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ACCOUNTING FOR BUSINESS COMBINATIONS UNDER COMMON CONTROL

Discussion paper

OCTOBER 2011

EFRAG
European Financial Reporting Advisory Group

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DISCUSSION PAPER

OIC

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The purpose of the discussion paper is to stimulate debate on the issues presented and to assist the IASB in making progress with its common control project.

The paper is issued by the European Financial Reporting Advisory Group (EFRAG) and the Italian standard-setter, the Organismo Italiano di Contabilità (OIC).

The issue of this paper is also supported by the following standard-setters in Europe:

Austria, AFRAC – Austrian Financial Reporting and Auditing Committee
Belgium, Commission des Normes Comptables/Commissie voor Boekhoundkundige Normen
Cyprus, ICPAC – Institute of Certified Public Accountants of Cyprus,
Denmark, FSR – Danske Revisorer
Estonia, EASB – Eesti Raamatupidamise Toimkond
Lithuania, AAA – Audito ir Apskaitos Tarnyba
Malta, The Malta Institute of Accountants
The Netherlands, RJ – Raad voor de Jaarverslaggeving
Norway, Norsk RegnskapsStiftelse
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Portugal, CNC – Comissão de Normalização Contabilística
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Spain, ICAC – Instituto de Contabilidad y Auditoría de Cuentas
Sweden, Rådet för finansiell rapportering
United Kingdom, ASB – Accounting Standards Board

DISCLAIMER

These bodies, while encouraging debate on the issues presented in the paper, do not express any opinion on those matters at this stage.

Copies of the paper are available from the websites of those bodies issuing the paper. A limited number of copies of the paper will also be made available in printed form, and can be obtained from either EFRAG or the OIC.

The paper invites comment on its proposals via the 'Questions for Respondents' at the end of each section (which are summarised in the Invitation to Comment). Such comments should be sent by email to:

commentletters@efrag.org or by post to:

EFRAG
35 Square de Meeûs
B-1000 Brussels
Belgium

so as to arrive no later than 30 April 2012. All comments received will be placed on the public record unless confidentiality is requested.

The BCUCC Project and our Proactive Work in Europe

The Business Combinations under Common Control (BCUCC) project was initiated to respond to concerns about the lack of consensus how BCUCC transactions should be reflected in financial statements prepared under International Financial Reporting Standards (IFRS). This Discussion Paper (DP) represents the first step in EFRAG's response to those concerns. Accordingly, decisions had to be taken about what to include in this DP and what may be considered in future phases of the project. The DP outlines the key issues and considers different ways of analysing the issues with the objective of promoting discussion and debate within Europe and beyond at an early stage in the standard setting process. It will hopefully, also encourage the International Accounting Standards Board (IASB) to bring the topic back onto its active agenda.

Several commentators have highlighted the importance of considering the accounting treatment of BCUCC in the separate financial statements of the transferee. This issue has been carefully considered and it was decided that given its significance it was too complex to adequately address in this DP. Accordingly, EFRAG and the OIC have invited constituents to comment on this issue (see Invitation to Comment, Question 2.2, page 8). EFRAG together with the National Standard-Setters of Italy (OIC), the Netherlands (DASB) and Spain (ICAC) have commenced a project specifically to look at the issues arising from the application of IFRS to separate financial statements more generally to ensure that a comprehensive response to the issues is developed.

It is important to set the project within the broader context of our Proactive Work. EFRAG aims to influence future standard-setting developments by engaging with European constituents and providing timely and effective input to early phases of the IASB's work. This proactive work is done in partnership with National Standard-Setters in Europe to ensure resources are used efficiently and to promote stronger coordination at the European level. There are four strategic aims that underpin proactive work:

- Engaging with European constituents to ensure we understand their issues and how financial reporting affects them;
- Influencing the development of global financial reporting standards;
- Providing thought leadership in developing the principles and practices that underpin financial reporting; and
- Promoting solutions that improve the quality of information, are practical, and enhance transparency and accountability.

More detailed information about our proactive work and current projects is available on the EFRAG's website (www.efrag.org).

Executive Summary

Business Combinations under Common Control (BCUCC) are frequently undertaken for many different reasons to achieve purposes that vary from business combinations of entities not under common control. For example, they may take place to re-organise group activities with an aim to achieve synergies or to obtain tax efficiency within the group. The often complex structures and arrangements to effect such changes raise considerable challenges for financial reporting. International Financial Reporting Standards (IFRS) are currently silent on how the entity receiving a business under common control should account for the transaction. There are many examples in practice that suggests that diversity exists when accounting for BCUCC and warrant urgent attention.

This discussion paper (DP) represents the first stage of responding to that diversity. It principally aims at setting out the arguments and providing analysis to stimulate discussion and debate. Accordingly, the DP does not offer any answers or conclusions because engaging with constituents is a critical step in developing our understanding to help formulate a position in the future.

BCUCC are scoped out of IFRS 3 *Business Combinations* (IASB 2011) which has led to diversity in practice in the manner in which these transactions are accounted for. This DP deals with initial recognition and measurement of BCUCC transactions in the consolidated financial statements of the transferee[1]. It is acknowledged that there are also questions to be answered on how to account for BCUCC in the separate and individual financial statements of the transferee, however, it was concluded in preparing this DP that it was not possible to deal with those issues adequately, so a separate project has been initiated to address them more comprehensively. There is also scope to deal with BCUCC in the separate financial statements in future phases of the BCUCC project.

The DP includes a number of important assumptions and guiding principles that are important for the reader to understand. This is because they provide a better understanding of how the different views in this project have been developed. In developing approaches to BCUCC, the principles in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (2011) have been applied. That is, in the absence of an IFRS that deals specifically with BCUCC, we have turned to the IAS 8 hierarchy to consider ways to account for BCUCC at initial recognition and measurement so that it results in financial information that is likely to be relevant to the economic decisions to be taken by users of the financial statements of the transferee.

We do that from the perspective of a standard-setter and not a preparer. We assume in our analysis that the transferee is a reporting entity that produces IFRS general purpose financial statements. We acknowledge that a standard-setter would not apply IAS 8 but would nonetheless follow the logic of the standard in making decisions about how BCUCC should be accounted for. In applying the logic of the IAS 8 hierarchy, consideration is given to drawing an analogy between BCUCC and business combinations dealt with under IFRS 3, however it is noted that other analogies could be drawn to IFRIC 17 *Distributions of Non-cash Assets to*

[1] Refer to Appendix A for the definition of a ‘transferee’ that explains the distinction between a transferee and an acquirer.

Owners (IASB 2011). Applying an IAS 8 approach (and looking for parallels with 'like' transactions) has not, in our view, constrained our thinking but kept us to the discipline of considering approaches that are likely to work in practice and do not create significant inconsistencies with existing IFRS.

The nature of BCUCC can differ substantially from other business combinations and those 'differences' can serve to weaken the appropriateness of any analogy being drawn with IFRS 3. That is, because a BCUCC is under 'common control', it may be difficult to identify an acquirer or because the ultimate parent entity can direct the identification of an acquirer so it may lead to an accounting outcome that is not a faithful representation of the BCUCC transaction.

Similarly, an analogy to IFRS 3 may be invalidated because applying the recognition and measurement principles in IFRS 3 can lead to an accounting outcome that does not result in useful information for users of the financial statements. This could happen in some situations where there has been no change in the ability of the entity to meet the claims that existed prior to the BCUCC. The arguments that provide justification to question whether the recognition and measurement principles of IFRS 3 lead to an accounting outcome which is relevant to users are that: 1) BCUCC are driven by many different reasons and for purposes that are different to a business combination and 2) the information needs of users in a BCUCC are diverse and cannot be treated as a homogenous class of transactions which is very different to a business combination under IFRS 3.

In other circumstances, the unique characteristics of a BCUCC, namely the absence of market forces to the transaction, may not invalidate the analogy to IFRS 3 entirely but it could restrict the appropriateness of recognising goodwill and other intangible assets because it may not represent a reliable measure.

It is noted that there is no 'ideal' approach and that depending on what approach is applied, it is likely that some inconsistencies will remain either with the measurement of related party transactions or with the treatment of business combinations under IFRS 3.

In considering whether it is appropriate to analogise to IFRS 3, we draw out three different views or ways of looking at the problem. The discussion does not favour one view over another but presents them as different points on a 'spectrum' of thinking about the issues. We highlight some of the key strengths and weaknesses of each view by considering the fundamental qualitative characteristics – as they serve as a means of deciding what constitutes useful information for users of the financial statements. It is the veracity of these arguments that we particularly welcome constituents to consider and challenge.

Under view one, we consider that it is possible to take a position where IFRS 3 would always apply to BCUCC. However, if the current scope exemption was to be removed there are certain modifications that may need to be made to address the unique features of such transactions. Whilst recent IFRS have placed less emphasis on the role of reliable measurement as one of the criteria for recognition, it is noted that in doing so the needs of users may be compromised by 'forcing' the application of the acquisition method (and the application of fair value) in circumstances where transactions are not subject to market forces. It is contended that there is a necessary relationship between relevance and reliability (faithful representation) that should not be ignored. The analysis does not question the appropriateness of the acquisition method in IFRS 3 for business combinations – that was outside the scope of the DP and therefore we

assume that IFRS 3 produces decision-useful information about business combinations for users of the financial statements. The analysis of user needs strengthens the justification for not questioning the validity of the analogy to IFRS 3. This is because, in the absence of the controlling shareholder being a user of the financial statements of the transferee, it is difficult to contemplate why the user information needs in a BCUCC would be different to those for a business combination between external parties.

Under view two, the arguments suggest that it is not appropriate to analogise to IFRS 3 as the operation of the standard breaks down when applied to BCUCC. This happens when it is either difficult to identify an acquirer or even if an acquirer can be identified, the ultimate parent entity can direct the identification of the accounting acquirer within the ultimate reporting entity group with an objective to achieve an optimal accounting outcome so that the depiction is slanted. This depiction could increase the probability that financial information would be favourably received by users (i.e. the accounting outcome is not a faithful representation of the underlying BCUCC transaction). For that reason, the use of predecessor or 'fresh start' accounting could be favoured to deal with these unique issues. The accounting approach that should be applied to deal with these issues depends on who the users are and their information needs. It is noted that 'predecessor accounting' is not specified under IFRS and there are several variants in practice and a number of complex issues need to be addressed if this method where applied to BCUCC. In particular, it could either result in the restatement of prior year income and cash flow statements or a note disclosure to achieve some continuity in performance-related information.

Starting with an understanding that BCUCC represent a diverse group of transactions, view three is based on the premise that the analogy to IFRS 3 can only be supported when the accounting outcome results in decision-useful information for the users of the financial statements of the transferee (as in view one). It is necessary to assess the facts and circumstances of each transaction rather than applying the same approach to the entire class of BCUCC transactions. The justification for questioning whether acquisition accounting produces decision-useful information is that there is diversity in the information needs of users between a BCUCC and a business combination under IFRS 3.

Whether IFRS 3 is applied depends on whether the BCUCC transaction leads to a change in the ability of the reporting entity to meet the claims of capital providers that were in existence prior to the business combination. It follows the cost constraint in the *Conceptual Framework* (IASB 2011) which limits the extent to which the standard-setter can apply the principles in IFRS 3 where it is unclear what benefits flow to users from the resulting information.

The desire to stimulate a debate on accounting for BCUCC is a genuine one. At this stage of our due process we are not fixed on a particular solution but want to ensure that we have analysed all the key issues in a comprehensive and technically sound manner that is consistent, where appropriate, with the IFRS literature. It is important to stress that this is not intended to be an interpretation of the current literature but the first step in the possible development of an accounting standard that tackles the issues that arise when considering the initial recognition and measurement of BCUCC transactions.

The next steps to be taken in this project by EFRAG and its partners will depend on the comments received from constituents and the decisions taken by the IASB on its future agenda.

QUESTIONS TO CONSTITUENTS

EFRAG and the OIC invite comments on all matters in this DP, particularly in relation to the questions set out below. Comments are very helpful if they:

a) address the question as stated;

b) indicate the specific paragraph reference, to which the comments relate; and

c) describe any alternative approaches EFRAG and the OIC should consider.

The EFRAG and the OIC will consider all comments, which will be received in writing by **30 April 2012**.

The following section should be read in conjunction with the defined terms in **Appendix 1** to this DP.

Question 1.1 – Concerns about BCUCC transactions

Chapter 1 refers to concerns expressed by the European Commission and others regarding the diversity in accounting practice that exists in relation to BCUCC because of the scope exemption in IFRS 3. BCUCC raise a number of significant financial reporting issues that needs to be addressed in the IFRS literature. This diversity in practice is evidenced by recent submissions to the IFRS Interpretations Committee and the significant amount of guidance produced by accounting firms (e.g. Deloitte 2010, Ernst & Young 2010, KPMG 2010, PricewaterhouseCoopers 2010).

Do you think that the concerns have been accurately described in relation to the issues arising from accounting for BCUCC transactions? If not, please could you suggest other significant concerns that have not been addressed?

Question 1.2 – The approaches in practice

Chapter 1 suggests that many practitioners usually select either a predecessor basis of accounting or the acquisition method (as described in IFRS 3) when accounting for a BCUCC. A number of standard-setters in the past have also considered use of 'fresh-start' accounting to account for BCUCC. However, it is unclear whether the benefits for users are justified by the costs of valuation that would be incurred by preparers for initial measurement.

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?

Question 2.1 – The scope of the project

Chapter 2 outlines the scope of the project, which includes the initial recognition and measurement of a BCUCC in the transferee's[2] consolidated financial statements.

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?

Question 2.2 – Separate and individual financial statements of the transferee

Chapter 2 highlights that the accounting for BCUCC in the separate and individual financial statements is not included in the scope of the project. It was considered that is was not feasible to adequately address all the issue in this DP therefore a decision was made to address them in a separate EFRAG proactive project. Accordingly, we welcome input from constituents to help with the development of that project.

There are a number of questions that relate to separate and individual financial statements. For instance, it may be questioned whether information needs of users of separate and individual financial statements differ from those of consolidated financial statements and whether those different user needs justify different accounting at initial recognition and measurement.

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?

Question 2.3 - Disclosures

Chapter 2 states that the project does not address disclosures, because at this stage there seemed to be little value in proposing disclosures ahead of reaching a conclusion on initial recognition and measurement of BCUCC transactions.

Are there any specific issues you think need to be addressed when considering what information about a BCUCC should be disclosed in the notes to the financial statements of the transferee?

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[2] A distinction is made between a transferee and an acquirer. In later chapters, when the DP discusses whether the analogy to IFRS 3 is valid, a distinction is drawn between an acquirer and a transferee. That is, if the analogy to IFRS 3 is not valid, then the term 'transferee' is used to describe an entity that receives control over one or more businesses. This term is used to avoid suggestions that one of the combining entities is the accounting acquirer.

Question 3.1 – Addressing the information needs of primary users

In Chapter 3, when considering how to frame an appropriate approach for BCUCC the objective was to develop approaches that are most likely to produce information that is decision-useful to primary users of the financial statements. The objective of financial reporting according to the *Conceptual Framework* is to provide financial information that is useful to existing and potential investors, lenders and other creditors ('primary users') that cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need.

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?

Question 3.2 – The transferee is a reporting entity

The analysis in the DP looks at financial reporting from the perspective of the transferee consistent with the entity perspective. It also assumes that the transferee is a reporting entity.

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?

Question 3.3 – Applying the logic of the IAS 8 hierarchy to help develop an approach on how to account for BCUCC

The DP proposes that the development of accounting approaches for BCUCC should be based on the principles of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to ensure that any accounting approach:

a) is consistent with the *Conceptual Framework*, particularly with the objective of financial reporting; and

b) achieves consistency with other parts of the existing IFRS literature, which deal with measurement.

In our view, this 'logic' reflects the steps that the IASB would typically consider in developing an accounting approach for a class of transactions. This allows for analogies to be made to existing IFRS, where appropriate.

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?

Questions 3.4 and 3.5 – Initial recognition and measurement

The key issue considered in the DP is how the transferee should measure in its consolidated financial statements, the assets received and liabilities assumed (that together constitutes a business) in a transaction with another entity in the group.

When the analogy to IFRS 3 is valid and it is concluded that the transaction is similar to the acquisition of a business, we do not challenge the presumption in IFRS 3 that applying fair value at initial measurement is always likely to provide users with financial information that is relevant and a faithful representation of the underlying BCUCC.

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?

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 4.1 and 4.2 – The unique features of a BCUCC transaction

Identifying the unique features of a BCUCC is a complex exercise as the nature of the BCUCC transaction can significantly vary from a business combination under IFRS 3. The unique features of a BCUCC, which can have an effect on whether the analogy to IFRS 3 applies, can be characterised as follows:

a) *purpose of the transaction*: the purpose of the transaction does not alter its economic substance; however, it can play a significant role in selecting a measurement attribute to apply to the BCUCC at initial measurement that results in decision-useful information for users of the transferee consolidated financial statements.

b) *the absence of the market conditions*: the lack of a market-based transaction challenges the assumption in IFRS 3 that the transaction price is deemed to represent fair value; and

c) *nature of the consideration*: it does not alter the economic substance of the BCUCC transaction. The nature of the consideration could in some circumstances have no effect on previous decisions taken regarding the entity's prospects for generating future cash flows (e.g. in a share-for-share exchange).

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. 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?

Question 4.3 – Understanding the information needs of users about BCUCC transactions

When comparing the information needs in relation to a business combinations under IFRS 3 and a BCUCC there is one view that differences exist when the controlling shareholder is a user of the financial statements of the transferee and when existing and potential lenders (and other creditors) do not focus on the consolidated financial statements of the transferee, but on other information, including the separate/individual financial statements. These differences give support to the view that BCUCC represent a diverse group of transactions. Accordingly, BCUCC cannot be treated as a homogeneous class of transactions and developing accounting approaches that consider the most relevant measurement basis to apply at initial measurement will depend on facts and circumstances.

There is another view that the information needs from business combination under IFRS 3 and a BCUCC do not differ when the controlling shareholder is not a user of the consolidated financial statements of the transferee. This is because such users want information about any change to the prospects of future net cash flows and about the subsequent performance of the management of the transferee. Accordingly, BCUCC can be treated as a homogenous class of transactions and are sufficiently similar to a business combination under IFRS 3 in terms of the information needs of users.

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

Questions 4.4 and 4.5 – Identification of an acquirer

There are two views expressed in the DP on identifying an acquirer:

View A: it may be difficult to identify an acquirer because the transaction is under common control; and

View B: an acquirer can always be identified. However, the ultimate parent entity can select the accounting acquirer and direct an entity to acquire a business within the ultimate reporting entity group with an objective to achieve an optimal accounting outcome that does not represent a neutral depiction. According to the Conceptual Framework (QC14), “A neutral depiction is

without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users." It could be viewed that this problem arises due to the asymmetry in accounting that result from applying the measurement principle in IFRS 3.

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)?

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?

Question 4.6 – Obtaining control over one or more businesses

IFRS 3 establishes a principle that for each business combination, one of the combining entities shall be identified as the acquirer. That is, the guidance in IFRS 10 *Consolidated Financial Statements* (IASB 2011) shall be used to identify the acquirer – the entity that obtains control of the acquiree.

This principle could be considered to be flawed for a BCUCC because the current ability to direct the relevant activities (i.e. the power element of the control definition in IFRS 10 of the acquired/transferred business is retained before and after the BCUCC by the ultimate reporting entity. In other words, the ability to control the transferred does not change.

However, this line of reasoning may be inconsistent with the control notion in IFRS 10, which defines control from the perspective of the separate reporting entity and not the ultimate reporting entity.

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?

Question 4.7 – Acquisition of a business

It is argued that the identification of a business, as contemplated in IFRS 3, does not cause any particular difficulty in the context of transactions between entities under common control since the definition of a business in IFRS 3 can also be applied to a BCUCC.

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

Questions 4.8 and 4.9 – Applying the 'mechanics' of IFRS 3 – the recognition and measurement principle

The recognition principle in IFRS 3 (Paragraph 10) states that "the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree".

If the analogy to IFRS 3 could be made then the lack of a market-based transaction could result in goodwill (where the consideration transferred in a BCUCC is greater than the fair value of the net identifiable assets acquired) and other identifiable intangible assets not being recognised because they cannot be measured reliably due to the absence of a market-based transaction.

The measurement principle in IFRS 3.18 states: "the acquirer shall measure the identifiable assets and the liabilities assumed at their acquisition date fair values".

