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Accounting and Audit

Table of Contents

Discussion Paper on Business Combinations Under Common Control

Discussion Paper on Business Combinations Under Common Control

Introduction

Business Combinations under Common Control means the combining of entities or businesses which are ultimately controlled by the same party or parties both before and after the business combination i.e. mergers and acquisitions of companies within the same group. Presently, the accounting standard IFRS 3 *Business Combinations* sets out reporting requirements for business combinations and requires the use of the acquisition method.

However, there is no IFRS Standard that specifically applies to business combinations under common control. In view of this gap in the IFRS Standards, companies report these combinations in different ways, either using the acquisition method or the book-value method.

The acquisition method measures the assets and liabilities received in the combination at fair value and recognizes goodwill. On the other hand, the book-value method measures those assets and liabilities at their existing book values with no recognition of goodwill. In addition, there is a variety of book-value methods used in practice. Hence, diversity in practice makes it difficult for investors to understand the effects of these transactions.

The International Accounting Standards Board (IASB) has explored possible reporting requirements for business combinations under common control to provide users of financial statements with better information. They have now published a Discussion Paper that sets out its preliminary views on the reporting requirements for these business combinations.

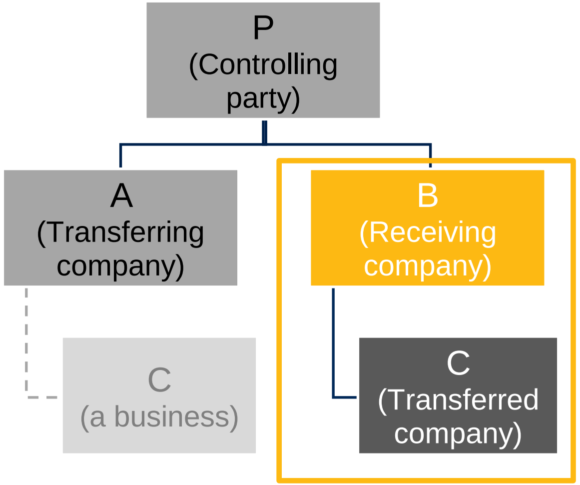
Discussion Paper on Business Combinations Under Common Control

What is the scope?

Business combinations under common control are combinations in which all of the combining entities or businesses are ultimately **controlled by the same party, both before and after** the combination. Diagram 1 illustrates a simple example of a business combination under common control. Companies A, B and C are controlled by the same party which is Company P. Company C is transferred from Company A to Company B.

The scope of transactions considered in this Discussion Paper is limited to those in which a **business** is **transferred.** It does not cover transfers of assets under common control or transfers of companies that do not have a business. As shown in Diagram 1, Company C is a business and its transfer is within the scope of the project. Further, the project is considering the reporting requirements on consolidated financial statements of the receiving company which is Company B in Diagram 1. The project is not considering the reporting requirements of other parties affected by the transactions (Company P, A & C).

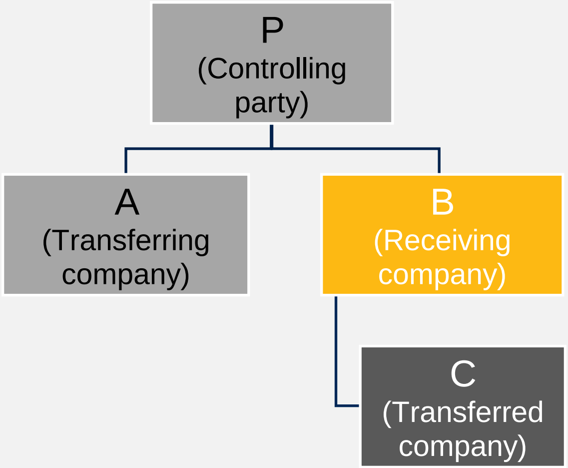
Diagram 1 : Business Combinations under Common Control



Discussion Paper on Business Combinations Under Common Control

Summary of scope of the discussion paper

Which transaction?	• Transfers of businesses under common control
Which company?	• Receiving company
Which financial statements?	• Typically consolidated financial statements



Discussion Paper on Business Combinations Under Common Control

When to apply the acquisition method and the book-value method

The Board's view is that one size does not fit all. For some business combinations under common control, the acquisition method should be used and for others, a book-value method should be used. Diagram 2 summarises the Board's preliminary views.

