate parent entity can direct the identification of an acquirer so that the accounting outcome is not a faithful representation of the underlying BCUCC transaction?

Questions to Constituents

Control – Business – Absence of a marked based transaction

4.6 Do you agree with the analysis above that under IFRS 10 'control' should be assessed from the perspective of the reporting entity and not from that of the ultimate parent entity? If not, why not

4.7 Do you agree that the definition of a 'business' in IFRS 3 raises no particular issues for BCUCC? If not, why not?

4.8 Do you agree with the main features of a BCUCC identified above? If not, what other features would you highlight? It is noted above that BCUCC can be substantially different in nature from business combinations between unrelated parties.

4.9 Do you think the absence of a market-based transaction can have consequences when applying the recognition principle in IFRS 3 because of a lack of measurement reliability? If so, do you agree with the analysis? If not, why not? Do you think it is appropriate to apply the measurement principle in IFRS 3 to BCUCC when the analogy to IFRS 3 is valid? If not, why not?

Questions to Constituents

Transaction price vs fair value – Goodwill

5.1 Do you believe that the transaction price should be referenced against the fair value of the business acquired and bifurcated (when the transaction price exceeds the fair value of the business acquired) if the transaction price does not reflect a proxy for fair value? This ensures the BCUCC transaction reflects two transactions: a) a contribution from (distribution to) the ultimate parent entity, and b) a business combination.

5.2 Do you believe that goodwill and/or identifiable intangible assets should not be recognised in the balance sheet of the acquirer on the basis that they cannot be reliably measured?

5.3 Do you believe that where the consideration transferred is lower than the fair value of the net assets acquired, the difference should reflect a contribution from the ultimate parent entity or recognised as income?

5.4 Do you agree with the main features of a BCUCC identified above? If not, what other features would you highlight? It is noted above that BCUCC can be substantially different in nature from business combinations between unrelated parties.

Questions to Constituents

View 1, 2 and View 3

5.5 Do you think that the BCUCC should be viewed as a transfer‘ of a business rather than an acquisition of a business when the analogy to IFRS 3 can never be applied? Do you believe that all the arguments and views presented are valid when it is not appropriate to apply an analogy to IFRS 3?

5.6 Do you agree that the approaches outlined in Appendix 3 are unlikely to result in decision-useful information? If not, why not

5.7 Do you believe that the diversity in the information needs of users when compared to a business combination and the cost constraint in financial reporting provide justification to consider whether or not the recognition and measurement principle in IFRS 3 are appropriate when accounting for BCUCC?

5.8 Do you believe that all the arguments presented in relation to view three are valid or are there others that you would consider?

Next steps

Next Steps

Next Steps

RESPOND

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