An important principle in IFRS is that similar transactions should be accounted for in a similar way. A possible view was stated that the three building blocks could equally apply to BCUCC. Accordingly, there is a view that it is difficult to justify not applying the IFRS 3 measurement principle to the extent that an IFRS 3 accounting outcome is relevant to the users of the financial statements of the acquirer. The unique characteristics of a BCUCC do not invalidate the analogy to IFRS 3 but it could lead to some assets not being recognised due to the absence of a market-based transaction.

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 5.1, 5.2 and 5.3 – View one: IFRS 3 can always be applied by analogy

The definition of a business combination equally applies to BCUCC; however, the unique features of a BCUCC can affect the application of the mechanics of IFRS 3.

There are three variants to consider:

Variant one: The recognition and measurement principle in IFRS 3 should equally apply to BCUCC. There is no justification to apply different recognition and measurement principles because, the fair value of the business acquired can be reliably measured on the basis of Level 3 inputs and it does not undermine the reliability of measurement. However, if the transaction price is not subject to market forces it may be difficult to determine its fair value. In such cases the consideration transferred should be referenced against the fair value of the business acquired. Similarly, where the transaction price is greater than fair value of the

business acquired, it should be bifurcated into 1) a distribution to the ultimate parent entity and 2) the consideration transferred being measured at the fair value of the business acquired.

Variant two: Goodwill should not be recognised in the balance sheet of the transferee. This is justified on the basis that goodwill cannot be faithfully represented due to the absence of a market-based transaction. Under this approach, the consideration transferred would not be referenced against the fair value of the business acquired. As the transaction is not a proxy for the fair value of the business acquired then it is possible that the transaction price could either be greater or less than the fair value of the acquired net identifiable assets.

Variant three: Goodwill and intangible assets should not be recognised in the balance sheet of the transferee. Similar to the arguments outlined in variant two, the recognition of such assets would not be justified because it could not be reliably measured. This is for two reasons: 1) the BCUCC is never subject of market forces which is arguably a pre-condition of satisfying the reliability criterion and 2) there may be no history or evidence of such exchange transactions. Using this approach, the consideration transferred would not be referenced against the fair value of the business acquired. As the transaction does also not represent a proxy for the fair value of the business acquired then it is possible that the transaction price could either be greater or less than the fair value of the acquired net identifiable assets.

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.

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?

The absence of a market-based transaction and not analysing the consideration could result in the transaction price being lower than the fair value of the identifiable net assets acquired. The recognition of a bargain purchase may be inconsistent with the *Conceptual Framework* because it may not meet the definition of income; but represent equity.

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?

Questions 5.4 and 5.5 – View two: It is not appropriate to apply IFRS 3 by analogy

Applying an analogy to IFRS 3 may not be appropriate because there could be difficulty in identifying an acquirer or the accounting outcome may not represent a faithful representation of the BCUCC transaction where the ultimate parent entity directs the selection of the accounting acquirer (refer to the reasoning in Question 4.4 and 4.5).

Two accounting treatments could be applied under these unique circumstances: 'fresh start' accounting and a predecessor basis of accounting. The selection of an accounting treatment is dependent upon who the users are and their information needs. That is 'fresh start accounting' could apply where users deem that the assessment of the prospects of future net cash inflows is best reflected through fair value measurement. A predecessor basis of accounting could be applied when the information needs of users are best served through a historical trend analysis of the income and cash flow statements and the statement of financial position.

Where the analogy to IFRS 3 is not applicable then the BCUCC could be characterised as the 'transfer' of a business rather than the acquisition of a business.

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?

Questions 5.6, 5.7 and 5.8 – View three: The analogy to IFRS 3 may apply

It is often stated that BCUCC represent a diverse group of transactions that are carried out for many different reasons to achieve a purpose that is very different to a business combination under IFRS 3. It was also demonstrated that the information needs of users of the financial statements of the transferee/acquirer are diverse so that BCUCC do not represent a homogeneous class of transactions.

Over the course of developing this DP, several accounting models were developed that, to some extent, were largely based on the unique features of BCUCC transactions that attempted to cater to the diversity. There seemed to be an intuitive appeal to developing indicators that served as the basis for establishing under what conditions different bases of measurement at initial recognition were justified. The indicators considered were similar to many of the drivers that lie behind existing approaches that have been developed and applied in practice.

These approaches were contemplated, but not taken further because they were considered to be too arbitrary. It was questionable whether the approaches would produce information that was relevant and a faithful representation of the underlying BCUCC transaction. Further details of these approaches and the reason for not considering them further are set out in **Appendix 3.**

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

View three outlines an approach whereby IFRS 3 applies when the BCUCC leads to a re-evaluation of previous economic decisions taken by of the consolidated financial statements of the transferee. Such an approach is consistent with the objective of financial reporting which is to provide "information that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve

buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit."

Such a principle is made operational by focusing on whether or not the BCUCC changes the ability of the reporting entity (entity) to meet the claims against the combining entities that existed prior to the BCUCC. It is argued that if the BCUCC transaction leads to an economic effect on the claims of user that existed prior to the BCUCC, then this would lead to a change in the previous economic decisions taken by them. Therefore, users would want to understand the effect of that change.

Chapter 4 highlighted that there is diversity in information needs of users in a BCUCC when compared to a business combination under IFRS 3 when 1) the controlling shareholder is considered to be a user of the financial statements of the transferee, and 2) when existing and potential lenders (and other creditors) focus on the separate/individual financial statements of the combining entities as opposed to the consolidated financial statements of the combining entities.

The diversity in the information needs of users provides the justification to consider whether the BCUCC transaction has an economic effect on the claims of users that existed prior to the BCUCC transaction. If it does not, then arguably, the user would not be interested in an accounting approach based on IFRS 3.

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?

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

EFRAG
European Financial Reporting Advisory Group

ORGANISMO ITALIANO DI CONTABILITÀ

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Chapter One: Introduction

Chapter 1 outlines the general concerns raised by constituents in Europe and elsewhere, and the consideration of Business Combinations under Common Control (BCUCC) by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRS IC).

The lack of authoritative accounting guidance in International Financial Reporting Standards (IFRS) on this subject has created diversity in financial reporting practice. Different but broadly accepted accounting practices have emerged. These practices produce very different accounting outcomes that, amongst other things, potentially impair comparability of financial statements.

There is a shared view in Europe, and farther afield, that this is an issue that warrants urgent attention. The IASB had a project on this topic, but work on it has been paused.

The objective of this Discussion Paper (DP) is to stimulate debate on this important subject at an early stage in the standard-setting process and to assist the IASB in making progress with its common control project.

The objective of the DP

1 Entities carry out BCUCC for many different reasons. Sometimes these reasons can originate from internal reorganisations for tax strategy purposes or to potentially spin-off certain businesses within a group. The fact that BCUCC are scoped out of IFRS 3 raises significant financial reporting issues on how to account for them. This Chapter discusses how the lack of authoritative guidance has led to inconsistent accounting for BCUCC, which has resulted in significant concerns expressed by European constituents and others farther afield.

2 The objective of this proactive project and the rationale for issuing this DP is to encourage debate on BCUCC and to assist the IASB in making progress on its common control project. The IASB is currently consulting on its future agenda, and this topic may be added to the IASB's active agenda. However, at this stage it is unclear if and when the common control project will be dealt with by the IASB.

General concerns regarding BCUCC

3 Accounting for BCUCC has been a topic of debate amongst standard-setters for some time. The G4+1[3] (1999) had a project to address the accounting for BCUCC in the 1990s

[3] The Standard-Setters of Australia, Canada, New Zealand, United Kingdom and the United States of America. The International Accounting Standards Committee participated in the meetings as an observer.

and the topic was also planned to be considered by the U.S. Financial Accounting Standards Board (henceforth referred to as 'FASB') as part of its Consolidations project around the same time, but for various reasons no conclusions have ever been reached on the topic. It has proven to be a technically challenging and somewhat intractable issue, on which views remain divided.

4 Since the adoption of IFRS in the European Union in 2005, it has become apparent that the accounting treatment of BCUCC is a significant issue that needs to be addressed, partly due to the absence of any clear guidance. There is no generally accepted analysis leading to a relevant accounting approach to BCUCC. As a consequence, entities have developed diverse practices, which have led to less transparent and inconsistent representation of the impact of BCUCC transactions which results in impaired comparability.

5 Global National Standard-Setters (GNSS) have shown considerable interest in the topic, and some jurisdictions have identified a pressing need to deal with this issue. In some countries where local GAAP addresses accounting for BCUCC, the application of those requirements has proven to be problematic in practice.

European concerns

6 In September 2006, the European Roundtable for the Consistent Application of IFRS, identified combinations between entities or businesses under common control as a problematic accounting issue where there was a widely shared sentiment that divergent application is significant.

7 Based on the Roundtable discussion, the European Commission submitted a formal agenda request to the IASB in October 2006, asking the IASB to take BCUCC on their agenda as an active project. The agenda request noted:

The accounting treatment of "Common Control Transactions" has been identified by the Roundtable as being one such issue. By "Common Control Transactions" we mean transactions involving entities under common control; for example in business combinations, spin-offs, split-offs or de-mergers. Roundtable participants believe that the boundaries of the scope exclusion in IFRS 3 Business Combinations need further clarification. Furthermore, the basis of accounting to be used for Common Control Transactions is currently not resolved in IFRS and therefore needs to be developed urgently.

Neither the current standard on Business Combinations (IFRS 3), which scopes out business combinations between entities under common control, nor the current proposal for amending IFRS 3 (Phase II) deals with these kind of transactions. Therefore, questions arise as to what the boundaries of the scope exclusion in IFRS 3 are and how business combinations between entities under common control should be accounted. For example, recording the transaction at fair value or use of pre-transaction book values of the parent company as deemed cost. Current practice shows that both methods are used.

In view of its scope and complexity the Roundtable further concluded that the issue should be dealt with by the IASB rather than IFRIC.

IASB and IFRIC have made several attempts to deal with the issue in the past but none of them has resulted in the development of the principles urgently needed. The Roundtable participants took the view that there remained compelling reasons for the IASB to take up this issue as it has widespread and practical relevance and divergent practices exist.

Therefore, the issue is of fundamental importance and quick resolution is required. In spite of IASB's constraints regarding staff resources and available Board time we believe that the issue should be taken on the IASB agenda as an active project as soon as possible in 2007.

8 The European Commission also noted that, both 'book value' accounting (known as the predecessor basis of accounting[4]) and 'fair value' accounting (the acquisition method) are being used in practice for BCUCC transactions. The European Commission also raised some concerns that the absence of specific IFRS guidance could result in diversity in practice which could impair the comparability of financial information between entities that apply IFRS.

The European regulator's view - ESMA

9 The European Securities and Markets Authority (ESMA) have considered the accounting treatment applied to BCUCC through its enforcement decisions. The Committee of European Securities Regulators (CESR) the predecessor of ESMA, published in May 2008 the enforcement decision EECS/0508-04. It stated that in the absence of a specific standard on BCUCC, the application of SFAS 141[5] (FASB 2007) was acceptable, but not required.

10 In addition, CESR also published in June 2008, the enforcement decision EECS/1209-14, which came to the conclusion that a pooling-of-interest method was acceptable in the absence of a specific IFRS dealing with BCUCC.

11 These enforcement decisions provide examples that in the absence of an IFRS on BCUCC then applying alternative accounting treatments are acceptable. The acceptability of alternative accounting treatments contribute to diversity in practice when accounting for BCUCC.

4 It should be emphasised that there are different terms used to describe predecessor basis of accounting, such as pooling-of-interest; however, this term is used consistently throughout the DP. This method of accounting is discussed in the superseded version of paragraph B62 of SFAS 141 *Business Combinations*, "the pooling method effectively side steps the reckoning that comes with business combination transactions by assuming that those transactions are exchanges between the owners of the combining entities rather than between the entities themselves. The method does not recognise the values exchanged in the records of the combined entity, only the carrying amount of the predecessor entities."

5 Throughout this DP, we make references to Statement of Financial Accountant Standard (SFAS) 141 (Revised 2007) and SFAS 141 (as issued in June 2001) (FASB 2001) which have both been superseded by Topic 805 *Business Combinations* (FASB 2007). Although both financial reporting standards have been superseded, the basis for conclusions provide important information to help understand some of the issues with applying the predecessor basis of accounting. We make reference to Topic 805 when referring to the accounting that currently applies at recognition and measurement to BCUCC transactions.

IASB

12 The scope exclusion for BCUCC in IFRS 3 (issued in 2008) has been carried forward from two generations of financial reporting standards on business combinations: IFRS 3 (issued in 2004) and IAS 22 *Business Combinations*.

13 In 2001, the IASB considered the scope exclusion for BCUCC in developing IFRS 3, which replaced IAS 22. The project was originally planned to be conducted in two phases: accounting for transactions or other events that meet the definition of a business combination, in the first phase, with BCUCC being scoped out and deferred until the second phase.

14 The first phase of the project resulted in the IASB issuing IFRS 3 in March 2004. That version of IFRS 3 retained the scope exclusion for BCUCC. The Board concluded that the nature of the scope exclusion would be better expressed as ''business combinations involving entities or businesses under common control'' rather than ''transactions among enterprises under common control'' (the scope exclusion in IAS 22). In addition, authoritative guidance on the application of the scope exclusion was included in the new standard.

15 The second phase of the project was undertaken as a joint project with the FASB. This involved a broad reconsideration of the requirements in IFRS and US GAAP on the application of the purchase method (now referred to as 'the acquisition method' in IFRS 3), and resulted in the IASB publishing in June 2005 a draft of a revised IFRS 3, which proposed to replace the previous version of IFRS 3 . Eventually, this part of the project resulted in the IASB issuing, in January 2008, the revised version of IFRS 3. However there was no change to the position on BCUCC. Therefore, the original intention to consider BCUCC in the second phase of the project was not pursued. The equivalent US GAAP standard Topic 805 *Business Combinations* (henceforth referred to as 'Topic 805') (formerly SFAS 141(R) *Business Combinations)* maintained the position that requires initial measurement of the net assets acquired under a BCUCC at their predecessor amounts (see Topic 805-50-30-5).

16 The IASB added the BCUCC topic to its agenda in December 2007 (agenda proposal on Common Control Transactions). The IASB staff proposed to limit the scope of this project to accounting for combinations between entities or businesses under common control in the acquirer's consolidated and separate financial statements.

17 According to the IASB work plan, in light of other priorities, the Board paused the project and should take a decision on whether to resume work on this topic based on responses to the agenda consultation.

18 The tentative scope of the IASB project will examine the definition of a business combination involving entities under common control and the methods of accounting for BCUCC in the consolidated and separate financial statements. The Board also included demergers and spin-offs in the scope because they observed that similar issues arise.

The IFRS IC

19 The IFRS IC (formerly referred to as IFRIC) considered several topics related to BCUCC. This is additional evidence that the IFRS literature relating to this subject is insufficient.

20 It is relevant to note that there have been constant requests for the IFRS IC to consider BCUCC-related issues, but it has decided not to include such issues on the agenda until the broader issue of accounting for BCUCC is addressed by the IASB. The following submissions are examples of two recent issues brought before the IFRS Interpretations Committee and are not intended to represent a complete list or to bring emphasis to any issues that are specific to BCUCC.

21 In November 2009, the IFRS IC considered an issue of the presentation of comparatives when applying the 'pooling-of-interests' method for business combinations under common control (IFRS IC 2009). In July 2011, the IFRS IC also considered the applicability of IFRS 3 to a specific fact pattern of a BCUCC in which a parent entity transfers a business to a new entity formed by the parent entity's shareholder (IFRS IC 2011). Specifically, three issues were discussed:

a) whether IFRS 3 can be applied to account for the transfer of a business to the new entity,

b) whether or not an imminent initial public offering that might occur after the formation of the new entity is considered relevant for identifying an acquirer, and

c) whether a business that is not a legal entity can be considered the acquirer in a reverse acquisition.

Accounting firms

22 In the absence of an IFRS that specifically applies to the BCUCC transaction, entities should select an accounting policy in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and that accounting policy should be consistently applied to the class of transactions. Accounting firms have developed extensive guidance on interpreting different ways to apply the principles of IAS 8 to BCUCC transactions which has contributed to the diversity in practice. In our review of this literature, we found that the accounting approach adopted strongly relies on professional judgement based on the individual facts and circumstances of a particular transaction.

23 An example of this diversity is one view that BCUCC represents a homogeneous class of transactions, and once an accounting policy has been selected it should be consistently applied to all BCUCC transactions. There is another view that a selected accounting policy should be applied consistently to the same class of BCUCC transactions, acknowledging that different classes of BCUCC transactions exist.

24 One of the reasons for accounting firms developing extensive guidance for BCUCC transactions is that the issues are not limited to initial recognition and measurement. There are a number of other issues that arise in practice and contribute to the diversity, for example, the treatment of the consideration transferred.

The lack of guidance: IFRS 3 scope exclusion for BCUCC

25 Paragraph 2(c) of IFRS 3 states that the standard does not apply, amongst other things, to a combination of entities or businesses under common control.

26 Accordingly, there is no specific guidance in IFRS on the accounting for BCUCC and there is also no formal definition of BCUCC in the IFRS literature.

27 However, paragraph B1 of IFRS 3 provides a description of a BCUCC. It states that a business combination involving entities or businesses under common control is 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[6].

28 The concept of control[7] is defined in paragraph 6 of IFRS 10 *Consolidated Financial Statements,* "an investor controls an investee when it is exposed, or has rights, to variable returns from its investment with the investee and has the ability to affect those returns through its power over the investee". Paragraph 7 of IFRS 10 makes clear that an investor controls an investee if the investor has power over the investee, exposure, or rights, to variable returns from its involvement with the investee and the ability to use its power over the investee to affect the amount of the investor´s returns. This definition of control applies also to BCUCC.

29 Paragraph B2 of IFRS 3 states that the scope exclusion for BCUCC is applied to control executed by an individual or a group of individuals, and that it is not dependent on the combining entities being included as part of the same consolidated financial statements.

30 A group of individuals is regarded as controlling an entity, when they act together under a contractual arrangement, are exposed, or have rights, to variable returns from their involvement with the investee and have the ability to affect those returns through their power over the investee. In the absence of a contractual arrangement, a group of

---

[6] The term "transitory" is not defined under IFRS however, the IFRIC considered a question in May 2006 relating to transitory common control in the context of IFRS 3 (issued in 2004). The consideration of the issue remains relevant for IFRS 3 (revised in 2008) because the scope exclusion was carried forward. At that meeting, the IFRIC discussed whether a reorganisation involving the formation of a new entity to facilitate the sale of part of a group is a business combination within the scope of IFRS 3 (as issued in 2004). This was because some had suggested that control of the new entity was transitory. It was clarified that common control is not transitory when the combining entities or businesses have been under common control for a period before the combination.

[7] The guidance in IFRS 10 is used to identify the acquirer: *the entity that obtains control of another entity*. This follows from IFRS 10, Appendix D Amendments to other IFRS. It should be noted that at the time of preparing this DP, IFRS 10 was yet to be endorsed for application within EU and that IAS 27 was still applicable. However for the purposes of the discussion it was appropriate to cite the most recent pronouncements of the IASB.

individuals does not have the collective power to govern the financial and operating policies of each of the combining entities.

31 Finally, paragraph B4 of IFRS 3 specifies that “the extent of non-controlling interest in each of the combining entities before and after the business combination is not relevant to determine whether the combination involves entities under common control”. This is because a partially-owned subsidiary is under the control of the parent entity both prior to and after the transaction. Hence, transactions involving partially-owned subsidiaries that are under common control are also outside the scope of the standard. Similarly, the fact that one of the combining entities is a subsidiary excluded from the consolidated financial statements is not relevant.

Question to constituents

1.1 Do you think that the concerns have been accurately described in relation to the issues arising from accounting for BCUCC transactions? If not, please could you suggest other significant concerns that have not been addressed?

Approaches in practice

32 In the absence of specific guidance in IFRS, transactions involving BCUCC should be accounted for in accordance with the ‘hierarchy’ described in paragraphs 10-12 of IAS 8. As a consequence, appropriate accounting policies have to be developed and applied consistently.

33 In current practice, one of the following two methods of accounting for BCUCC is usually selected:

(a) The predecessor basis of accounting; and

(b) The acquisition method (as described in IFRS 3).