Diagram 2 : Board's Preliminary Views

A single method in all cases?	Neither the acquisition method nor a book-value method should apply in all cases
How to 'draw the line'?	The acquisition method should apply when **non-controlling shareholders** are affected
What about the cost-benefit trade-off?	There is an **exception** to and an **exemption** from the acquisition method for cases where costs outweigh the benefits
When to apply a book-value method?	A book-value method should apply in all other cases

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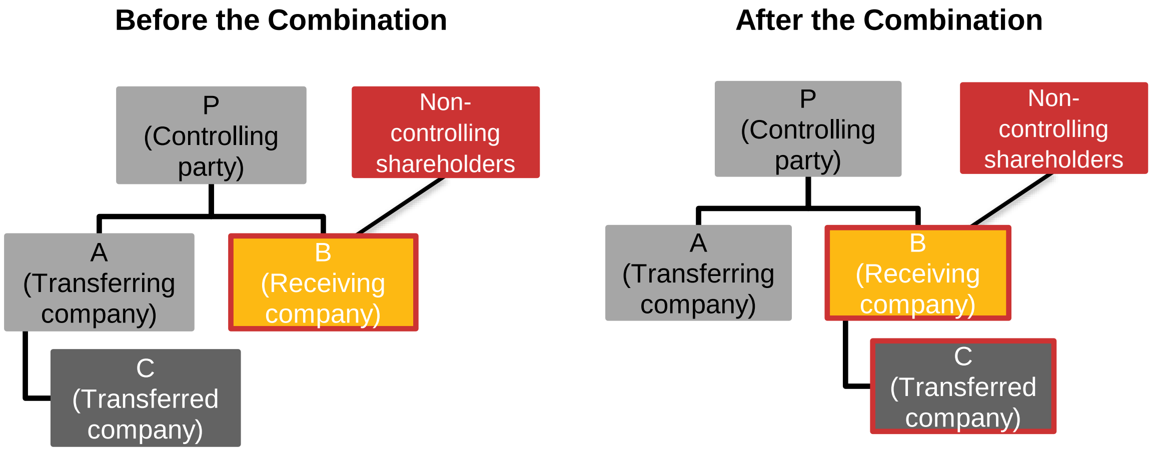
When to apply the acquisition method and the book-value method (Cont'd)

Diagram 3 : Non-controlling shareholders: Common control



Non-controlling shareholders

Diagram 3 illustrates a business combination under common control that affects non-controlling shareholders (NCS) of the receiving company. Company B gains control of Company C. As a result, the NCS of the receiving company acquire an ownership interest in the business transferred to the receiving company. The Board's view is that the acquisition method should be applied for business combinations under common control that affect NCS of the receiving company. For all other business combinations under common control, a book-value method should be applied.

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When to apply the acquisition method and the book-value method (Cont'd)

Receiving company's shares

Whether the shares of the receiving company are publicly traded or privately held would determine which accounting method should be used to account for the business combinations under common control. The Board's view is that publicly traded receiving companies should be required to apply the acquisition method. When the receiving company shares are privately held, the Board is suggesting special conditions for private companies, namely:

- The optional exemption from the acquisition method – the receiving company is ***permitted*** to apply the book-value method if the NCS do not object
- The related-party exception to the acquisition method – the receiving company is ***required*** to apply the book-value method if the NCS are the company's related parties.

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When to apply the acquisition method and the book-value method (Cont'd)

Receiving company's shares

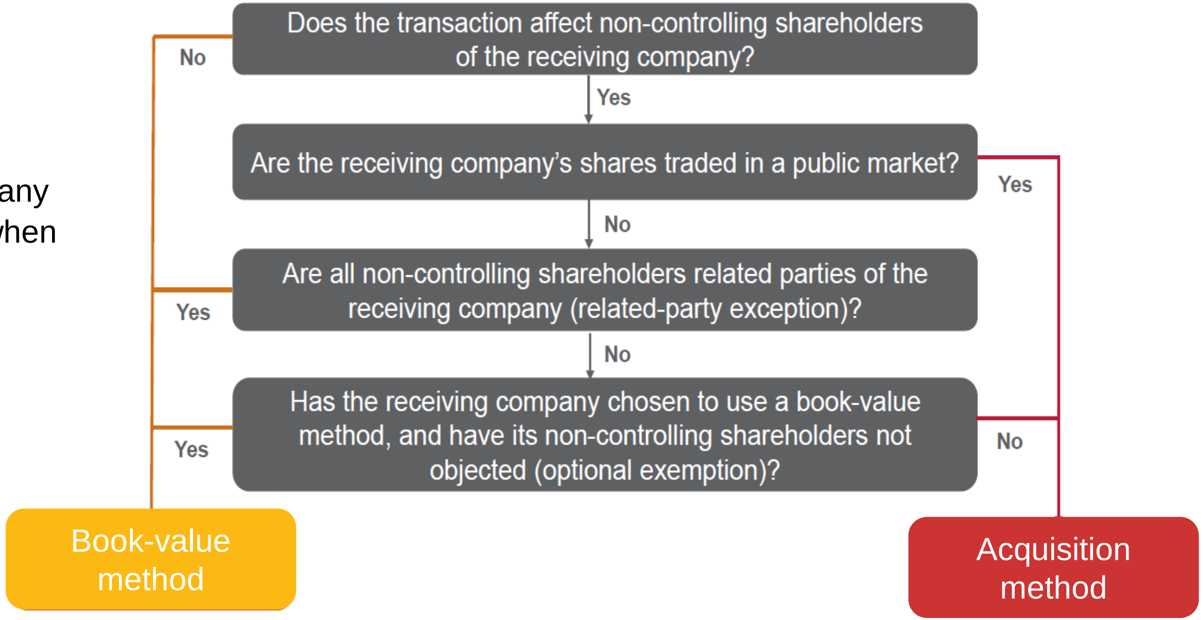
Public company	Private company	
Costs are presumed to be justified by the benefits	Cost may or may not be justified	
Requires the acquisition method	The optional **exemption** from the acquisition method	The related-party **exception** to the acquisition method
	Permits a book-value method if NCS do not object	Requires a book-value method if NCS are the company's related parties