34 The application of these approaches is not straightforward as there are variations made in practice. For instance, predecessor accounting can involve using values from the target entity or push-down values from the parent reflecting the initial acquisition of the business by the group. In US GAAP the use of predecessor accounting could lead to measurement adjustments on initial measurement. Specifically, Topic 805-30-6 states that “in some instances, the entity that receives the net assets or equity interest (the receiving entity) and the entity that transferred the net assets or equity interests (the transferring entity) may account for similar assets and liabilities using different accounting methods. In such circumstances, the carrying amounts of the assets and liabilities transferred may be adjusted to the basis of accounting used by the receiving entity if the change would be preferable.” Accordingly, even the application of predecessor accounting may itself involve some form of adjustments in certain circumstances.

35 The staff of IFRS IC conducted outreach activities in July 2011 amongst 18 national standard-setters. Responses received from 13 participants confirmed the diversity in practice. Some stated that acquisition accounting was applied ‘to synchronise’ the

accounting with the tax values and others applied a 'pooling-of-interests' because they did not want to introduce volatility to the future earnings or because an acquirer could not be identified. Furthermore, a predecessor basis of accounting was most commonly used in practice because it did not regard NEWCO as the acquirer. However, diversity exists in the application of this method of accounting.

36 There has been a suggestion from various parties, including the G4+1 and the FASB in its own work on consolidation, that the 'fresh start' accounting[8] could be an alternative method to account for BCUCC, and business combinations more generally. However, there is a lack of evidence that the costs of applying fair value to the combined entity are justified by the benefits.

37 In fact, the IASB considered the use of 'fresh start' accounting in business combinations and stated that there could be a case for using this method for rare business combinations, in which an acquirer cannot be identified, or in which the acquirer is substantially modified by the transaction. However, the Board rejected the use of the 'fresh start' method because the transactions under consideration were already being accounted for using the acquisition method. Therefore, the Board decided not to change that current practice (Paragraph BC56 of IFRS 3).

Question to constituents

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?

Applying the qualitative characteristics

38 When reflecting a BCUCC transaction in the financial statements of the reporting entity, the presence of an accounting policy choice may cause concerns because there are different views on whether the accounting outcome would be relevant and faithfully represent the BCUCC transaction. That, in turn, calls into question the decision-usefulness of the resulting information for users of the financial statements.

39 Comparability is one of the enhancing qualitative characteristics of the *Conceptual Framework* for Financial Reporting under IFRS. Therefore, comparability of financial statements portraying the financial effects of a BCUCC is an important consideration in developing an approach to initial recognition and measurement of BCUCC transactions.

40 Achieving faithful representation and improving comparability was the one of the reasons for the IASB and FASB did not consider the pooling-of-interests an alternative when accounting for so called *mergers* in developing IFRS 3 (SFAS 141(R). It is explained in paragraph BC38 of IFRS 3 that "[the] use of different accounting methods for the same set of facts and circumstances makes the resulting information less comparable and thus less

[8] Under the 'fresh start' method, all assets and liabilities of the newly formed group would be measured at their acquisition date fair values. This description was extracted from the IASB paper on common control transactions (June 2007).

useful for making economic decisions. As discussed in BC29-BC35, the boards concluded that all business combinations are economically similar. Accordingly, the use of the same method to account for all combinations enhances comparability of the resulting financial reporting information".

Our approach to the project

41 Considering the above issues, EFRAG, the OIC and the ANC agreed to pool resources and work closely together, so that European input could be developed in order to participate in, and contribute more effectively to, the global accounting debate about BCUCC.

42 Therefore, EFRAG, the OIC and the ANC established a proactive project on BCUCC. The project team (see Appendix 4) included staff from EFRAG, the OIC and the ANC, all of whom have made significant contributions to the development of this DP.

43 The project has been supported by an expert Advisory Panel (see Appendix 5), which has provided input to the project. The key issues in the paper have also been presented and debated by European National Standard-Setters in EFRAG's Consultative Forum of Standard-Setters and GNSS.

44 As part of the research on the project, staff conducted a survey of European National GAAPs with an objective to seek out what accounting methods were considered to be acceptable practice. The results of the European survey suggested that there was no consistent method applied to BCUCC transactions. In many instances, there either was no specific guidance or certain accounting approaches were preferred depending on the purpose of the transaction. For instance, some national GAAP preferred a predecessor basis of accounting for mergers or group reconstructions. It was clear from the survey that divergence in practice exists because there were no consistent ways of accounting for BCUCC.

Chapter Two: Scope of the DP

This Chapter defines the scope of the DP, which is to consider initial recognition and measurement of BCUCC in the consolidated financial statements of the transferee with the aim of providing decision-useful information about such transactions.

Introduction

1 The scope of the DP is defined as follows:

"Initial recognition and measurement of a BCUCC in the transferee's consolidated financial statements".

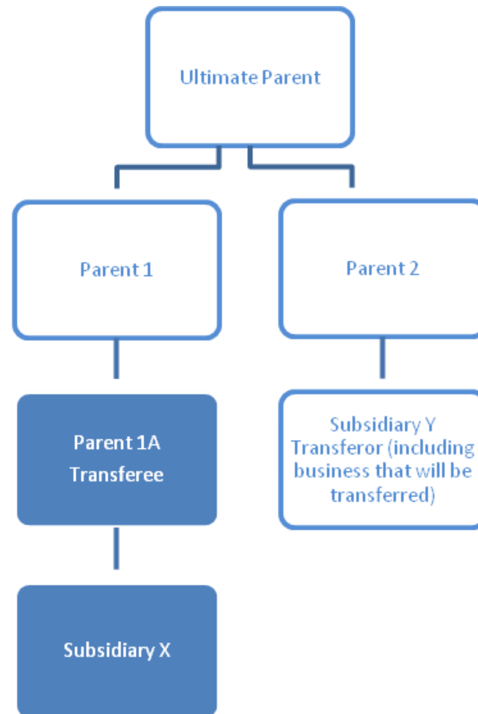
What is within the scope?

2 The discussion below sets out the reasoning behind the scope of the project. As far as consolidated financial statements are concerned, the scope is aligned with the deemed scope of the IASB's proposed project on common control.

3 The example on the next page illustrates diagrammatically the boundaries of the scope of the project.

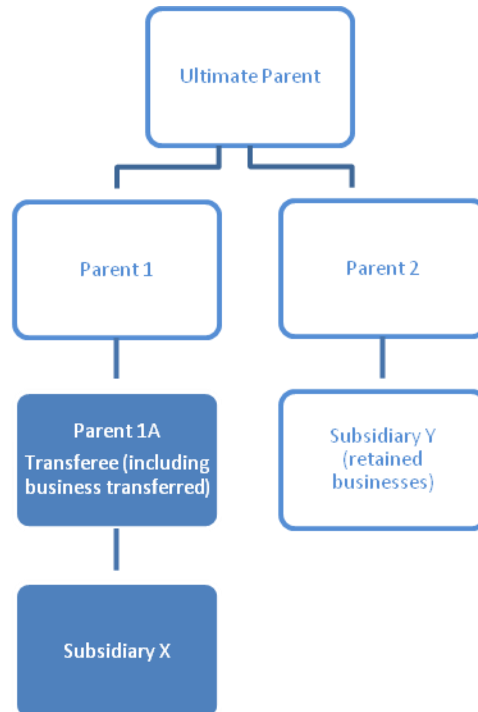
Before the BCUCC

(Note: all entities within the economic entity are 100% controlled by the ultimate parent entity)



After the BCUCC

(Note: all entities within the economic entity are 100% controlled by the ultimate parent entity)



a) Description of the position before the transaction:

- A group of entities controlled by the ultimate parent entity with all entities under common control.
- The group is structured as follows: the ultimate parent entity controls 100% of the shares/voting rights of its two subsidiaries, Parent 1 and Parent 2.
- Parent 1A owns 100% of the shares/voting rights of Transferee.
- Transferee owns 100% of the shares/voting rights of the subsidiary X. Transferee prepares consolidated financial statements.
- Parent 2 owns 100% of the shares/voting rights of subsidiary Y. Subsidiary Y contains two separate businesses.

b) Transaction:

- Transferee receives target business from Parent 2.

Accounting for BCUCC in the financial statements of the transferee

Consolidated financial statements of the transferee

4 The entity (the 'transferee')[9] which receives control over one or more businesses is required to account for the BCUCC transaction in its consolidated financial statements. BCUCC transactions are scoped out of IFRS 3. As BCUCC are scoped out of IFRS 3, there is no specific guidance in IFRS on how a BCUCC transaction should be accounted for in the financial statements of the transferee.

In the example illustrated above, the consolidated financial statements of Transferee are included within the scope of the project.

Recognition and measurement of the elements of financial statements

5 The core issues in this project are how to account for the effects of a BCUCC transaction at initial recognition[10] and measurement[11] in the consolidated financial statements of the transferee.

Question to constituents

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?

---

9 A distinction is made between a transferee and an acquirer. The term 'transferee' is used to describe when an entity receives one or more businesses from the ultimate parent entity. In later chapters, when the DP discusses whether the analogy to IFRS 3 is valid, a distinction is drawn between an acquirer and a transferee. That is, if the analogy to IFRS 3 is not valid, then the term 'transferee' is used to describe an entity that receives control over one or more businesses. This term is used to avoid suggestions that one of the combining entities is the accounting acquirer.

10 According to paragraph 4.37 of the *Conceptual Framework* (IASB 2010), "recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition set out in paragraph 4.38". Paragraph 4.38 of the *Conceptual Framework* goes on to explain that an item that meets the definition of an element should be recognised if:1) it is probable that any future economic benefit associated with the item will flow to the entity; and 2) the item has a cost o*r value that can measure*d with reliability".

11 According to paragraphs 4.54 and 4.55 of the *Conceptual Framework*, measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and income statement. This involves the selection of the particular basis of measurement (such as historical cost; current cost; realisable value and present value).

What is out of scope?

6 There are three issues that are not dealt with in this DP:

(a) subsequent measurement;

(b) financial reporting for the entity that loses control;

(c) accounting for BCUCC in the separate and individual financial statements of the transferee; and

(d) disclosures

The reasons for their exclusion are explained below.

Subsequent measurement

7 The accounting of BCUCC transactions at subsequent measurement in the consolidated financial statements of the transferee is not included in the scope of the project. The transferee is required to subsequently measure the assets acquired, liabilities assumed or incurred and equity instruments issued in accordance with applicable IFRS.

Financial reporting for the entity that loses control

8 In the financial statements of the transferor, de-recognition of a business should be accounted for in accordance with other applicable IFRS. The financial reporting of the entity that loses control is not considered to be in the scope of the project.

> In the example illustrated above, the parent that loses control is Parent 2, the financial reporting of which is not included in the scope of the project.

Separate and individual financial statements of the transferee

9 In addition to the consolidated financial statements, the transferee may be required to prepare separate financial statements as defined in IAS 27 *Separate Financial Statements* (2011) or individual financial statements.

10 As a result of a BCUCC, the transferee can obtain control over one or more investments in subsidiaries or receive a group of assets that meet the definition of a business. There could be initial recognition and measurement issues for a transfer of investments in subsidiaries or a group of assets that constitutes a business in the separate and individual financial statements of the transferee, respectively.

11 When the IASB discussed common control transactions at its December 2007 meeting, the IASB staff suggested that a potential project on common control transactions should make clear whether BCUCC falls within the scope of IAS 27.

12 The IASB staff also recommended that a project on common control transactions should focus on the consolidated and separate financial statements of the transferee that obtains control over one or more businesses.

13 The potential implications of accounting for BCUCC in the separate and individual financial statements were discussed when preparing this DP; however, it was not considered feasible to adequately address all the issues at this time.

14 Accordingly, the DP does not consider in detail the potential implications, but invites comments from constituents. This input will inform our proactive project on separate financial statements. It should be noted that during EFRAG TEG discussions, it was clear that an equity interest in a subsidiary in a BCUCC should be accounted for in the separate financial statements of the transferee in accordance with IAS 27. The key question is how a transferee should account for a BCUCC transaction where the transferee receives a group of assets and liabilities that meet the definition of a business. If the transferee is not a parent, it may prepare individual financial statements.

15 There are a number of questions that could be asked if separate and individual financial statements were included in the scope of the DP. For instance, it may be questioned whether the information needs of users of the separate and individual financial statements differ from those of users of the consolidated financial statements and, whether differences in needs justify application of different accounting policies on initial recognition and measurement.

16 That is, the information needs of the users of separate and individual financial statements may have a different objective in terms of financial reporting when compared to the information needs of the users of the consolidated financial statements. For instance, the users of the separate or individual financial statements may be interested in understanding the rights and obligations of the stand-alone entity and that information would only be provided by the financial statements of the parent (individual) entity. If the objectives are different, then arguably, the 'symmetry' in the accounting for a BCUCC in the separate and consolidated financial statements on initial recognition might not be essential. Similar arguments would apply, if individual financial statements were prepared.

17 EFRAG together with the National Standard-Setters of Italy (OIC), the Netherlands (DASB) and Spain (ICAC) have commenced a project looking at the issues arising from the application of IFRS to separate financial statements.

Question to constituents

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.

Disclosures

18 This project has not addressed the issue of disclosures although information in the notes to the financial statements about BCUCC is likely to be of particular relevance in satisfying the needs of users. The nature of such disclosures will depend, in part, on the approach adopted for recognition and measurement of BCUCC. Accordingly, at this stage there seemed to be little value in proposing disclosures ahead of reaching a conclusion on initial recognition and measurement of BCUCC transactions.

Question to constituents

2.3 Are there any specific issues you think need to be addressed when considering what information about a BCUCC should be disclosed in the notes to the financial statements of the transferee?

Chapter Three: Assumptions and guiding principles

This Chapter considers the assumptions and guiding principles that underpin the analysis in the DP. It is important to understand the main assumptions and approach taken because they help to shape the views and arguments that are developed in later chapters. The DP assumes that the transferee is a reporting entity, for which there are primary users that rely on its general purpose financial statements to make decisions and assess management's stewardship of resources.

The Chapter discusses an approach to accounting for BCUCC transactions, which is based on the logic of the IAS 8 hierarchy. The main objective is to principally ensure that the accounting approach results in information, which is relevant to the users of the transferee's financial statements, and which faithfully represents the underlying transaction; and not to open up the broader topic of common control transactions.

Background

1 This Chapter sets out the main assumptions in this DP. It is important for the reader to understand how the main assumptions interact with the arguments that have been developed to support the different views on accounting for BCUCC transactions in the financial statements of the transferee. These different views are presented in Chapter 5.

2 The main assumptions and principles employed in this DP are as follows:

a) any approach to BCUCC must satisfy the objective of financial reporting. That is, the accounting should result in information that is decision-useful for users;

b) the transferee is a reporting entity[12]; and

c) applying the logic of the IAS 8 hierarchy is appropriate to develop ideas on how to account for BCUCC transactions consistently with other IFRS requirements.

Addressing the needs of primary users

3 In considering how to frame an appropriate approach for BCUCC, our main objective was to develop approaches that are most likely to produce information that is decision-useful to primary users[13] of the financial statements. The objective of financial reporting according

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[12] It is acknowledged that the *Conceptual Framework* currently does not address the reporting entity concept, although it is a central feature of the objective of financial reporting. If the transferee is deemed not to be a reporting entity, then there is no reporting issue to resolve under IFRS.

[13] In this DP we use the *Conceptual Framework* notion of 'primary users' on the basis that it refers to the providers of capital to the reporting entity. The *Conceptual Framework* arguably makes a distinction between providers of capital and any other users. However, it is acknowledged that

to paragraph OB5 of the *Conceptual Framework* is to provide financial information that is useful to existing and potential investors, lenders and other creditors ('primary users') that cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Whilst we recognise that there may be other users of the financial statements, our analysis does not specifically address their information needs.

Question to constituents

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?

The transferee is a reporting entity

4 Defining the reporting entity is essential to resolving the issue of initial recognition and measurement of BCUCC transactions. We presume throughout this DP that the transferee is a reporting entity, and the financial reporting of BCUCC transaction is considered from its perspective. The description of a reporting entity is intended to be consistent with the objective of general purpose financial reporting. This is because the boundaries of a reporting entity are set to ensure that the information that is reported is useful for resource allocation decisions to be taken by existing and potential equity investors, lenders and other creditors ('primary users') .

5 According to the paragraph RE2 of the Exposure Draft *Conceptual Framework for Financial Reporting: The Reporting Entity (IASB 2010)*, a reporting entity is described as "a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether management and the governing board of that entity have made efficient and effective use of the resources provided".

6 The assumption that the transferee is always a reporting entity is intended to be consistent with the definition of users of general purpose financial statements. That is, the usefulness of information about the BCUCC to primary users is considered in assessing how to account for these transactions in the financial statements of the transferee.

7 It is also assumed that the transferee cannot take advantage of the exemption[14] in IFRS 10 to produce consolidated financial statements.

EFRAG thought that the assumption that information needs of the primary users would meet the needs of others was an unsupported assertion.

[14] Paragraph 4 of IFRS 10 states that a parent need not present consolidated financial statements if it meets all the following conditions:

(i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

8 Some discussions about BCUCC in the existing literature rely heavily on distinguishing between the 'entity perspective'[15] and the 'proprietary perspective'[16] – at a level of generalisation they are useful in guiding whether a transaction is assessed from the perspective of the reporting entity or from that of its owners. However, the implications of applying the perspectives are not well developed in the accounting literature; and the perspectives themselves appear to defy precise definition. Whilst the IASB has not taken a position on the role of the perspectives, it is reasonably clear that IFRS generally support an entity perspective. Changes made to IAS 27 as part of Phase II of the Business Combinations project are an illustration of the emphasis given to the entity perspective.

Question to constituents

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?

(ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

(iv) its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with IFRS.

15 The entity perspective is described in the May 2008 IASB Discussion Paper *Preliminary Views on an Improved Conceptual Framework for Financial Reporting The Reporting Entity (paragraph 109)* (IASB 2008)*"* Under the entity perspective, economic resources provided by owners or other capital providers become resources of the entity and cease to be resources of the owners or other capital providers. In exchange for the resources provided, capital providers are granted claims on the economic resources of the reporting entity. Thus, the entity is the focus of financial reporting, rather than its owners or others who have an interest in it.

16 The proprietary perspective is described in the May 2008 IASB Discussion Paper *Preliminary Views on an Improved Conceptual Framework for Financial Reporting The Reporting Entity (paragraph 108)* "Under the proprietary perspective, no distinction is drawn between the entity and its owners—the entity does not exist separately from the owners. The resources of owners remain their resources and do not become resources of an entity because the entity does not exist separately from its owners.

Applying the logic of the IAS 8 hierarchy to help develop ideas on how to account for BCUCC

9 An approach based on the principles of IAS 8 is consistent with the *Conceptual Framework* and other parts of the existing IFRS literature, especially those dealing with measurement issues. In particular, we were guided by the need to ensure that the accounting outcome best served the information needs of users as contemplated in the *Conceptual Framework*. One way of achieving this is applying similar accounting treatment to similar economic events.

10 Stating that we have applied the logic of IAS 8 means that we have considered the hierarchy of requirements set out in paragraphs 10-12 of IAS 8. In developing an approach to accounting for BCUCC, judgement should be applied to ensure that the accounting outcome is relevant to the economic decisions to be taken by users, and that it faithfully represents the BCUCC transaction. The logic of the hierarchy requires considering the following (in descending order):

a) the requirements in IFRS dealing with similar and related issues;

b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Conceptual Framework*; and

c) the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with IFRS.

11 In our view, this ‘logic’ represents the steps that the IASB would typically follow in developing an approach for a class of transactions. Applying the logic of the IAS 8 provides a platform for the IASB to develop ideas in relation to accounting for BCUCC in the financial statements of the transferee so that it could potentially be developed into a future financial reporting standard.

Why the IAS 8 hierarchy leads us to focus primarily on possible similarities with other business combinations under IFRS 3?

12 Similarities between BCUCC and other transactions could leads us to consider:

a) other transactions under common control

IFRS do not provide exceptions for transactions under common control. Supplementary disclosures for related party transactions are all that is specifically required for transactions under common control, such as the transfer/sale of a group of assets. The exception has been made for business combinations only, and it has been so for two generations of accounting principles for business combinations. The reasons for the scope exemption in IFRS 3 have not been understood and it is difficult to conclude what implications, if any, its presence could have when applying an analogy to IFRS 3. However the existence of the scope exemption suggests that

the IASB has made a distinct case for BCUCC and differentiates such transactions from other related party transactions. Accordingly, drawing an analogy to other related party transactions seems to be inappropriate. In other words, applying the same accounting treatment to BCUCC transactions as other related party ones is, in our view, inappropriate.

b) IFRIC 17 *Distributions of Non-cash Assets to Owners*

Although IFRIC 17 scopes out common control transactions involving non-cash assets, arguably there are principles in IFRIC 17 that could be analogised to, because the transaction is considered to be sufficiently similar to BCUCC. That is, IFRIC 17 deals with the distribution of a business from one entity to an owner transacting in its capacity as an owner and similarly BCUCC could be viewed as a transaction between an entity and its owner.

An analogy could be drawn to the measurement principle in IFRIC 17, as stated in paragraph 11. That is, the measurement of the liability to distribute non-cash assets should be based on fair value. Therefore, if the transaction price was not based on fair value, then a re-measurement would be required. Similarly, with BCUCC this may provide some justification for analysing the consideration transferred. This point is further explored in Chapters 4 and 5.

IFRS 3 *Business Combinations*

c) Consideration is given to the potential similarities, if any, with business combinations under IFRS 3; and hence, whether the key principles of IFRS 3 could be applied by analogy to BCUCC. That does not imply that IFRS 3 is the 'default' standard to be applied by analogy, but it would seem logical to assess whether or not the existing requirements for business combinations under IFRS are valid for transactions under common control.

13 IFRS 3 defines a business combination as "a transaction or other event in which an acquirer obtains control of one or more businesses".

14 IFRS 3 also contains the following three key principles:

a) the recognition principle, as stated in paragraph 10 of IFRS 3: "as of the acquisition date, the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquire …";

b) the measurement principle, as stated in paragraph 18 of IFRS 3: "the acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition date fair values"; and

c) disclosure principle, IFRS 3 contains a disclosure objective (as detailed in paragraph 59 of IFRS 3) that "the acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination…"

15 If the analogy to IFRS 3 applies, that is, if and when it can be concluded that the transaction is similar to a business combination, we do not challenge the presumption in IFRS 3 that applying fair value at initial measurement is always likely to provide users with financial information that is relevant and a faithful representation of the underlying BCUCC.

16 If the analogy to IFRS 3 does not apply, then applying the logic of IAS 8 would lead to an accounting approach that results in financial information that is relevant to the economic decisions to be taken by users and is a faithful representation of the BCUCC transaction based on the principles of the *Conceptual Framework*. Such an approach would arguably be guided by the analysis of the information needs of users.

17 It is argued in this DP that if the definition of a business combination in IFRS 3 does not apply to BCUCC, then it could not be concluded that BCUCC and business combinations under IFRS 3 represent similar economic events and accordingly IFRS 3 cannot be analogised to. Even if the definition of a business combination is satisfied, the analogy to IFRS 3 could be invalidated because applying the measurement principle in IFRS 3 may not result in information that is relevant or a faithful representation of the BCUCC transaction.

Questions to constituents

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?

Chapter Four: Defining the problem

This Chapter builds on the assumptions and principles set out in Chapter 3 that the IAS 8 hierarchy logic should be applied. In applying the logic of IAS 8 it requires firstly to analyse the main features that characterise BCUCC transactions: namely, BCUCC represents a transaction between related parties, whether it is subject to market forces or not and the nature of the item being 'exchanged' between the parties. This analysis considers whether IFRS 3 can – and if so to what extent – be considered relevant requirements for BCUCC. Those features serve as the basis for the analysis in this Chapter and the views that are presented in Chapter 5.

The analysis shows that the distinguishing features of a BCUCC are as follows:

a) *BCUCC represents a transaction between related parties;*

b) *BCUCC is not subject to market forces;*

c) *the nature of the item being 'exchanged' between the parties can differ substantially from a business combination;*

d) *the information needs of users in an business combination and BCUCC may differ but only if the controlling shareholder is considered to be a primary user of the financial statements of the transferee; and*

e) *there may be diversity in the information needs of users to a business combination because lenders and other creditors may focus on the separate/individual financial statements of combining entities; however, such diversity in information needs may equally apply to business combinations under IFRS 3.*

The appropriateness of an analogy to IFRS 3 can be affected by the distinguishing features of a BCUCC. That is, the fact that it could be difficult to identify an acquirer in a transaction under common control, or the ultimate parent entity can direct the identification of the acquirer (and the accounting outcome) could prevent acquisition accounting being a faithful representation of the BCUCC transaction. Furthermore, the diversity in the information needs in a BCUCC could provide justification to question whether it is relevant to analogise to the recognition and measurement principles in IFRS 3.

If the analogy to IFRS 3 is valid, then the unique features (specifically the fact that the BCUCC is never the subject of market forces) can challenge whether parts of IFRS 3 should apply because the accounting would not result in the faithful representation of the underlying BCUCC transaction. That is, the lack of a market-based transaction can lead to goodwill and other intangible assets remaining unrecognised in the financial statements of the transferee.

Introduction

1 This Chapter explores whether or not BCUCC have unique characteristics and how these can create problems when analogising to, and applying the mechanics of IFRS 3. To a large extent these characteristics differ substantially from those found in business combinations, and this Chapter demonstrates that IFRS 3 may not necessarily always be a 'good fit' for BCUCC transactions.

2 The main objective of the IAS 8 hierarchy is to develop an approach that would result in financial information that is relevant to primary users for making economic decisions and that faithfully represents the BCUCC transaction.

The unique features of BCUCC transactions

3 Identifying common features of a BCUCC is a complex exercise as the nature of BCUCC transactions can vary significantly in practice, as well as the motivation that lies behind them. The characteristics considered below are not intended to cover all the possible features of BCUCC, but to highlight some of the most relevant ones. These include the:

a) purpose of the transaction;
b) absence of market conditions; and
c) nature of items being exchanged.

The purpose of the transaction

4 It is often argued that BCUCC do not represent a homogeneous class of transactions, because they are often driven by many different reasons, which may differ substantially from the reasons for carrying out a business combination under IFRS 3. The latter are often driven by a purpose of satisfying economic needs of both parties (otherwise there is no rational reason to enter into such a transaction). The reasons for carrying out a BCUCC may not be the same as a business combination which are evident when considering the effects of the BCUCC. That is, the purpose may not be to benefit the combining entities, but other entities within the group.

5 Furthermore, the effect of a BCUCC is unlikely to result in any capital 'at risk', because both parties to the transaction (and the other parties to the transaction) will typically have full access to information and records. Therefore, the information asymmetries between the parties are likely to be minimal. That is unlikely to be the case with business combinations under IFRS 3.

6 In practice, the purpose of the transaction is often considered in determining whether or not the BCUCC possesses economic substance[17]. This requires applying judgement about the extent to which the BCUCC transaction has the features of a business

[17] The term 'economic substance' is not defined in IFRS. In this DP it refers to a change in the economic flows of the transferee as a result of the transferred assets and assumed liabilities associated with a BCUCC.

combination. Some of the guidance issued by the accounting firms referred to in Chapter 1 is based on the view that if a BCUCC transaction has economic substance then acquisition accounting should apply.

7 However, the purposes of and the reasons behind BCUCC transactions do not alter their economic substance. The reporting entity that combines one or more businesses as a result of the transaction is likely to generate future cash flows, which differ from those that could be expected from the entities/businesses being combined on a stand-alone basis. This may be the case regardless of the purpose of the transaction, even though the transaction may be conducted in order to benefit the group as a whole rather than the entities that are parties to the transaction.

8 Nonetheless, the business purpose can be taken into account in determining the most relevant measurement basis for initial recognition of BCUCC based on the information needs of users. That is, if the analogy to IFRS 3 is not appropriate, the business purpose may play a significant role in selecting a measurement attribute that result in decision-useful information.

9 Accordingly, we conclude at this stage that the business purpose cannot alter the economic substance of a transaction; however, it can play a significant role in deciding which measurement attribute is likely to result in the information that is most relevant to users. The fact that BCUCC are diverse transactions is principally because the ultimate parent entity drives the transaction for different reasons and purposes that are significantly different for which the combining entities engage in an exchange transaction.

10 This is evidenced later on under the section “understanding the information needs of users about BCUCC transactions”. It is demonstrated that the controlling shareholder may have different motivations, and as such, if their viewpoint dominated the accounting then it may represent a very different accounting outcome than acquisition accounting.

The absence of market conditions

11 One of the most significant features of a BCUCC is that it is a transaction between related parties. An entity is considered to be a ‘related party’ if the entity and the reporting entity are members of the same group (this includes parents, subsidiaries and fellow subsidiaries related to the others) (IAS 24.9(a) (IASB 2011)). The definition of a related party in this instance also applies to entities that are under common control.

12 IAS 24 specifies that special consideration is required for related party transactions since a related party relationship could have an effect on the profit or loss and financial position of an entity.

13 BCUCC are transactions conducted between related parties and this may impact the following aspects:

a) the purpose of the transaction (we have discussed this earlier in the Chapter);

b) the process undertaken; and

c) the terms and conditions (timing, consideration and other aspects) of the transaction.

14 In particular, BCUCC may be a special class of related party transactions since they are transactions that may be conducted by owners acting in their capacity as owners[18]. If a transaction is strongly influenced by the ultimate parent entity (in terms of the decision to carry out the BCUCC and the transaction price) then this may affect the nature of the BCUCC transaction. That is, these related party aspects[19] may lead to some aspects of IFRS 3 not applying.

15 The transaction may be subject to significant management discretion, strongly influenced by the ultimate parent entity imposing the terms and conditions of the arrangement. The terms and conditions are likely to be significantly different from those negotiated in a market transaction.

16 The parties involved in a BCUCC often do not go through a complex negotiation and bargaining process[20] that is typical for business combinations. The parties often do not invest the same time and resources in identifying the target, in getting preliminary contacts or in obtaining an understanding of the counterparty, because entities under common control are generally not exposed to the information asymmetry risk that is 'priced' separately through the negotiation process.

17 For those reasons, BCUCC transactions cannot be considered similar to business combinations negotiated and conducted at arm's length. The concept of an arm's length transaction is a recurring concept within IFRS literature. For instance, IFRS 13 *Fair Value Measurement* (IASB 2011) describes fair value as "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction". An arm's length transaction is viewed as being consistent with the price agreed between market participants in a market-based transaction.

18 Furthermore, market-based transactions are deemed to occur between independent parties. The fact that the transaction is not subject to market forces challenges the assumption made in IFRS 3 that the price of the transaction is deemed to represent fair value.

[18] We argue in Chapter 5 that the BCUCC transaction could be considered as two transactions that should be separately accounted for in the financial statements of the acquirer. The first transaction is a contribution from the ultimate parent entity and the second is a business combination. It is argued that the first transaction always represents a transaction with an owner acting in its capacity as an owner; there will always be a contribution in the circumstances where the transaction price is not a proxy for fair value.

[19] In this DP the related party aspects refer to situations, in which the ultimate parent entity plays a significant role in defining the terms and conditions of the BCUCC transaction.

[20] This does not imply that there is no negotiation at all as the combining entities may seek to negotiate expectations of future returns and funding arrangements.

19 Accordingly, any accounting approach dealing with BCUCC has to acknowledge this fact. In applying the analogy to IFRS 3, the fact that the BCUCC is never the subject of an equal exchange could challenge the extent to which the analogy to IFRS 3 applies.

The nature of items being exchanged

20 In describing a BCUCC transaction, another aspect to consider is the nature of the items being 'exchanged': the net assets acquired versus the consideration given up. Focusing on what is being exchanged in the BCUCC transaction helps to define better the problem under discussion.

Net assets acquired

21 For the transferee, a BCUCC represents the transfer of assets and liabilities that constitute a business in return for consideration given up. While the transfer/acquisition of a business is not enough to characterise a BCUCC as a business combination, it is one of the necessary features of the definition of a business combination. This is explored later on in this Chapter.

22 IFRS 3 requires the recognition of all identifiable intangible assets at fair value and goodwill as being the difference between the price paid and the fair values (or different measurement bases for a few exceptions) of assets and liabilities acquired. If BCUCC can be analogised to other business combinations, the nature of BCUCC transactions may give rise to special issues in relation to the recognition of goodwill (and bargain purchases) and identifiable intangible assets. This is discussed further in Chapter 5.

The consideration given up

23 The nature of the consideration given up could also differ substantially. For instance, it is stated in paragraph 37 of IFRS 3 (IASB 2011) that the nature of the consideration may vary from cash to other assets, a business or a subsidiary of the transferee, contingent consideration, ordinary or preference equity instruments, options, warrants and member interests of mutual entities. However, in a BCUCC the consideration given up often involves cash, intercompany debt or shares.

24 Some argue that the nature of the consideration has relevance in determining the accounting outcome. That is, it is often argued that a transaction that involves cash consideration has economic substance whereas a share-for-share exchange between related parties is representative of a transaction that shifts the boundaries within an existing economic entity where the transaction lacks economic substance.

25 The position taken in this DP is that, consistent with IFRS 3, the nature of the consideration does not alter the economic flows associated with the underlying business and accordingly it has no effect on whether or not the BCUCC transaction possess economic substance.

26 However, the nature of the consideration may not change the ability of the transferee to meet existing claims against the combining entities, and when it does not, then arguably the BCUCC would not lead to a user re-assessing previous resource allocation decisions

in relation to the transferee. For example, if as a result of BCUCC, the transferee transfers cash, its liquidity risk may change whereas a share for share exchange may not lead to a reassessment of previous decisions taken by users.

Questions to constituents

4.1 Do you agree with the main features of a BCUCC identified above? If not, what other features would you highlight?

4.2 It is noted above that BCUCC can be substantially different in nature from business combinations between unrelated parties. 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?

Understanding the information needs of users about BCUCC transactions

27 The following discussion considers whether or not the information needs of users in respect of a BCUCC differ from those in respect of a business combination that generally involves an exchange transaction, and more importantly whether or not these needs are unique to BCUCC. The purpose of the analysis is to consider whether BCUCC represent a diverse group of transactions which warrants a different accounting approach than that applied to business combinations under IFRS 3.

28 The DP applies the principles in the *Conceptual Framework* to determine what is considered to be decision-useful. That is, primary users (existing and potential investors, lenders and other creditors) want information to help them assess the returns that they expect from an investment. The expectations about returns depend on the assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity (paragraph OB3 of the Conceptual Framework).

29 In order for users to assess an entity's prospects for future net cash inflows, they need information about the resources (i.e. assets) and claims against the entity (i.e. liabilities), and how efficiently and effectively management has discharged their responsibilities to use the entity's resources (i.e. management stewardship).

30 Users typically assess the future net cash inflows of a reporting entity in two ways:

a) balance sheet analysis: the cash generating abilities of the business are analysed through the recoverability of its assets and settlement of its liabilities. In this case, fair value measurement is likely to be relevant, and

b) profit and loss/cash flow analysis: the cash generating abilities are analysed through current and past performance (i.e. a historical trend analysis of the profit and loss).

These two methods are not a binary choice or trade-off, but simply a basis for highlighting the various ways, in which future cash flows can be assessed.

31 IFRS 3 is clear that the cash generating abilities are best reflected through fair value measurement. The DP is not intend to open up a debate as to whether fair value represents the most relevant measurement attribute in a business combination, but question what is the most relevant measurement attribute for initial recognition of a BCUCC.

32 The following analysis considers the information needs of each group of users in respect of a BCUCC and compares those with the user information needs in relation to business combinations. This analysis is intended to better explain under what circumstances BCUCC is dissimilar to a business combination under IFRS 3.

Existing equity investors

33 Equity investors do not necessarily have the same information needs when they control the entity and when they do not. As a result, our analysis is split into two parts:

a) the controlling equity investor; and

b) the non-controlling equity investor.

The controlling equity investor

34 Before addressing the information needs of the controlling equity investor, we consider whether the controlling equity investor is a user of general purpose financial statements. Two views have emerged and are considered below:

a) the controlling equity investor is a user of the financial statements of the transferee; and

b) the controlling equity investor is not a user of the financial statements of the transferee.

The controlling equity investor is a user of the financial statements of the transferee

35 Under the first view, the ultimate parent entity is a user of the financial statements of the transferee because this forms the basis of its investment decisions.

36 A BCUCC may not trigger any material change to the prospects of future net cash flows of the reporting entity from the ultimate parent perspective (under assumption that no synergies are created).

37 This is because a BCUCC shifts the boundaries within the ultimate reporting entity group where no exchange with any third party to the group has occurred. The BCUCC therefore, from the viewpoint of the ultimate parent lacks economic substance and is more

representative of a reshuffling of the boundaries of entities within the ultimate reporting entity group. Some would argue that existing equity investors may be more interested in a 'continuity of existing values' that allows for an assessment of the historical performance against the 'original' investment made.

38 The management stewardship (i.e. holding management to account) aspect of the information needs of existing equity investors may be affected by a BCUCC because they want to assess the change in performance of the combined entity over time.

39 Under this view, the information needs of existing shareholders in relation to BCUCC are quite different from the information needs in relation to a business combination with an entity external to the group.

The controlling equity investor is not a user of the financial statements of the transferee

40 Under the second view, the ultimate parent entity is not a user of the financial statements of the transferee. This is because the ultimate parent entity could obtain internally the financial information that it needs. Although not explicit in the *Conceptual Framework* (IASB 2011), there is a presumption that if a party can obtain internally the information that would be provided by general purpose financial statements, then such party does not need to rely on those financial statements. According to paragraph OB9 of the *Conceptual Framework*, "the management of a reporting entity is also interested in financial information about the entity. However, management need not rely on general purpose financial reports because it is able to obtain the financial information it needs internally."

41 In a BCUCC, the controlling equity investor is represented by the management of the ultimate parent entity and not necessarily by the management of the transferee.

42 Accordingly, the information needs of the ultimate parent entity (and its existing owners) would be ignored in the analysis of a BCUCC. This is in contrast to the analysis of a business combination that occurred outside of the economic entity.

Non-controlling interests

43 A BCUCC is likely to have an impact on the future profitability of the transferee, on how the entity is operated, on its business model(s) etc. For that reason, the holders of the non-controlling interest (henceforth referred to as 'NCI') will have to make reassessments before making investment decisions to either hold (i.e. for dividends) or sell the investment (i.e. for capital appreciation). Accordingly, the holders of NCI are interested in a change to the prospects of future net cash flows.

44 The nature of the consideration (i.e. shares versus cash transferred) may lead to a reassessment of whether to hold or sell an investment. This is because cash (which would change the risk profile of the reporting entity) or shares (which could potentially

dilute the relative interest in the combining entity post BCUCC) could have an impact on the claims held by the holders of NCI.

45 Holders of NCI may not be interested in the initial assessment of the investment made, because the decision to transact would generally be directed by the ultimate parent entity and; therefore, management of the transferee is not held accountable for the investment made. This would be different in relation to a business combination under IFRS 3. In other words, the price paid may bear no relevance to the ability of the management of the transferee to obtain a 'fair price'.

46 However, the management of the transferee may be accountable for the subsequent performance of the transferred business. Accordingly, holders of NCI may be interested not in the historical performance of the transferred business, but in the post-combination performance of the transferee. Therefore, information resulting from the application of the acquisition accounting (i.e. the erasing of the historical performance) would satisfy the information needs of the holders of NCI.

47 Accordingly, holders of NCI may be interested in understanding:

a) how the BCUCC affects their previous assessment of either to hold or to sell an investment; and

b) how management of the transferee have performed subsequent to the BCUCC.

The views expressed above in relation to management stewardship will not be repeated when considering the other users, because the same arguments equally apply.

48 To summarise, there is a difference between business combinations (involving a party outside of the group) and BCUCC in terms of accountability for the initial investment made. However, this should arguably not affect the information needs of holders of NCI because they are interested in understanding how the BCUCC could affect their previous assessment of the prospects of future cash inflows regardless of the initial investment made.

Potential equity investors

49 Potential equity investors want to understand the return that they would receive from investing in equity of the transferee. To assess the future returns from an investment, the potential equity investors are interested in understanding the prospects of the transferee to generate future net cash flows and any changes to those prospects. The information needs of the potential equity investors in relation to a BCUCC are consistent with those in relation to a business combination involving a party outside the group. In other words the information needs of potential equity investors do not differ in relation to a business combination under IFRS 3 and a BCUCC.

Existing and potential lenders (and other creditors)

50 Existing and potential lenders (and other creditors) are interested in assessing (the liquidity and solvency of the transferee in order to make decisions on lending and/or the extension of credit. In doing so, arguably, they potentially would also make reassessments of previous decisions subsequent to a change to the prospects of future cash flows or to the way the entity is managed.

51 Users may focus only on stand-alone entities (i.e. the separate/individual financial statements of the combining entities) as opposed to the consolidated financial statements of combined reporting entity; unless the transferee provides financial guarantees to the claimants of its new subsidiary. That is, in some situations existing and potential lenders (and other creditors) may not require information about the consolidated financial statements of the transferee.