Discussion Paper on Business Combinations Under Common Control

When to apply the acquisition method and the book-value method (Cont’d)

Diagram 4 summarizes the criteria that would determine when a receiving company should use the acquisition method and when it should use a book-value method.

Diagram 4



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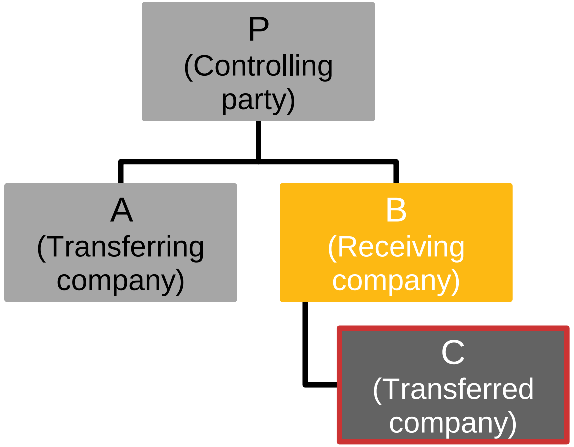
How to apply a book-value method

Assets & liabilities

IFRS Standards do not specify a book-value method. In practice, a variety of book-value methods are used e.g. using the transferred company's book values or the controlling party's book values. These book values differ if the transferred company was previously acquired from a third party.

The Board's view is that the receiving company should measure the assets and liabilities received at their book values reported by the transferred company (Company C) and not the controlling party's book values.



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How to apply a book-value method (Cont'd)

Consideration

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

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

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

In addition, the Board should not prescribe how the consideration paid in the receiving company's own shares should be measured.

Discussion Paper on Business Combinations Under Common Control

How to apply a book-value method (Cont'd)

Difference

When applying a book-value method, any difference between the consideration paid by the receiving company and the book value of the assets and liabilities of the transferred company received in a business combination under common control is typically recognized within the receiving company's equity.

The Board's view is that it should not prescribe in which component, or components, of equity the receiving company should present that difference.

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How to apply a book-value method (Cont’d)

Summary

Diagram 5 : The Board’s views on a single book-value method

Assets and liabilities received	Measure at transferred company's book values
Consideration paid	Generally measured at book value at the receiving company
Difference	Recognize as an increase or decrease in equity

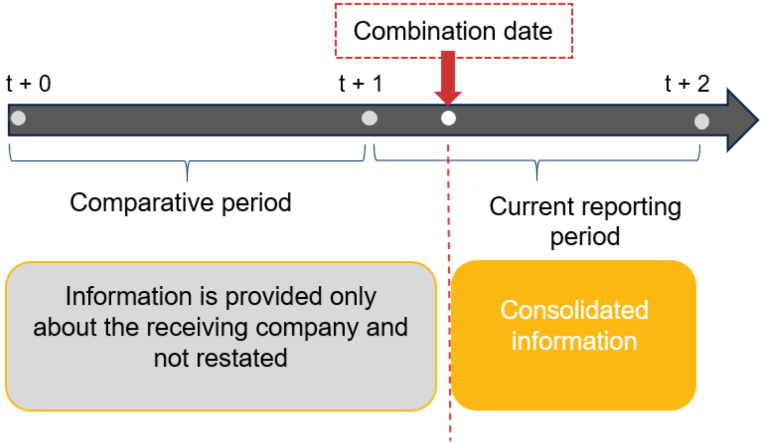
Discussion Paper on Business Combinations Under Common Control

How to provide pre-combination information

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

The Board's view is that the receiving company should include the transferred company in its financial statements from the date of combination and, hence, should not restate its pre-combination information i.e. use the ***Prospective Approach*** (see Diagram 6).

Diagram 6 : Prospective Approach



Discussion Paper on Business Combinations Under Common Control

Next Steps

The Board has allowed a comment period of up to 1 September 2021. Stakeholders are encouraged to provide feedback to the International Accounting Standards Board in the form of comment letters.

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