52 If the assumption that users are only interested in the financial information in relation to the separate/individual financial statements is valid, then existing and potential lenders (and other creditors) may have different information needs depending on the legal form of a BCUCC. For instance, consider two scenarios:

Scenario 1: a transferee obtains control over another entity in the group; and

Scenario 2: the combining entities are 'merged' together to form a new entity (i.e. the combined entity).

53 In scenario 1, the future cash flows associated with the rights and obligations within the confines of the individual entities do not change even though the BCUCC could create some synergistic benefits. This is because the users focus on the individual/separate financial statements of the combining entities.

54 In scenario 2, the future cash flows may alter because the BCUCC involves combining the economic resources of both entities to form a new reporting entity.

55 It would seem that the information needs of existing and potential lenders (and other creditors) would vary depending on the legal form of the BCUCC.

56 Furthermore, the assessment of liquidity and solvency based on the individual/separate (or consolidated) financial statements of the transferee may be affected by any cash component that forms part of the consideration transferred as opposed to a share for share exchange. From an existing and potential lender (other creditors) perspective, any cash that is transferred outside of the individual/separate (or consolidated) entity changes the short-term liquidity. However, the assessment of liquidity and solvency would be broader than any change in the short-term liquidity of the entity. That is, the assessment of liquidity and solvency is dependent on the prospects of future net cash flows and any change in the short-term liquidity should be considered together with all other facts and

circumstances. Hence, the nature of the consideration may not lead to a re-assessment of liquidity and solvency of the transferee which presents no difference in terms of the user information needs in a business combination; but it depends on what entity the user focuses on to satisfy their information needs.

57 However, IFRS 3 focuses on the cash generating abilities of the combined entity that results from the business combination which would result in a user re-assessing the prospects for future net cash inflow resulting from the transaction and not to changes in the cash generating abilities of the combining entities as stand alone ones. Arguably, in a business combination under IFRS 3 users may also focus only on the separate/individual financial statements and accordingly, the problem is not unique to BCUCC. This argument is supported by OB7 of the *Conceptual Framework* that states that "General Purpose Financial Reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources."

58 There are two conclusions that could be drawn:

a) the analysis considers lenders (and other creditors) as users of the financial statements of the transferee however whether these users rely on the individual/separate or consolidated financial statements of the transferee is irrelevant because users may only focus on the individual/separate financial statements of the transferee in any business combination. Determining whether differences exist in terms of which financial statements users focus on, is not a unique problem to BCUCC. Accordingly, the analysis should focus on whether the BCUCC transaction leads to a re-assessment liquidity and solvency of the transferee as a combined entity and not to the individual combining entities; and

b) the analysis considers lenders (and other creditors) as users of the financial statements of the transferee; however in their analysis, this group of users may consider consolidated financial statements in some instances but in other instances place more emphasis on obtaining information from other sources, including the separate/individual financial statements of the combining entities. The extent to which lenders (and other creditors) rely on the other information sources including the separate/individual financial statements of the transferee and not the consolidated ones depends facts and circumstances in a given situation.

What best serves the information needs of users when contemplating a change in the cash generating abilities of the transferee?

59 The *Conceptual Framework* suggests that users are interested in the information about changes to the cash generating abilities of the reporting entity, because this could make them reassess their economic decisions. However, it is questioned whether users want historical trend analysis of the combined entity as if it had always existed, so they can

predict the cash generating abilities, or the cash generating abilities should be reflected through fair value measurement.

60 An EFRAG's User Survey on *The Needs of Users of Financial Information* (EFRAG 2009) highlighted that there are different interpretations of what information is deemed to be useful in assessing the cash flow prospects. For example, some users want historical information on past cash flows, so that they can conduct their own analysis of the future cash flows. Arguably, under this view, the users would focus on historical information trends to predict the future cash flows of the acquired business. The information needs of users can either be satisfied: 1) through initial measurement, whereby the income statement and the cash flow statement of the combined entity may be restated as if it existed prior to the BCUCC[21] or 2) by disclosure. The disclosure objective in IFRS 3 (paragraph 59) requires that the acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination. Conversely, other users believe that balance sheet valuations that focus on the future cash flows provide better information.

61 It cannot be ignored that there are different views on what best serves the information needs of users. It is explicit in IFRS 3 that fair value provides a better representation of the future cash generating abilities and this DP does not challenge this. That is, if the analogy to IFRS 3 is valid then fair value is deemed to best reflect the cash generating abilities associated with the acquired business; albeit in relation to the acquisition of the acquired net assets at the date of acquisition.

62 If the analogy to IFRS 3 breaks down, an accounting approach should be developed that results in decision-useful information. This could result in either applying predecessor basis of accounting or fresh start accounting at initial measurement to the BCUCC transaction. Under a predecessor basis of accounting, the financial statements of the combined entity could be restated as if the entity existed prior to the BCUCC. Using fresh start accounting to account for the BCUCC, both the transferee and the acquired business are re-measured to fair value.

63 It could be argued further that even if the analogy to IFRS 3 is valid then IFRS 3 could be modified to make it explicit that disclosures should reflect a restatement of the income and cash flow statement of the combined entity as if the entity existed prior to the BCUCC. This would ensure that the different views of what measurement basis is considered to best represent a change in the cash generating abilities is reflected in the financial statements of the transferee.

64 Those who believe that information needs are best satisfied by historical information would argue that a predecessor form of accounting best represents the cash generating abilities

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[21] The application of a predecessor basis of accounting could lead to an entity restating the comparative period (and possibly earlier periods) as if the combined entity had always existed. However, the focus of this paper is not to consider whether this is appropriate because it may open up a broader debate on the application of predecessor basis of accounting which is not within the scope of the DP. In some jurisdictions, IAS 27 is interpreted to suggest that the comparative period should be restated.

of a transferee. Conversely, others would suggest that fair value best reflects the cash generating abilities of the transferee (consistent with IFRS 3).

65 As mentioned earlier, this DP does not intend to challenge the presumption in IFRS 3 that fair value best reflects the cash flows associated with the acquired business, when the analogy to IFRS 3 is considered to be appropriate. This is because such a debate would re-open the issue of the most relevant measurement attribute in accounting for a business combination between parties that are not under common control by the ultimate parent. This DP discusses the most relevant measurement basis for BCUCC accounting, which would result in information useful for users in assessing the prospects for the future net cash flows of the transferee, when the analogy to IFRS 3 is not considered appropriate.

Are the information needs of users in relation to a BCUCC different to those in relation to a business combination?

66 In summary, users are interested in two things:

a) the prospects of future net cash flows; and

b) the stewardship of management.

67 The difference in the information needs of users between a business combination under IFRS 3 and a BCUCC give support to the view that BCUCC represents a diverse group of transactions. Accordingly, BCUCC cannot be treated as a homogeneous class of transactions and developing accounting approaches that considers what the most relevant measurement base should apply at initial measurement depends on facts and circumstances. The analysis above demonstrated that the following differences in information needs exist:

a) The prospects of future net cash flows. There are two differences to consider:

(i) where the controlling shareholder in a BCUCC, who is considered to be a user of the financial statements of the transferee, arguably would not find any "new" information for itself because there is no change to the future cash flows as a result of the BCUCC. This is different to a business combination under IFRS 3, as the new controlling external investors would want to understand the prospects of future net cash flows, principally because an exchange transaction has taken place; and

(ii) when existing and potential lenders (and other creditors) do not focus on the consolidated financial statements of the transferee, but on other information, including the separate/individual financial statements.

b) Management Stewardship – when considering a BCUCC, users would not be particularly interested in the accountability of the transferee's management for the

initial investment made. This is because management of the transferee is generally never responsible for achieving a fair price, which would force them to examine the transaction carefully. Unlike with a business combination under IFRS 3, when considering a BCUCC users may not be interested in this aspect, because it is often the ultimate parent entity and not the management of the transferee who initiates the transaction.

68 When comparing the information needs between a business combination under IFRS 3 and a BCUCC, there are no differences when the controlling shareholder is not a user of the consolidated financial statements of the transferee. This is because such users want information about any change to the prospects of future net cash flows and about the subsequent performance of the management of the transferee. Accordingly, this gives support to view that BCUCC can be treated as a homogenous class of transactions.

Question to constituents

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

Assessing whether the definition of a business combination and the key principles of IFRS 3 are relevant

69 When determining whether IFRS 3 could be applied by analogy to a BCUCC it is necessary to reflect on how the unique features of a BCUCC impact the appropriateness of drawing such an analogy. Each of these key principles will be discussed in turn.

70 The analogy to IFRS 3 can be invalidated in two circumstances:

a) the definition of a business combination cannot be applied to a BCUCC; or

b) if the definition of a business combination is satisfied, but the most relevant measurement attribute to be applied at initial recognition may not be fair value but some other measurement basis (i.e., there is an overarching objective in applying the logic of the IAS 8 hierarchy that the accounting outcome should be relevant and be a faithful representation of the BCUCC transaction). This is because of the diversity in the information needs of users when comparing the information needs of users in a BCUCC to a business combination under IFRS 3.

71 If the information needs of users in relation to a business combination are similar to those in relation to a BCUCC, then there is no need to contravene the general principle in IFRS that similar transactions should be accounted for in a similar manner. That is, if the information needs of users are similar in relation to business combinations, then the recognition and measurement principles of IFRS 3 should apply to the significant

economic event, which is obtaining control over one or more business, albeit with different modifications because of the unique characteristics of BCUCC.

72 The analysis below presumes that the information needs of users in a BCUCC do not differ from those in relation to a business combination under IFRS 3. Applying the analogy to IFRS 3 in the forthcoming analysis can only be invalidated when the definition of a business combination cannot be applied to the BCUCC transaction.

Could the existing definition of a business combination equally apply to BCUCC?

73 In practice it is sometimes argued that the existence of common control may imply that a business combination has not taken place but rather it is a 'transfer' of a business or the re-defining of the boundaries of a reporting entity, that is, an event that is different to that contemplated in IFRS 3.

74 To test these arguments and whether or not the related party aspects play a significant role in determining whether or not a business combination has occurred, it is necessary to test whether the building blocks of the business combination definition are appropriate to BCUCC (the DP considers that where the business combination definition can be applied then it is possible to analogise to IFRS 3).

75 Paragraph 3 of IFRS 3 states that "an entity shall determine whether a transaction or other event is a business combination ..." That is, it is necessary to establish whether the facts and circumstances being considered give rise to a business combination.

76 According to IFRS 3, a business combination is defined as "a transaction or other event in which the acquirer obtains control of one or more businesses".

77 It is said therefore that the definition of a business combination has three building blocks: a) there must be the identification of an acquirer, b) there must be the obtaining of control over one or more businesses and c) there must be the acquisition of a business as defined in IFRS 3. If one of the three building blocks does not apply because of the presence of the common control elements, then it is argued that the analogy to IFRS 3 is invalid. The discussion will now turn to discuss each of these 'building blocks'.

78 If the analogy is not valid, on the basis that the definition of a business combination is not satisfied, the entity that receives the business has to consider the other aspects of the IAS 8 hierarchy.

79

Identification of an acquirer

80 The principles to apply for identifying an acquirer are set out in IFRS 3 and the standard is premised on the view that it should always be possible to identify an acquirer. Paragraph 6 of IFRS 3 states that "for each business combination, one of the combining entities shall be identified as the acquirer". Paragraph 7 of IFRS 3 goes onto say that "the guidance in IFRS 10 shall be used to identify the acquirer – the entity that obtains control of the acquiree. IFRS 3 establishes a principle that it is the entity that, in substance, obtains control over the acquiree (as defined in IFRS 10) that is identified as the acquirer.

81 However, because of the unique features of BCUCC transactions the assertion in IFRS 3 that an acquirer can always be identified may not hold. We set out below two alternative views to the position taken in IFRS 3.

a) View A: an acquirer may be identified; it depends on facts and circumstances; and

b) View B: an acquirer can always be identified but it is not meaningful.

View A: an acquirer may be identified; it depends on facts and circumstances

82 Only in some circumstances, it is difficult to identify an acquirer because the transaction is under common control due to some of the unique features of a BCUCC.

83 For instance, consider the following fact pattern. Consider a BCUCC involving five entities, which are controlled by the same ultimate parent entity. A new entity is formed to issue equity instruments to effect the BCUCC transaction. Each of the potential combining entities are of equal relative size and the transaction is initiated by the ultimate parent entity.

84 Although not all the facts and circumstances may be present, a tentative view is that it is difficult in this fact pattern to identify the acquirer for the following reasons:

a) the transaction is not initiated by any of the combining entities;

b) a new entity cannot be identified as the acquirer, because B18 of IFRS 3 states that "if a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the business combination, shall be identified as the acquirer ...";

c) the composition of the relative voting rights in the combined entity after the BCUCC is irrelevant because the combining entities are ultimately controlled by the same ultimate parent entity before and after the BCUCC transaction; and

d) the relative size of the combining entities is very similar, which suggests that none of the combining entities represents a dominant position.

85 However, the principle in IFRS 3, that one of the combining entities shall be identified as the acquirer, would apply to BCUCC. In the fact pattern above, there must be consideration of all facts and circumstances. For instance, B15 to B18 in IFRS 3 provide detailed guidance on identifying an acquirer, but this list is not exhaustive. The language used in B15 of IFRS 3 does suggest this because it states “other pertinent facts and circumstances shall also be considered in identifying an acquirer in a business combination effected by exchanging equity interests.

View B: an acquirer can always be identified but it may not be meaningful

86 Consistent with the arguments presented above, the principle in IFRS 3 that one of the combining entities shall be identified as the acquirer equally applies to BCUCC.

87 Although, the principle may be difficult to apply in some circumstances, particularly, when the business combination is effected by the formation of a new entity that issues equity instruments, the ‘difficulty’ in applying the principle in IFRS 3 equally applies to business combinations under IFRS 3.

88 Even though an acquirer can always be identified, one problem that could exist is that the ultimate parent entity can ‘choose’ which of the combining entities is to be identified as the acquirer albeit within the confines of the guidance in IFRS 3. The ultimate parent entity can select the accounting acquirer and direct an entity to acquire a business within the ultimate reporting entity group with an objective to achieve an optimal accounting outcome so that the depiction is slanted. This may increase the probability that financial information would be favourably received by users. As a result it could be argued that this is not a faithful representation of the BCUCC transaction.

89 On the other hand this argument may be of limited relevance, because in any business combination there is a possibility for the parties to select the accounting acquirer, although within the boundaries of IFRS 3 guidance provided on the identification of an acquirer.

Questions to constituents

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?

Obtaining control over one or more businesses

90 Some use the argument that the principle in IFRS 3, that one of the combining entities is the acquirer is flawed in the circumstances of a BCUCC, because neither of the combining entities initiates, negotiates or ultimately directs the BCUCC transaction. The current ability to direct the relevant activities of the acquired business is retained both before and after the BCUCC transaction by the ultimate parent entity.

91 However, IFRS 10 considers control from the perspective of a separate reporting entity which is a group – a parent and its subsidiaries (Paragraph 2(a) of IFRS 10). A 'group' may include economic entities (or sub-groups) within the overall economic entity (group). IFRS 10 clearly contemplates the notion of a reporting entity comprising an intermediate parent and its subsidiaries. Therefore it is difficult to sustain an argument that control can only be understood from the perspective of the ultimate parent entity.

Question to constituents

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?

The acquisition of a business

92 IFRS 3 defines a business as "an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members or participants".

93 IFRS 3, Appendix B, explains that a business also has three elements: "inputs and processes applied to those inputs that have the ability to create outputs."

94 The scope of IFRS 3 also states the acquisition of an asset or group of assets does not constitute a business and that such a transaction or event does not give rise to goodwill.

95 The identification of a business as contemplated in IFRS 3 does not raise any particular difficulty in the context of transactions between entities under common control since the definition of a business as provided by IFRS 3 can be applied also for a BCUCC.

Question to constituents

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

The verdict on applying the definition of a business combination

96 We have considered whether or not the building blocks of the definition of a business combination in IFRS 3 could equally apply to BCUCC. The analysis suggests there are two views to consider:

(a) it may be problematic to identify an acquirer because the transaction is under common control; and

(b) the principle in IFRS 3 that one of the combining entities shall be identified as the acquirer equally applies to BCUCC. However, the fact that the ultimate parent entity can choose the acquirer may result in an accounting that may not represent a neutral depiction of the BCUCC transaction.

Applying the 'mechanics' of IFRS 3

97 If a business combination has been identified, IFRS 3 applies a number of principles which constitute the acquisition method. This principally consists of the recognition and measurement of the identifiable assets and liabilities assumed, and any non-controlling interest in the acquiree and goodwill or a gain from a bargain purchase as a residual. The recognition and measurement principles will be considered in the next section.

The recognition principle

98 Paragraph 10 of IFRS 3 states that "the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree". Although the recognition and measurement of goodwill or a gain from a bargain purchase is not considered as part of this specific recognition principle; the problems are considered here.

99 When considering whether the recognition principle could equally apply to BCUCC, different views emerge. There are circumstances where the mechanics of the recognition principle becomes somewhat invalid because the transaction is never subjected to market forces. There are two views that could emerge: 1) problems are created when applying the recognition principle because there is no market-based transaction and 2) there are no problems because a market-based transaction can always be simulated using Level 3 inputs.

100 This raises the question whether or not the recognition of goodwill (and in some instances other intangible assets) would be consistent with the *Conceptual Framework*.

101 The Framework (paragraph 4.38) includes reliable measurement as a criterion to consider when ensuring that the elements satisfy the criteria for recognition in the financial statements of the acquirer.

The recognition of goodwill in a BCUCC

102 One view could be that applying the recognition criteria is problematic in recognising goodwill as a residual which would be based on the difference between the excess of the price paid and the fair values (or different measurement bases for a few exceptions) of the identifiable assets and liabilities acquired. This is because BCUCC are never subjected to market forces and it is difficult to simulate market conditions to faithfully represent goodwill. However, it is possible to reliably measure the identifiable intangible assets because such assets would arise from legal or contractual rights (i.e. the assets are separable) and there should be enough information to reliably measure the identifiable intangible asset acquired.

The recognition of the acquired identifiable intangible assets in a BCUCC

103 Another view is that it may be questionable whether intangible assets in a BCUCC should be recognised. This is because the recognition of identifiable intangible assets principally because of the lack of market forces. The absence of a market-based transaction means that valuing the intangible assets may not be reliable and therefore the recognition criteria in the *Conceptual Framework* would not be met. This would be starkly different to a business combination because the transaction would take place between unrelated parties where there should be sufficient information available to reliably measure the intangible assets at fair value as there would be an exchange at market.

The recognition principle should be applied in full in a BCUCC

104 Contrary to the position outlined above, it could be argued that the recognition principle could be applied in all cases (and recognise goodwill) and the fact that the BCUCC is never subject to market forces is irrelevant. This is because IFRS 13 (IASB 2011) presumes that it is possible to apply a fair value measurement in the absence of market activity, through the use of unobservable inputs.

Recognising a gain from a bargain purchase

105 It is worth considering if there are any problems when applying the mechanics of IFRS 3 where the consideration transferred is less than the fair value of the identifiable net assets acquired (i.e. a bargain purchase).

106 It is questionable whether this accounting treatment is consistent with the *Conceptual Framework*. This is because paragraph 4.25(a) of the *Conceptual Framework*, states that "income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from an equity participant." Hence, the 'credit' side could be viewed as a contribution from the ultimate parent entity. However, an

alternative view could be that a bargain purchase is consistent with the Framework because it represents an increase in economic benefit for the combining entities.

Conclusion

107 In conclusion, there are different views that have emerged when applying the recognition principle in IFRS 3:

a) where the consideration transferred is greater than the fair value of the net identifiable assets acquired:

(i) the lack of a market-based transaction could lead to the conclusion that either goodwill or goodwill and acquired identifiable intangible assets could not be reliably measured; and

(ii) it is possible to apply the recognition principle regardless of whether or not there is a market-based transaction. This is because the use of Level 3 inputs could be used to simulate a market-based transaction;

b) one problem that should be addressed is that due to a lack of a market-based transaction then it is possible that the consideration transferred may be greater than the fair value of the acquired business.

c) where the consideration transferred is lower than the fair value of the net identifiable assets acquired the difference between the fair value of the net identifiable assets acquired and the consideration transferred should be representative of a:

(i) contribution from the ultimate parent entity because the contribution does not represent an increase in economic benefit; or a

(ii) bargain purchase consistent with IFRS 3 because it represents an increase in economic benefit for the entity.

Question to constituents

4.8 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?

The measurement principle

108 The measurement principle in IFRS 3.18 (IASB 2011) states: “the acquirer shall measure the identifiable assets and the liabilities assumed at their acquisition date fair values”. In other words, there is a presumption in IFRS 3 that fair value is the most relevant measurement attribute that should apply at initial measurement.

109 An important principle in IFRS is that similar transactions should be accounted for in a similar way. A possible view was stated that the three building blocks could equally apply to BCUCC. Accordingly, there is a view that it is difficult to justify not applying the IFRS 3 measurement principle to the extent that an IFRS 3 accounting outcome is relevant to the users of the financial statements of the acquirer. The unique characteristics of a BCUCC do not invalidate the analogy to IFRS 3 but it could lead to some assets not being recognised due to the absence of a market-based transaction.

Question to constituents

4.9 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?

110 In this Chapter, we have noted some of key issues raised by BCUCC. Whilst IFRS 3 is a recent standard and deals comprehensively with business combinations the application of that standard to BCUCC is not straight-forward.

111 This Chapter demonstrated that the unique features of a BCUCC (purpose of the transaction, the absence of the market conditions and the nature of the consideration) create some unique problems that arguably should be reflected in the accounting outcome. We learned that:

a) the purpose of the transaction does not alter the economic substance however it could have an impact on the information needs of users;

b) the absence of a market-based transaction may question:

(i) whether goodwill and/or acquired identifiable intangible assets could not be reliably measured due to the lack of a market-based transaction;

(ii) how to treat the ‘excess’ where the consideration transferred is greater than the fair value of the acquired business; and

c) the nature of the consideration does not alter the economic substance, however it may have an impact on the information needs of users.

112 When considering whether the information needs of users differ from that of a business combination involving external parties it was demonstrated that:

a) there is no difference if the controlling shareholder is ignored in the analysis (because they are not a user of general purpose financial statements), arguably the users in a business combination under IFRS 3 are placed in the same position as those in a BCUCC. Accordingly, there is no basis to question whether or not IFRS 3 could be analogised to in full; and

b) the following differences could exist which provides justification to question whether fair value is the most relevant measurement attribute to apply at initial measurement:

(i) if the controlling shareholder is a user of general purpose financial statements (and their view dominates financial reporting) then arguably this may prevent an analogy to IFRS 3 because the measurement principle of IFRS 3 can never be analogised to; or

(ii) when existing and potential lenders (and other creditors) do not focus on the consolidated financial statements of the transferee, but on other information, including the separate/individual financial statements of the combining entities.

113 When applying an analogy to IFRS 3, the fact that the transaction is under common control may make it difficult to identify an acquirer and arguably the analogy breaks down. It could lead some to argue that the definition of a business combination is not satisfied.

114 In the next Chapter, we consider the different ways the analysis in this Chapter could be interpreted.

Chapter Five: Consideration of potential ways to account for BCUCC at initial recognition and measurement

As explained in Chapter 3 our approach to follow the IAS 8 hierarchy in investigating ways to account for BCUCC in the consolidated financial statements of the transferee/acquirer has led us to test the appropriateness of the analogy to IFRS 3. In particular whether the definition of a business combination can be applied to BCUCC and does the accounting outcome when applying the recognition and measurement principles produce financial information that is relevant and representationally faithful? The analysis in Chapter 4 identifies different perspectives from which the different views in this Chapter are derived.

The three views that have emerged over the course of developing this DP consider that there are circumstances when the analogy is appropriate and others when it is not. Where the analogy is appropriate the unique characteristics of BCUCC can play different roles in shaping the accounting outcome when applying the recognition and measurement principles of IFRS 3. This is because they have an effect on determining what makes information useful for users of the financial statements of the transferee/acquirer. Also, to some extent, the diversity in information needs challenges whether or not the recognition and measurement principle should apply at all.

When the analogy is not appropriate because the transaction is under common control, the use of 'fresh start' or a predecessor basis of accounting may be appropriate, depending on the specific facts and circumstances and the analysis of user needs.

Introduction

1 Chapter 4 considered whether an analogy could be made to IFRS 3 and the extent to which the unique characteristics of BCUCC transactions invalidates some or all of the analogy to IFRS 3.

2 Applying an analogy to IFRS could be invalid where: 1) an acquirer cannot be identified, or 2) an acquirer can be identified but the influence of the ultimate parent entity could lead to the selection of the accounting acquirer and direct an entity within the ultimate reporting entity group with an objective of achieving an optimal accounting outcome that may not represent a neutral depiction.

3 The unique characteristics can invalidate some of the analogy to IFRS 3 because goodwill and/or identifiable intangible assets may not be reliably measured due to the absence of a market-based transaction.

4 When considering potential ways on how to account for BCUCC at initial recognition it is important to bear in mind that the accounting outcome should best serve the information needs of users. This ensures that any accounting approach developed is consistent with the objective of financial reporting.

5 When considering the qualitative characteristics of what makes information decision-useful the unique features of a BCUCC could have an effect on the quality of financial information to be provided to the users of the financial statements of the acquirer/transferee. The unique features of BCUCC transactions should not affect the analogy to IFRS 3 but it could have an impact on the accounting outcome when applying the mechanics of IFRS 3.

6 There are three views that have emerged over the course of this project that are primarily concerned with the accounting outcome when, and if, analogising to IFRS 3. Such an approach follows the logic of the IAS 8 hierarchy (and the *Framework*) that requiring the accounting outcome results in decision-useful information. This Chapter explores the three views on how to account for a BCUCC at initial recognition – they are best seen as different points along a spectrum giving more weight to some of the unique features of BCUCC and less to others. They are presented here to stimulate debate about different ways of interpreting the analysis.

7 The strengths and weaknesses of each of the three views (to the extent that they are not covered in this Chapter are further elaborated in Appendix 2

Consideration of the three views

8 In considering the applicability of IFRS 3 to BCUCC, a number of views emerged that about the appropriateness of analogising to the core principle in IFRS 3. They are presented here as typical arguments that are often presented when considering BCUCC and are derived from considering the relevant accounting literature. It is important to state that whilst the various views have certain parallels with approaches taken in the past, they have been developed further in this DP and set within an IFRS context.

a) **View one**: IFRS 3 can always be applied by analogy. The definition of a business combination equally applies to BCUCC despite the related party aspects and the transaction takes place between owners in their capacity as owners. However the unique features of a BCUCC can have implications when applying the mechanics of IFRS 3. Those supporting this view consider that the information needs of users are similar in a business combination and do not consider the controlling equity investor as a primary user of general purpose financial statements, and believe that all that is needed to fulfil other users' needs is supplementary disclosure to understand the common control context of the transaction, as for any other common control transaction under IFRS.

b) **View two**: IFRS 3 can never be analogised to. Applying the analogy to IFRS is made difficult for two reasons: a) an acquirer can never be identified or b) an acquirer can be identified but the ultimate parent entity can decide the acquirer in a BCUCC which leads to an accounting outcome that is not a faithful representation of the underlying BCUCC transaction. Those supporting this view believe that appropriate accounting requirements will deal with the two combined entities in a symmetrical fashion, and that the use of the predecessor basis of accounting or 'fresh start' accounting will depend on users' needs, varying from one set of fact patterns to the next.

c) **View three**: The analogy to IFRS 3 may apply however because the information needs of the users are diverse, it is difficult to conclude that an accounting outcome based on IFRS 3 would always produce relevant information that faithfully represent a BCUCC. Applying the recognition and measurement principles of IFRS 3 depend on who the users are and their information needs. Those supporting this view would conclude that BCUCC represents a diverse group of transactions and that diversity could have an effect on the information needs of users.

9 The discussion will now turn to describe each of these three views.

View one: IFRS 3 can always be applied by analogy

10 IFRS establish a general principle that similar transactions should be accounted for in a similar way. For instance, paragraph 13 of IAS 8 states "an entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions …". The general principle is strengthened by the analysis that is performed in Chapter 4 which suggests that the information needs in business combinations and BCUCC are similar meaning that the recognition and measurement principles of IFRS 3 should equally apply to BCUCC.

11 Accordingly, the analogy to IFRS 3 applies in full, however, the unique characteristics, particularly the fact that the BCUCC is not subjected to market forces could have an effect on the qualitative characteristics that makes information useful to users when applying the mechanics of IFRS 3. The unique characteristics do not invalidate the analogy to IFRS 3 but rather question to what extent the recognition and measurement principles of IFRS 3 should apply. We also said in Chapter 4 that the absence of market forces could have an impact on the recognition of goodwill and, in some cases, other intangible assets because the reliability criterion would arguably not be satisfied.

12 If the analogy to IFRS 3 is valid then the use of acquisition accounting eliminates any pre-acquisition profits associated with the acquired business. However, as it was stated in Chapter 4, the information needs of those who believe that historical trends provides important information regarding the prospects for future net cash inflows could be satisfied through applying the disclosure objective in IFRS 3.

13 On this basis, it is suggested that there are three variants of view one. Such variants emerge primarily because BCUCC are a related party transaction that has an impact on the fundamental qualitative characteristics of useful information. The three variants of view one are as follows (with supporting reasons for their justification):

a) **Variant one:** the recognition and measurement principle in IFRS 3 should be equally applied to BCUCC. There is no justification to apply different recognition and measurement principles because, the fair value of the business acquired can be reliably measured on the basis of Level 3 inputs and it does not undermine the reliability of the measurement;

b) **Variant two:** goodwill should not be recognised in the balance sheet of the acquirer. This is justified on the basis that goodwill cannot be faithfully represented due to the absence of a market-based transaction; and

c) **Variant three:** goodwill and intangible assets should not be recognised in the balance sheet of the acquirer. Similar to the reasons, as specified in variant two, there may not be sufficient information to reliably measure the acquired intangible assets due to absence of a market-based transaction and there is no history or evidence of exchange transactions that are similar in nature.

14 Each of these three variants will now be explained in detail in the next section.

Variant one: the recognition and measurement principle in IFRS 3 should equally apply to BCUCC

15 Even though BCUCC and business combinations differ in terms of the nature of the transaction, in both instances the acquirer has obtained control over one or more businesses. Accordingly, there is no justification to apply a different recognition or measurement principle than those that in IFRS 3. So what does this mean in terms of accounting outcome?

16 When applying the recognition principle, the fact that BCUCC transactions have unique characteristics has no effect on the qualitative characteristics of the *Framework*. That is, the related party aspects have no effect on the reliability of financial information to be presented to users of the acquirer's financial statements. This is because IFRS 13 (and the IFRS 3 treatment on business combinations achieved by contract alone) presumes that it is possible to apply a fair value measurement to the consideration transferred and to the net identifiable assets acquired in the absence of market activity, through the use of unobservable inputs.

17 Respondents to the Board in its deliberations on applying IFRS 3 to combinations of mutual entities highlighted that the consideration often involved the absence of readily measurable consideration which would make it necessary to use other valuation techniques. However, the board highlighted that such combinations are unique to mutual entities and as such does not justify separate accounting.

18 It is likely that due to the related party aspects of the transaction and the absence of market forces, the consideration transferred will never be approximately equal to the fair value of the business acquired. Therefore, it may be difficult to reliably measure the fair value of the consideration and to do so it may be necessary to rely on the fair value of the business[22] acquired[23]. As a result, the 'consideration' may need to be parsed into its components where it is either below or above the fair value of the business acquired.

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[22] Reference is to the 'business' and not the net identifiable assets which allows for goodwill or a bargain purchase gain to be recognised.

[23] IFRS 3.37 requires that "the consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer to the former owners of the acquiree, the liabilities incurred by the acquirer to the former owners of the acquiree and the equity interests issued by the acquirer". This is predicated on (a) the existence of an exchange transaction and therefore a relevant economic relationship between the consideration given up and the business acquired; and (b) that the fair

19 The justification for analysing the consideration transferred includes:

a) The BCUCC is viewed as potentially two separate transactions that represent (i) a contribution (or a distribution) from the ultimate parent entity and (ii) a business combination. An analysis of the consideration (where the transaction price was lower than the fair value of the business acquired) would ensure that accounting outcome reflects a faithful representation of the contribution from the ultimate parent entity. Similarly, where the transaction was greater than the fair value of the business acquired then the transaction is bifurcated to ensure that goodwill is not over-stated.

b) To faithfully represent the contribution (distribution) (which represents the difference between the transaction price and the fair value of the business transferred by the ultimate parent entity), it should reflect the fair value contributed (distributed) to the acquirer. This would be consistent with paragraph 11 of IFRIC 17 which states that, "an entity shall measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets (including a business) to be distributed". Arguably, if the dividend was not based on fair value of the business to be distributed then the dividend would be re-measured;

c) There would be further consistency with B53 of IFRS 2 *Share Based Payments* ('IFRS 2') treats equity instruments issued by the parent entity to the employees of its subsidiary. In other words, according to IFRS 2 the subsidiary shall measure the employee services at fair value with a corresponding increase in equity which reflects a contribution from the parent entity. When considering BCUCC the contribution would be measured by the difference between the value of the business received and the consideration given up by the entity.

d) Consistency in recognition and measurement between business combinations under IFRS 3 and BCUCC. This promotes comparability between entities that are under common control and those that are not.

20 However, opponents of this view consider that the consideration transferred should not be analysed because IFRS 3 is built on the presumption that an exchange transaction has taken place and simulating the conditions that would exist in an exchange transaction cannot be done. In particular, it may be difficult to faithful represent goodwill. Furthermore, it is argued that there is a significant difference between business combinations under IFRS 3 and BCUCC because the former would reflect entity-specific synergies.

21 Such an approach would also be inconsistent with existing IFRS. That is, existing IFRS do not analyse transactions into components because they occur between related parties. The financial effects of the 'special relationships' that exist between related parties is dealt with through the use of disclosures in IAS 24. Analysing the consideration transferred could lead to a wider debate about the measurement of related party transactions.

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value of the consideration can be determined reliably. The suggestion here is that the related party nature of the transaction effectively breaches both those conditions.

Variant two: Goodwill should not be recognised in the balance sheet of the acquirer

22 The unique features of BCUCC, in particular the related party aspect, have a significant impact on the qualitative characteristics that makes information useful to users. That is, the absence of market forces on the transaction makes it difficult to faithfully represent goodwill as a 'residual'. This is because there is a view that there is no way to reliably measure the consideration at fair value. This provides the basis to not analyse the consideration transferred based on the fair value of the business acquired so that goodwill is, arguably, comparable to a business combination that involves external parties.

23 It is explained in BC3.19 of the *Conceptual Framework* that the term reliability was replaced with *faithful representation*, however reliability still remains part of the recognition criterion in the *Framework* and is likely to remain so until Phase B of the *Conceptual Framework* project is complete (which deals with definitions of elements, recognition and derecognition).

24 When applying the recognition criterion, it would result in the recognition of identifiable assets and liabilities assumed and any non-controlling interest in the acquiree. Accordingly, the consideration transferred should not be analysed to enable the mechanics of IFRS 3 to apply so that, except in the rare cases the acquirer makes a bargain purchase, the consideration transferred exceeds the fair value of the net identifiable assets acquired.

25 The justification for not recognising goodwill is that its relevance is questionable as it does not arise from an exchange based transaction. Even though the recognition of goodwill may represent a complete depiction of the business acquired the lack of a market-based transaction would make it difficult for the user to understand what the amount of goodwill represented.

26 By not analysing the consideration transferred would lead to either the transaction price being greater than, equal to, or less than the fair value of the net identifiable assets acquired. In these circumstances, any difference between the transaction price and the fair value of the identifiable net assets could be treated as a distribution to the ultimate parent entity (i.e. where the transaction price is greater than the fair value of the net identifiable assets acquired) or a contribution from the ultimate parent entity (i.e. where the transaction price is less than the fair value of the net identifiable assets acquired – note the latter point is considered later on in this Chapter).

Variant three: Goodwill and intangible assets should not be recognised in the balance sheet of the acquirer

27 The unique characteristics of BCUCC transactions have an even greater impact on the qualitative characteristics than in variant two. The absence of market conditions makes it difficult to faithfully represent goodwill and identifiable intangible assets. This also provides the basis to not analyse the consideration transferred similar to the reasons in variant two.

28 The recognition of intangible assets cannot be reliably measurable for two reasons: a) the BCUCC is never subject to market forces. Accordingly, there may not be sufficient information available to reliably measure the acquired intangible assets and b) there is no history or evidence of exchange transactions that are similar in nature. The nature of the identifiable tangible assets that would be recognised would be capable of reliable[24] measurement because arguably there would be evidence of exchange transactions that are similar such as for property, plant and equipment.

29 The Board in developing the 2005 business combinations exposure draft decided to remove the reliability of measurement criterion for intangible assets acquired in a business combination because the separate recognition and measurement of intangible assets provided better information than including their values in goodwill. Although this may be the case, the reliability criterion still exists in the *Conceptual Framework* when recognising an item in the financial statements. This arguably provides justification not to recognise certain intangible assets when their fair value cannot be measured with reliability.

30 When applying the recognition principle in IFRS 3, the acquirer would only recognise the identifiable tangible assets acquired and liabilities assumed and any non-controlling interest in the acquiree.

31 Similar to the reasons for not recognising goodwill, the accounting would be relevant to users and would faithfully represent the BCUCC transaction similar for the reasons for not recognising goodwill (i.e. the accounting outcome would not be complete nor possess predictive value).

32 Opponents of this variant would argue that the accounting outcome would be inconsistent with what makes information decision-useful. That is, users want information about the cash generating abilities of the reporting entity and this is best representative of recognising all identifiable net assets acquired.

33 The accounting treatment explained in paragraph 27 above when considering the difference between the transaction price and the fair value of the net identifiable assets would equally apply under variant three, except that identifiable intangible assets would not be recognised in the balance sheet of the acquirer.

The implications of possibly not analysing the consideration transferred – a bargain purchase or a contribution from the ultimate parent entity?

34 When the consideration transferred is not analysed, so that it is equal to or greater than the fair value of the acquired net identifiable assets, it raises a question about the treatment of a bargain purchase in a BCUCC. That is, due to the lack of a market-based transaction, there may be a circumstance where the consideration transferred is lower than the fair value of the net identifiable assets acquired. The question to be considered is

[24] This assumption may not be the case for highly specialised tangible assets that are specific to certain industries. In this instance, it is argued that there may not be evidence of exchange transactions that are similar in nature.

whether the recognition of a bargain purchase is consistent with the *Conceptual Framework*.

35 According to paragraph 4.25(a) of the *Conceptual Framework,* “income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to **contributions** from an equity participant.”

36 The recognition of a *bargain purchase* may be inconsistent with the neutrality[25] principle. This is because a BCUCC whose only purpose may be to achieve a gain is also not faithfully representational of the economic phenomena. That is, the accounting outcome would be ‘slanted’ toward presenting information that could have a bias influence over the users of the financial statements.

37 However, it is acknowledged that a bargain purchase may result for other reasons whose purpose is not to achieve a revenue gain. In these circumstances, the recognition of a bargain purchase may not faithfully represent the BCUCC transaction.

38 To demonstrate the different variants, consider the following fact pattern. An acquirer obtains control of one or more businesses from another entity within the same ultimate reporting entity group for 56CU in cash. The fair value of the business acquired is 148CU and the fair value of net identifiable assets is 115CU (included is 35CU of identifiable intangible assets). It is assumed that the acquirer is a new entity that has substance of its own, and prior to the BCUCC transaction, it has 100CU in cash and share capital.

[25] According to QC14 of the *Framework* “a neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users. Neutral information does not mean information with no purpose or no influence on behaviour. On the contrary, relevant financial information is, by definition, capable of making a difference in users’ decisions”.

Illustrative Example

Extract of the Consolidated Financial Statements of the Acquirer

	Variant one		Variant two		Variant three
Goodwill	33[26]		-		-
Tangible assets	124[27]		124[27]		124[27]
Intangible assets	35		35		-
Total assets	192		159		124
Share capital	100		100		100
Other equity	92[28]		59[28]		24[28]
Equity	192		159		124

26 148CU (fair value of the business acquired) – 115 CU (Fair value of the net identifiable assets acquired) = 33CU

27 100CU (opening cash) + 115CU (fair value of the net identifiable assets acquired) – 35CU (identifiable intangible assets) - 56CU (cash transferred) = 124CU.

28 Other equity reflects a contribution from the ultimate parent entity. The 92CU represents the difference between 148CU (the fair value of the business acquired) and the cash transferred (56CU). The 59CU is calculated by the difference between the fair value of the identifiable assets acquired (115CU) – the cash transferred (56CU). The 24CU is representative of the fair value of the tangible assets acquired (80 CU) (115CU-35CU) – cash transferred (56CU) = 24CU.

39 Key observations about the effects of the different variants are as follows:

a) Total assets:

(i) Goodwill is recognised only under variant one on the basis that it can be reliably measured. This arguably provides a more faithful representation of the business acquired than the other variants because a business generally includes goodwill. This is a more complete depiction of the expected cash flows associated with the acquired assets and liabilities. The other variants only provide a partial depiction. Furthermore, applying variant one may improve comparability with other business combinations with external parties; and

However, proponents of variant one would argue that not recognising goodwill and possibly other intangible assets provides a more faithful representation and improves comparability because the key distinction between business combinations under IFRS 3 and BCUCC is that the former is generally an exchange transaction that occurs between market participants in an orderly transaction.

b) Total equity:

(i) Under variant one, the total equity reflects the 'full' contribution from the ultimate parent entity which is representative of the value of the business transferred and the cash paid. This potentially provides a more complete depiction of the contribution from the ultimate parent than the other variants.

Questions to constituents:

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?

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

40 The arguments presented in earlier chapters suggest that the definition of a business combination may not be valid to BCUCC as an acquirer cannot be identified or the 'neutrality' principle is contravened because the ultimate parent entity can decide the 'acquirer' in a transaction which could lead to accounting outcome that is bias.

41 The unique problems that are created by BCUCC can arguably be solved by applying accounting approaches at initial measurement that lead to symmetrical accounting treatment to the combined entities. That is, applying either a predecessor basis of accounting or 'fresh start' accounting depends on the information needs of the users.

42 Two accounting outcomes could apply under these unique circumstances: 'fresh start' accounting and a predecessor basis of accounting. It is important to understand how the information needs of users can effect which one these two measurement bases would apply which is primarily driven by the analysis performed in Chapter 4.

43 'Fresh start' accounting could apply where the users deem that the cash generating abilities are best reflected through a fair value measurement. Such an accounting outcome would apply when the controlling shareholder is not deemed to be a user of the financial statements of the transferee because they would be interested in a continuity of existing values.

44 The *Basis for Conclusions* in IFRS 3 considers that there can be rare circumstances where an acquirer cannot be identified and the use of 'fresh start' accounting could be applied (it is suggested in this DP that for BCUCC those circumstances may be more common). However, the boards rejected such an approach because it would change current practice because acquisition accounting was being applied in these situations. The boards also expressed an interest in 'fresh start' accounting when considering the formation of joint ventures or some formations of new entities in multi-party business combinations.

45 Applying 'fresh start' accounting would involve applying the recognition and measurement principles in IFRS 3 to all assets and liabilities of the (newly formed) group which would be measured at their acquisition date fair values. Similar to the variants that exist in view one certain asset (goodwill and identifiable intangible assets) may not be recognised due to the lack of a reliable measurement. As those arguments have already been considered they will not be repeated here.

46 The use of fresh start accounting would also eliminate the pre-acquisition profits and cash flows of both the combining entities. Accordingly, the historical trends that would be relevant to users to assess the prospects of the reporting entity to generate net cash flows would be eliminated.

47 Applying 'fresh start' accounting could be justified because it would provide a more faithful representation than acquisition accounting as the accounting outcome would reflect the cash generating abilities of the new combined entity rather than just the expected cash flows associated with the acquired assets and assumed liabilities.

48 The use of 'fresh start' accounting though has some draw backs:

a) it would be questionable whether or not the costs to the preparer would exceed the benefits to users;

b) drawing a boundary between applying acquisition accounting and 'fresh start' accounting could be arbitrary. For instance, there may be incentive to applying 'fresh start' accounting because the histories of the previous combining entities are 'erased' entirely;

c) it may be less relevant than applying acquisition accounting as it would have less confirmatory value because the previous history of the combining entities would cease to exist; and

d) it may not mitigate the fact that the ultimate parent entity has discretion over selecting the accounting acquirer because the same motivation may exist to select two entities to combine in order to achieve an optimal accounting outcome by applying fair value at initial measurement that may not be a faithful representation of the underlying BCUCC transaction.

49 A predecessor basis of accounting could be applied in two situations: 1) where the controlling shareholder dominates the analysis of the information needs of users (to the exclusion of other users) and 2) the users have similar information needs and believe that the cash generating abilities are best reflected through a historical trend analysis.

50 The accounting under a predecessor basis of accounting could be seen by some as more appropriate than applying acquisition accounting. Acquisition accounting relies on an acquiring entity surviving the combination (i.e. the identification of an acquirer) and fair value reflecting the cash generating abilities of the acquirer. Applying a predecessor basis of accounting could provide information that is more relevant and representational faithful because:

a) the absence of market conditions in a BCUCC makes it difficult to achieve a faithful representation of goodwill and in some instances intangible assets (refer to the discussion in the previous section);

b) it removes the neutrality issues created by the acquisition method of accounting whereby the net assets of the acquired entity being measured at fair value and the acquiring entity at historical cost; and

c) it maintains the historical profit and loss trends that are deemed relevant to users who are interested in the cash generating abilities of the transferee. The use of acquisition accounting eliminates the historical trends because the acquiree is re-measured to fair value. However, this is a problem that exists with acquisition accounting, in general, and is not unique to BCUCC.

51 The use of a predecessor basis of accounting can present some problems that are presented below:

a) It provides an exception to the general principle in IFRS that 'cost' is the fair value of the consideration given;

b) Applying a predecessor basis of accounting (or continuity of values) may not be consistent with existing IFRS. This is because IFRS does not generally entertain such notions. Although IFRS uses historical cost, this is generally not based on another entity's carrying amount and IFRS in general does not use the notion of "push down accounting[29]". In fact, the Board rejected a proposed amendment to IFRS 2 and IFRIC 11 in 2009, partly because IFRS does not address "push down accounting";

c) It is difficult to argue that a BCUCC and a business combination are not economically similar. For the combining entities[30], there is a change to the configuration of cash flows to be generated by the 'new' reporting entity. This would be similar to a BCUCC where the acquirer could be identified; and

d) It is argued in the superseded version of FAS 141 (B53) that the pooling method of accounting (also known as predecessor accounting) is not based on a sound underlying conceptual basis and there are inconsistencies with how this is applied around the world (note this was briefly discussed in Chapter 1). For instance the inconsistencies would be demonstrated by quoting the procedural guidance in the superseded version of FAS 141 (D15), "the carrying values of the assets and liabilities transferred may be adjusted to the basis of accounting used by the receiving entity if the change would otherwise have been appropriate". In other words, the carrying values transferred may be adjusted to the accounting policies of the receiving entity and this would be applied retrospectively. Applying a predecessor basis of accounting may have an impact on the comparability.

52 To demonstrate the use of predecessor basis of accounting and 'fresh start' accounting, consider the following fact pattern, which to some extent is a continuation of what was presented in paragraph 39. That is, a transaction occurs between two combining entities from the same ultimate reporting entity group for 56CU in cash. The fair value of the combining Entity A (previously the acquiree under view one) is 148CU and the fair value of net identifiable assets is 115CU (included is 35CU of identifiable intangible assets). The fair value of combining entity B (previously the acquirer under view one) is 104CU and the fair value of the net identifiable assets is 100CU (which is representative of cash). In addition, it is assumed that the carrying amount of the identifiable net assets in combining Entity A is 40CU (included is 12CU of intangible assets). It is assumed that the historical cost value in the transferring entity is the same value as those in the ultimate parent entity financial statements.

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29 Push down accounting is a method of accounting in which the financial statements of a subsidiary are presented to reflect the costs of the acquisition incurred by the parent entity instead of the subsidiary's historical costs.

30 As a reminder, even though an acquirer cannot be identified, there is still an accounting transaction to account for. Combining entities is used to differentiate the fact that no acquiring entity survives the BCUCC, but rather two combining entities come together to form the combined entity.

Extract of the Consolidated Financial Statements of the Transferee		
	Predecessor basis (CU)	Fresh-start (CU)
Goodwill	-	37[31]
Intangible assets	12	35
Tangible assets	72[32]	124[33]
Total assets	84	196
Share capital	100	100
Other equity	(16)[34]	96[35]
Total equity	84	196

53 There are some observations about the effects of the applying predecessor basis of accounting:

a) Total assets:

(i) 196CU arguably provides more predictive value than the 84CU because applying fresh start accounting will reflect the cash generating abilities of the combined entity at the date of the BCUCC. Some may, however, argue that the 84CU represent the original investment made in the combined entity and therefore has better confirmatory value than fresh start accounting. Furthermore, applying a predecessor basis of accounting could lead to the restatement of both the income and cash flow statement which could provide better confirmatory value than fresh start accounting.

[31] 148CU (fair value of combining entity A) – 115CU (fair value of net identifiable assets) + 104CU (fair value of combining entity B) – 100CU (fair value of net identifiable assets) = 37CU

[32] 100CU (opening cash) – 56CU (consideration transferred) + 40CU (identifiable net assets) – 12CU (identifiable intangible assets) = 72CU.

[33] 100CU (opening cash) – 56CU (consideration transferred) + 115CU -35CU (net identifiable assets excluding identifiable intangible assets) = 124CU

[34] 40CU (carry-over basis of the net identifiable assets) – 56CU (consideration transferred) = (16)CU.

[35] 148CU (fair value of combining entity A) – 56CU (consideration transferred) + 4CU (goodwill step up in combined entity B 104CU – 100CU) = 96CU.

Questions to constituents:

5.4 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?

5.5 Do you believe that all the arguments and views presented are valid when it is not appropriate to apply an analogy 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

54 It is often stated that BCUCC represent a diverse group of transactions that are carried out for many different reasons to achieve a purpose which is very different from a business combination.

55 In Chapter 4, it was also discussed that BCUCC are carried out for many different reasons to achieve a purpose that is very different to a business combination under IFRS 3. It was also demonstrated that the information needs of users of the financial statements of the transferee/acquirer are diverse.

56 These different purposes and information needs of users from a BCUCC and business combination under IFRS 3 provides justification to consider whether the information needs of users can be satisfied by relying on the same measurement attribute being applied at initial measurement. This approach is arguably consistent with the IAS 8 logic because the starting point of the IAS 8 hierarchy is to ensure that any accounting policy developed produces information that is relevant and a faithful representation of the BCUCC transaction.

57 Over the course of the project, several accounting models were developed that, to some extent, were largely based on the specific features of BCUCC transactions. There seemed to be an intuitive appeal to the development of indicators that served as discriminants for establishing the basis for initial measurement. The indicators considered were similar to many of the drivers that lie behind existing approaches that have been developed and applied in practice.

58 However, these approaches were not considered further primarily because they were considered too arbitrary and therefore it became questionable whether they would produce information that was relevant and representationally faithful. They either provided 'bright lines' that were difficult to explain or created inconsistencies with the treatment of similar transaction under IFRS. Further details of these approaches and the reasons for not developing them further are set out in Appendix 3.

Question to constituents:

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

59 The objective of financial reporting is to provide "information that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit."

60 A principle based approach was developed whereby IFRS 3 is applied only where the BCUCC leads to a reassessment of the previous economic decisions to be taken by the users of the financial statements of the transferee.

61 A BCUCC could potentially alter the configuration of the future cash flows (in terms of timing, uncertainty and amount) to be generated by the entity[36]. If it does, then arguably this would lead to a reassessment of the previous decisions taken by the users.

62 The principle is made operational by considering whether there has been a change in the ability of the entity to meet the claims against the combining entities that existed prior to the BCUCC (also referred to as 'the change in ability model'). Such an analysis is done by first considering who the users are and their information needs.

63 For instance, the change in the ability model can be characterised according to the information needs of users:

a) Equity investors: a change in the ability (in terms of amount, timing and uncertainty) of the entity to meet future dividends. Any change in the amount, timing or uncertainty associated with the reporting entity (entity) ability to meet future dividends will have an effect on the claims held (or potential claims) of equity investors;

b) Lenders: a change in the ability of the entity to meet interest and principal. Any change in the amount, timing or uncertainty (i.e. risks) associated with the repayment of interest and principal will have an effect on the claims held (or potential claims) of lenders; and

c) Other creditors: a change in the ability of the entity to repay the credit facility that has been granted. Any change in the amount, timing or uncertainty (i.e. risks)

[36] As explained in Chapter 4, users could satisfy their financial information requirements by looking at either the consolidated financial statements of the transferee (or the reporting entity) or the separate/individual financial statements of the combining entities. Hence, the description of 'entity' in view three is intended to be characterise these two scenarios.

associated could have an impact on the right of repayment or it could have an impact on potential other creditors to extend credit facilities.

64 As was stated in Chapter 4, these information needs can vary substantially. Accordingly, the accounting approach to be applied (IFRS 3, predecessor basis of accounting or fresh start accounting) depends on all facts and circumstances.

65 The decision to apply IFRS 3, predecessor basis of accounting or 'fresh start' accounting is done on a transaction-by-transaction basis is justified for two reasons: 1) the fact that BCUCC represents a diverse group of transactions (refer to the discussion in Chapter 4) and, 2) on the grounds of the cost constraint in financial reporting that the IASB would consider when developing a financial reporting standard on BCUCC.

66 If the analogy to IFRS 3 is valid, then acquisition accounting is applied only when the benefits outweigh the costs. If the benefits do not outweigh the costs, then IFRS 3 cannot apply and the analogy is constrained by the net cost implications.

67 If the analogy to IFRS 3 is not valid then similar to view two, either 'fresh start' accounting or a predecessor basis of accounting is applied which is dependent on who the users are and what their information needs entail.

68 Arguably, the other approaches in this DP do not take account of the pervasive cost constraint because either IFRS 3 is applied or it is not. In other words, view one and two consider users as having similar information needs and plays down the diversity that exists in BCUCC transactions.

69 When assessing whether or not there has been a change in the ability of the entity to meet the existing claims of capital providers against the combining entities that existed prior to the BCUCC, the following could be taken into account:

a) a change in the cash generating abilities of the entity. Arguably, where there is change (either an increase or decrease) in the amount, timing and uncertainty of the future cash flows to be generated then this has an effect of the ability of the entity to meet the claims that existed against the combining entities prior to the BCUCC. However this assessment could depend on how the user thinks the cash generating abilities is best analysed (for instance earlier we suggested that the cash generating abilities could be characterised by being reflected in fair value measurement or by historical trends); and

b) a change in the 'capital at risk' for the users because of the BCUCC. For instance, if the consideration transferred involves a cash component then arguably this changes the liquidity risk profile of the entity which could have an impact on the claims held by lenders or other creditors.

70 The analysis could be driven by different interpretations of the facts and circumstances. In other words, the accounting outcome is driven by many factors to which the preparer may place different weighting to different circumstances. This could be problematic because it would rely heavily on the exercise of judgement which could result in different fact patterns resulting in accounting outcomes that are difficult to compare. To some extent, this

situation does not help to solve the current practice problems. That is, the diversity in accounting practice to some extent is driven by the different interpretations of BCUCC that exist in accounting firms' literature, including the different purposes of the BCUCC transaction.

71 There could be different ways to solve this issue, and some may have the view this may not be an issue whatsoever. This is because IFRS are intended to be a principle based set of standards that requires the application of professional judgement. However, others may think that it may be necessary to develop indicators to guide the preparer in applying an accounting approach.

72 At this point of the discussion, it is worth considering an illustrative example that demonstrates a change in the ability of the reporting entity to meet existing claims against the combining entities.

73 If we consider an example to demonstrate a fact pattern where there has not been an effect on the ability of the acquirer/transferee to meet capital provider claims that existed prior to the BCUCC. Entity A is a manufacturer and Entity B is a distribution outlet and both are wholly owned subsidiaries of Holding Company. Entity A and B both operate in partnership whereby the purpose of Entity B is to distribute the products of Entity A. The future cash flows to be generated by Entity A and B are 135CU and 24CU respectively and each entity has one existing creditor claim of 35CU (Entity A) and 10CU (Entity B). The terms of the merger are a share for share exchange.

74 The ultimate parent entity decides to merge Entity A and B together into Entity AB. The result may be that there is no change in the ability of Entity AB to meet claims that existed in Entity A and B because there is no change in the amount, timing and uncertainty of the future cash flows to be generated. In this fact pattern, a predecessor basis of accounting may be the accounting outcome. This is explained as follows:

a) there is no change in the amount of cash flows to be generated This is because Entity AB will generate 159CU by merging Entity A and B to satisfy claims of 45CU. This does not represent a change in the amount of cash flows to be generated by the new combined entity (this analysis ignores any synergies created by the BCUCC); and

b) there is no change in the amount, timing or uncertainty of the future cash flows to be generated, because the 'residual' future cash flows that will be allocated to meet the claims that existed prior to the BCUCC have not changed.

75 Assume the fact pattern is altered so the merger of Entity A and Entity B generates future cash flows of 135CU and (45CU) respectively. All other things being equal, Entity B does not have the ability to meet its existing claims prior to the BCUCC. The merger of Entity A and B will have an effect on the existing lender claim in Entity A prior to the BCUCC because the future cash flows to be generated by combining Entity A and B has reduced from 135CU to 90CU. The 90CU will then be used to meet the claims that existed in Entity A and B prior to the BCUCC. This fact pattern represents an example of the change in the ability model where IFRS 3 would apply.

Questions to constituents:

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?

Chapter Six: Critical issues and next steps

In this Chapter some of the critical issues are set out to assist constituents in formulating their response to the Invitation to Comment.

We also explain that the next steps in the project will be to consider comments received to the questions in this discussion paper and to prepare a feedback statement. In considering what further work EFRAG and its partners will carry out on this project, EFRAG will carefully consider the comments received and consider how best to respond to the issues raised. We will also seek to engage the IASB more formally to try to ensure that our project influences the standard setting process going forward.

Critical issues

1 The analysis in this DP has highlighted some of the complex technical issues that need to be considered in developing an approach to initial recognition and measurement of BCUCC in the consolidated financial statements of the transferee. Any solution that is pursued needs to respond to the question of what information about BCUCC is likely to provide users with decision-useful information.

2 In satisfying users' needs any approach should take account of the diverse nature of BCUCC, the different economic outcomes that underlie them and the costs and benefits associated with adopting any accounting approach.

3 The research work and technical deliberations undertaken to prepare this DP has highlighted the difficulties in analysing the technical issues and the significant shortcoming in the existing literature in dealing with common control transactions – particularly where they entail the transfer of a business.

4 It is clear that the standard-setter will have to form judgements about the recognition and measurement principles that are most appropriate to apply to BCUCC. In part, those judgements need to informed by the experience of both users and preparers in addressing any information 'gaps' that exist under current IFRS reporting. In framing an appropriate approach the standard-setter will need to achieve a meaningful balance between what constitutes relevant information that is not so heavily compromised by the fact that the transaction is between related parties. That is, consideration needs to be given to the interplay between relevance and faithful representation that will inevitably lead to a debate as to whether future cash flows are best represented by maintaining information about historical performance or making a 'clean' break at the point of transfer to re-measure values to their fair value at that point in time. Hopefully, this DP has presented the arguments that lie at either side of that debate.

Next steps

5 We have very deliberately not taken a position by recommending a particular approach to BCUCC. Given the objective of the DP, we have attempted to provide a comprehensive analysis of the issues and the clear intention is for constituents to consider the arguments we have set out and provide their views. After the comment period closes we will publish a feedback statement which will form the basis for EFRAG's re-deliberation of the issues that fall within in the scope of the project. It will be at that stage that a decision will be taken about what further steps need to be taken before putting forward our views to the IASB.

6 At the time of preparing this DP, the IASB was considering its forward agenda and it was not clear what priority would be given to this project. As we noted in Chapter 1, there is considerable interest in this project around the world and many commentators have indicated that the lack of guidance under IFRS for BCUCC transactions is unsatisfactory and that the IASB needs to address the issue as a matter of priority. We are confident our work on this project, along with the comments received from constituents, will provide a sound basis for the IASBs future project on BCUCC.

Appendix 1 - Defined terms

1 The following defined terms have been used throughout the DP:

Transferee

2 The entity that receives the transferred business in a BCUCC transaction.

Acquiree

3 The business or businesses that the (intermediate) parent obtains control of in a business combination [IFRS 3 App. A (IASB 2011)]

Acquirer

4 The entity that obtains control of the acquiree [IFRS 3 (revised) App. A (IASB 2011)]

The (intermediate) parent entity that loses control

5 The entity that ceases to account for (derecognises) the business or the investment controlling an underlying business.

Control

6 An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. An investor controls an investee if and only if the investor has power over the investee, exposure, or rights, to variable returns from its involvement with the investee and the ability to use its power over the investee to affect the amount of the investor´s returns. [Paragraph 6 and 7 of IFRS 10]

Business

7 An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members or participants. [IFRS 3 (revised) App A]

Business combination

8 A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as “true mergers” or “mergers of equals” are also business combinations as these terms are used in this IFRS [IFRS 3 (revised) App A (IASB 2011)]

Consolidated financial statements

9 The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity. [Appendix A of IFRS 10]

Separate financial statements

10 Separate financial statements are those presented by a parent (i.e. an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or in accordance with IFRS 9 Financial Instruments. [Paragraph 4 of IAS 27 (IASB 2011)]

Individual financial statements

11 Individual financial statements are those presented by an entity who is neither an investor with control of a subsidiary nor an investor with joint control of, or significant influence over, an investee.

Appendix 2 - Assessing the strengths and weakness of each view

Introduction

1 The objective of this appendix is to consider what the strengths and weaknesses of each of the three views identified in the development of this DP.

2 It is important to consider the arguments for and against each of the views because this would satisfy one of key objectives of this DP which is to stimulate debate at an early stage in the standard setting process.

3 When considering this, the three views are assessed on the following basis:

a) each view is assessed against the qualitative characteristics of the *Framework,* because according to the IAS 8 hierarchy, the development of any accounting policy should be consistent with these characteristics. This is what makes information useful to users when considering the objective of financial reporting (and we think that the same principles hold for developing an accounting policy on the issue); and

b) similar and related transactions should be accounted for in a consistent manner.

View one: IFRS 3 can always be applied by analogy

4 Proponents of this view argue that, the analogy to IFRS 3 always applies and there is no justification to deviate from the recognition and measurement principles. However, the 'related party' aspect of the BCUCC transaction may have a significant impact on applying the mechanics of IFRS 3.

Arguments in favour

Relevance

5 According to IFRS 3, the obtaining control over one or more businesses is a significant economic event that leads to an acquirer measuring the identifiable assets acquired and liabilities assumed at their acquisition date fair values. It is clear in IFRS 3 that fair value, is generally the most relevant measurement to apply at initial measurement when accounting for the business combination. The analysis in Chapter 4 in relation to the user information needs strengthens the position that a BCUCC represents a significant economic event because the impact on the information needs of users of the financial statements of the acquirer are considered to be similar to a business combination under IFRS 3. That is, regardless of whether or not the transaction is a business combination or a BCUCC, the accounting outcome (i.e. the recognition and measurement principles of IFRS 3) should equally apply.

6 BC37 of IFRS 3 explains that "an important part of decision-useful information is information about the cash-generating abilities and cash flows generated". It goes onto say that "fair values reflect the expected cash flows associated with the acquired assets and assumed liabilities". Accordingly, reflecting the cash generating abilities associated with the acquired business through initial measurement is deemed to provide users with the most relevant financial information.

Faithful representation

7 Chapter 3 states that the BCUCC transaction should be viewed from the perspective of the reporting entity. The entity, because of the BCUCC transaction, has acquired rights associated with assets and is exposed to the risks associated with the assumed liabilities that it did not have prior to the BCUCC. Hence, reflecting on initial measurement the fair value of the identifiable net assets acquired faithfully represents the substance of the transaction.

8 According to QC12 of the *Framework* (IASB 2011), "Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent. To be a perfectly faithful representation, a depiction would have three characteristics. It would be complete, neutral and free from error. Of course, perfection is seldom, if ever, achievable. The Board's objective is to maximise those qualities to the extent possible".

9 QC13 goes on to say that "a complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations".

10 Users want to understand the cash generating abilities of the reporting entity and transactions and events that change them. It is argued that in order to present a complete depiction of the change in the cash generating abilities of the reporting entity, then initially measuring the identifiable assets acquired and assumed liabilities at fair values would faithfully represent the substance of the transaction.

Consistency with other IFRS

11 Some would argue that there is no difference in the economic event when comparing a BCUCC and a business combination under IFRS 3 because to conclude that there is any distinction is arbitrary and there is no other reason to apply different recognition principles and measurement bases to transactions that have the same economic event. This is because for the entity something of value is created and accordingly regardless of whether the parent entity transfers the business to the entity or the entity acquires a business from an outside party, the transaction represents an acquisition. Therefore, IFRS 3 should apply – otherwise the same economic event would be accounted for differently which would impair comparability.

12 For the purposes of the discussion consideration of IFRIC 17 *Distributions of Non-cash Assets to Owners* (henceforth referred to as 'IFRIC 17') (IASB 2011), is relevant, specifically in relation to the distribution of a business. According to Paragraph 3(a) of

IFRIC 17, a distribution of a non-cash asset could relate to a business as defined in IFRS 3.

13 There is consistency in the arguments presented in IFRIC 17 that could be used to support this view. Even though IFRIC 17 only deals with a narrow set of circumstances, there are some arguments that can be extracted. For instance:

a) The event that triggers a disposal of the asset is the transaction between the owner and the entity. This results in a loss of economic benefit for the entity as a result of a loss of control over the business that is distributed to the owners. According to BCZ182 of IFRS 10, a loss of control is a significant economic event. Similarly, as stated in BCZ173 of IFRS 10, obtaining control in a business combination is also a significant economic event that may provide future economic benefits for the transferee, and therefore should trigger re-measurement.

b) The accounting following from IFRIC 17 reflects the fact that something valuable has been distributed to the owners and recording the disposal of the non-cash asset at fair value faithfully reflects the value of the distribution at the time of the distribution. Similarly, the business acquired from the owners should be based upon fair value, because the outcome of the transaction should reflect the value of the business acquired.

c) The accounting outcome of a dividend distribution to its owners is treated consistently regardless of whether it is cash or a non-current asset that is being distributed. This is because even though the form of the transaction is different, the substance of the transaction is not. Similarly the recognition and measurement principles used to measure a BCUCC should not change because the nature of the consideration is different.

Arguments against

Relevance

14 It may be argued that the obtaining of control over one or more businesses is not a significant economic event that in all circumstances should lead to a transferee applying the measurement principle in IFRS 3 (the reasons for this basis are considered in the arguments for view three).

The cost constraint on useful financial reporting

15 When developing a new financial reporting standard for BCUCC, the costs involved when in applying acquisition accounting should be justified by the benefits. Even if the transferee obtains control over one or more businesses, the BCUCC may not lead to a change in the configuration of future cash flows to be generated by the entity. This is because there may be no change in the ability of the entity to meet claims over the combining entities that existed prior to the BCUCC. Chapter 5 provided examples of when this may occur.

Conclusion

16 The core issue of the project is developing and applying an accounting approach following the logic of the IAS 8 hierarchy that results in decision-useful information. We have argued under view one that there should be no deviation from the recognition and measurement principles in IFRS 3 because the economic event is the same and deviating from this principle would be arbitrary and inconsistent with the general principle in IFRS that similar transactions should be accounted for in a similar way.

View two: The accounting outcome under IFRS 3 does not produce decision-useful information

17 We said in Chapter 5 that the analogy to IFRS 3 may not be valid either because an acquirer cannot be identified or because the ultimate parent entity can decide the accounting acquirer then it may lead to accounting outcome that is not a faithful representation of the underlying BCUCC transaction. Accordingly, the problems that are unique to BCUCC may be solved by applying accounting outcomes that apply symmetrical accounting treatment to the combined entities. That is the accounting outcome of either a predecessor or revalued basis of accounting depends on the information needs of the users. However, in Chapter 5, we questioned whether the application of fresh start accounting would in fact mitigate the issues that arise by applying the measurement principle in IFRS 3.

18 It is important to understand how this fits into the logic of IAS 8. That is, if the analogy to IFRS 3 is invalid then there should be consideration of the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Conceptual Framework* (IASB 2011) to develop an accounting policy that is relevant to the economic decisions to be taken by the users and is a faithful representation of the BCUCC transaction.

19 The accounting outcome therefore depends on what constitutes decision-useful financial information to the users of the financial statements of the transferee. It was concluded in Chapter 4 that users want information that allows them to assess 1) the prospects for future net cash inflows (there was different interpretations of how this information was best represented to users) and 2) the stewardship of management. The *Conceptual Framework* (IASB 2011) considers that for financial information to be decision-useful it must contain the fundamental qualitative characteristics of relevance and faithful representation. That is, in selecting the measurement bases to be selected it must be relevant and faithfully represent the BCUCC transaction.

20 The following section will now discuss the arguments for and against view two according to each of the accounting approaches.

Arguments in favour

Predecessor basis of accounting

Relevance

21 One perceived problem with acquisition accounting is that it eliminates the historical trends associated with the acquired business. The use of predecessor accounting could lead to restating the current year or comparative balance sheet, income statements, cash flow statement as if the combined entity always existed. This arguably provides information to users that allows for an assessment of the cash generating abilities of the combined entity. Such an approach provides users with a better predictive value when estimating the cash generating abilities of the acquirer and it provides better confirmatory values on the basis that there is no 'break' in the historical trends in relation to the income and cash flow statements that would be eliminated through applying acquisition accounting.

Faithful representation

22 The accounting outcome represents a more 'neutral' depiction. This is because with BCUCC transactions the ultimate parent entity can decide the identification of the acquirer so that an optimal accounting outcome is achieved. This would most likely result in information that is not neutral. This arguably has the potential to influence decisions taken by users.

Cost benefit consideration

23 It may be argued that a predecessor basis of accounting may be less costly than applying either acquisition or 'fresh start' accounting. This is because there would not be the need to engage external valuation experts.

'Fresh start' accounting

Relevance

24 Applying the measurement principle in IFRS 3 results in applying fair value to the acquiree's net assets. Arguably, applying fair value to both the transferee and the acquiree's net assets at initial measurement is more relevant to the decisions to be taken by users. This is because it provides information that allows users to predict how the 'new' combined entity will generate future net cash in-flows.

Faithful representation

25 Applying 'fresh start' accounting would provide for a more faithful representation because the accounting outcome would reflect a more complete depiction than acquisition accounting. This is because it would reflect the cash generating abilities of the 'new' combined entity rather than the expected cash flows associated with the acquired assets and assumed liabilities.

Arguments against

Predecessor basis of accounting

Relevance

26 IFRS has a general principle that the cash generating abilities of any asset acquisition is best reflected through measurement at fair value and adopting predecessor basis would be inconsistent. Furthermore, disclosures could act as a mechanism to satisfy those users who believe that 'historical trends' provides more predictive value than fair value measurement.

27 It was highlighted in Chapter 4 that post-combination stewardship was an important information need of users. However, by applying a predecessor basis of accounting no distinction is drawn between the impacts on pre and post-combination stewardship.

Faithful representation

28 The accounting outcome does not represent a complete depiction. Accounting under a predecessor basis does not reflect the assets acquired and liabilities assumed because the financial statements of the combined entity are re-stated retrospectively as if the combining entities were always a combined entity.

'Fresh start' accounting

Cost benefit consideration

29 It would be arguable whether the costs to the preparer would exceed the benefits to users. It is likely to be very expensive to determine the fair value of all assets within the combining entities.

Faithful representation

30 It may not mitigate the fact that the ultimate parent entity has discretion over selecting the accounting acquirer because the same motivation may exist to select two entities to combine in order to achieve an optimal accounting outcome by applying fair value at initial measurement that may not represent a faithful representation of the underlying BCUCC transaction.

Conclusion

31 When the analogy to IFRS 3 is invalid, determining the most relevant measurement attribute to apply at initial measurement depends on what measurement basis best serves the information needs of users. That is, if users put more emphasis on an analysis of historical trends that enable an assessment of the cash generating ability of the transferee after the BCUCC then predecessor accounting should apply, and if not, then 'fresh start' accounting may be appropriate.

View three: The accounting outcome under IFRS 3 may produce decision-useful information

32 We have said in Chapter 4 that for the entity that obtains control of one or more businesses, fair value may not be the most relevant measurement base to apply at initial measurement principally because BCUCC transactions represents a diverse group of transactions. Furthermore, the differences that exist in the information needs of users between a business combination under IFRS 3 and a BCUCC suggest that analogising to the recognition and measurement principles in IFRS 3 may not produce relevant financial information to the users of the financial statements of the transferee.

33 Accordingly, view three takes a closer look at whether the BCUCC transaction could lead to a reassessment of the previous decisions taken by the users of the consolidated financial statements of the transferee. If it does and the three building blocks of the business combination definition equally applies to BCUCC (this making the analogy to IFRS 3 valid) then IFRS 3 should apply.

34 If the BCUCC leads to no reassessment of the previous decisions taken by users then IFRS 3 should not apply. This is because applying IFRS 3 would not produce relevant financial information to the users of the financial statements of the transferee.

35 This approach is arguably consistent with the logic of the IAS 8 hierarchy. This is because there is an over-arching consideration when developing an accounting policy that the accounting outcome results in information that is relevant and reliable.

36 To consider the merits of view three, the following section discusses the arguments for and against.

Arguments in favour

Relevance

37 In Chapter 4, we highlighted the fact that BCUCC represents a diverse group of transactions and the differences that exist in the information needs of users from a business combination may prevent an analogy to IFRS 3 being valid. This is because applying the measurement principle of IFRS 3 would not be relevant to the decisions to be taken by users.

38 This is arguably more relevant approach due to the diversity in the information needs of users between a business combination and a BCUCC. Therefore, each individual BCUCC transaction should be assessed individually to determine the most relevant measurement attribute that should be applied to cater for this diversity.

Faithful representation

39 The diversity in BCUCC transactions never alters the economic substance of the transaction. This is because for the entity that has obtained control of a business there is

always a change in the economic flows for that entity because it has acquired new assets and assumed new liabilities.

40 However, according to QC12, in order for financial information to be useful – it must not only represent relevant phenomena but also faithfully represent the phenomena. Accordingly, if providing fair value information is not relevant to the users when making economic decisions, then applying fair value at initial measurement will not be faithful representation of the underlying BCUCC transaction.

Cost benefit considerations

41 This approach considers whether the recognition and measurement principles in IFRS 3 are relevant for the economic decisions to be taken by users. Another justification to question whether or not these principles are relevant is on the basis of the pervasive cost constraint in financial reporting. That is, this approach assumes that where the BCUCC transaction leads to a reassessment of the previous decisions taken by users then it is assumed that the costs of applying IFRS 3 is justified by the benefits.

Arguments against

Comparability

42 Under this approach, the onus would focus on the preparer determining whether or not there is a change in the ability of the reporting entity to meet existing claims. It is argued that this could result in some BCUCC transactions accounted for differently because of different assessments of whether there has been a change in the ability of the reporting entity to meet existing claims against the combining entities.

Inconsistent with IFRS 3

43 According to paragraph 13 of IAS 8, an entity shall select and apply an accounting policy "consistently for similar transactions, other events and conditions, unless an IFRS specifically requires or permits categorisation of items for which different accounting policies may be applied". It is thought that if the economic event (i.e. the obtaining control over one or more businesses) is the same then the same accounting policy (i.e. the measurement principle in IFRS 3) should equally apply at initial measurement.

Conclusion

44 The fundamental argument for the basis of view three is that if BCUCC transactions do not represent a homogeneous class of transactions then it is difficult to conclude that the recognition and measurement principle in IFRS 3 would produce decision-useful information. This approach is arguably justified on the basis of 1) the diversity in the information needs of users in a BCUCC compared to a business combination under IFRS 3 and 2) the pervasive cost constraint in financial reporting. Arguably, view three provides an approach that results in more relevant financial information to the users of the financial statements and is sensitive to the operation of the cost/benefit constraint.

Appendix 3 - Potential discriminants considered to operationalise view three

1 The purpose of this Appendix is to provide readers with a summary of the discriminating factors there were considered by the BCUCC project team in formulating view three. We believe that providing this insight will allow readers to understand the basis of the models and why they have not been pursued.

Model Considered	Description	Reason for not considering the approach further
The exchange transaction approach	A re-measurement would occur where the conditions of the BCUCC transaction replicated those that underpin the notion of fair value. Certain indicators[37] were developed to ascertain whether there is a market-based type transaction.	The exchange notion as a feature to distinguish a BCUCC from BC was difficult because the indicators developed were considered to be subjective and a key feature of a BCUCC is that the transaction is always between related parties and accordingly, it is argued, defies the principles that underpin fair value. This is because it is generally assumed that market-based transactions occur between unrelated parties. Furthermore, the boundary was unclear when IFRS 3 should apply.
An approach that considered drawing a distinction between an acquisition and a transfer.	Distinguishing between an acquisition as a reciprocal (exchange) transaction and a transfer as a non-reciprocal transaction. If the transaction was one that is non-reciprocal, then it was deemed that there was no acquisition, and accordingly IFRS 3 would not apply[38].	There were a number of drawbacks to this approach because it was unclear what would distinguish between a reciprocal and non-reciprocal transaction. Amongst other things, this is because IFRIC 17 does not distinguish between non-reciprocal and reciprocal transactions when considering how to measure the distribution of the non-cash assets to owners. The nature of the consideration (i.e. reciprocal versus non reciprocal) does not alter the economics associated with the underlying transaction and therefore it would be incorrect to suggest that the accounting outcome should be altered based on this.

[37] The project developed a series of indicators to consider when determining whether or not the BCUCC transaction was an exchange transaction. The following indicators were considered: a) the degree of influence of the ultimate parent entity on the terms of the transaction and the conditions that the transactions is subjected to, b) the involvement of outside parties (for instance, the presence of a non-controlling interest), and c) the balance of rights and obligations. The use of a valuation expert would also provide evidence that the exchange amount has been supported.

[38] This approach was also considered by the IPSASB in adapting IFRS 3 to the public sector. We understand that the Board has since abandoned this approach as the distinction was too difficult to operationalise.

Amend the business combination definition to specifically test for commercial substance based on a set of indicators (similar to the way in which they operate in IAS 27.38B to determine if the transaction possesses commercial substance)	A rebuttable presumption (that a BCUCC never has commercial substance) would place the onus on the preparer to provide the evidence that the transaction has substance and therefore it is appropriate to trigger the re-measurement that would be effected under IFRS 3. The view developed two indicators (based on the Paragraph 13 of IAS 27 (IASB 2011)) which would indicate whether or not the BCUCC transaction possessed economic substance. Such an approach was deemed by the project team to be similar to the Canadian GAAP related party standard (section 3840 of the *CICA handbook*) (CICA 2011). This standard contains a 'fall back' position that a related party transaction should generally be recorded at its carrying amount[39]. . There are exceptions to this principle whereby the related party transaction should be measured at the exchange amount[40] when: (a) the transaction is in the normal course of operations and is either a monetary related party transaction or a non-monetary related party transaction that has commercial substance[41] or (b) the transaction is not in the normal course of operations and is either a monetary related	The indicators that had developed under this view related to what has changed for the owners, and ignored other users. Furthermore, the indicators of economic substance (as derived from the IAS 27.38B Amendment) apply to separate and not consolidated financial statements. Also, this approach requires certain criteria to be met.

39 The carrying amount is defined as "the amount of an item transferred, or cost of services provided, as recorded in the accounts of the transferor, after adjustment, if any, for amortization or impairment in value [section 3840.03(a) (CICA 2011)]

40 The exchange amount "is the amount of consideration paid or received as established and agreed to by related parties" [Section 3840.03(b)].

41 According to section 3840.19, a transaction is deemed to have commercial substance when either 1) the configuration of the future cash flows of the assets received are expected to change significantly from the configuration of the future cash flows of the asset given up, or 2) the entity specific values of the assets received differs substantially from the entity specific value of the asset given up and the difference is significant in relation to the exchange amount.

	party transaction or a non-monetary related party transaction that has commercial substance[41] and: (i) the change in ownership rights in the item transferred is substantive[42]; and (ii) the exchange amount is supported by an independent valuation A test for commercial substance is similar to FRS 6 *Mergers and acquisitions* (ASB 1994). Here, merger accounting[43] may be applied to a group reorganisation provided that the relative rights of the ultimate shareholders are not altered.	

42 A transfer would be considered substantive where the ownership interest changes and the ability to obtain future economic benefits from the item transferred also changes. According to paragraph 35 of Section 3840, there is a presumption of a substantive change when "a transaction results in unrelated parties having acquired or given up at least 20 percent..."

43 According to paragraph 16 of FRS, merger accounting states that "the carrying values of the assets and liabilities of the parties to the combination are not required to be adjusted to fair value on consolidation …"

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