19 August 2021

Dr Andreas Barckow
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Via online submission: www.ifrs.org

Dear Dr Barckow

Discussion Paper DP/2020/2: Business Combinations Under Common Control

As the representatives of over 280,000 professional accountants in Australia, New Zealand and around the world, CPA Australia and Chartered Accountants Australia and New Zealand (CA ANZ) thank you for the opportunity to comment on the above Discussion Paper ("the DP").

We welcome and appreciate the IASB's efforts in developing proposals to address the accounting for business combinations under common control (BCUCC), which are a common and material occurrence within groups in Australia, New Zealand and other countries around the world. As IFRS 3 *Business Combinations*, published in 2004 (and its predecessor IAS 22 *Business Combinations*), does not address the accounting for BCUCC, accounting for such transactions has required significant and unnecessary extra cost and effort, which has also resulted in considerable diversity in practice.

We are therefore pleased to support the proposals in the DP which will fill an existing and important gap in IFRS 3 with respect to accounting for BCUCC transactions. We believe that these proposals should lead to a reduction of diversity in practice, providing a clear and logical framework for accounting for a variety of such BCUCC. They should reduce the cost and effort in accounting for BCUCC, improve comparability and consistency of financial reporting, and provide more useful information to users of financial statements.

Nevertheless, we do have some concerns about the practical application of the proposed "book value method" that we believe warrant further consideration when developing these proposals into an Exposure Draft. We also have some additional scope suggestions and recommendations for improved terminology. More detail on these issues is included in our responses to the specific questions raised in the DP, included in the **Attachment**.

If you have any questions about our submission, please contact either Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au or Amir Ghandar (CA ANZ) at amir.ghandar@charteredaccountantsanz.com.

Your sincerely

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Attachment

Question 1

Paragraphs 1.10–1.23 discuss the Board's preliminary view that it should develop proposals that cover reporting by the receiving company for all transfers of a business under common control (in the Discussion Paper, collectively called business combinations under common control) even if the transfer:

(a) is preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies to an external party (that is, a party outside the group); or
(b) is conditional on a sale of the combining companies to an external party, such as in an initial public offering.

Do you agree with the Board's preliminary view on the scope of the proposals it should develop? Why or why not? If you disagree, what transactions do you suggest that the Board consider and why?

While we support the Board's preliminary view on the scope of the proposals we suggest the following matters be considered in developing these proposals further:

- There is likely to be significant judgement involved in applying the terms "transitory", "non-transitory control", "substantive ownership interest" and "significant ownership interest". We recommend providing clarity around these terms including application guidance to ensure consistent interpretation and application.

- The DP does not contemplate BCUCC that may arise within a group whose ultimate controlling parent meets the definition of an 'Investment Entity' under IFRS 10 *Consolidated Financial Statements* and is subject to the Investment Entity exception from preparing consolidated financial statements under that standard. While we have not received any feedback in respect of BCUCC that may arise in such circumstances, we suggest the Board considers this aspect.

- The DP does not address BCUCC that may arise within groups that have been subject to reverse acquisitions which is an issue addressed in the Application Guidance in Appendix B to IFRS 3. We suggest the Board considers the impact of reverse acquisitions on BCUCC.

- Consider extending the proposals to address the accounting by the transferring company in order to provide clarity to both sides of the transaction, particularly around necessary consolidation adjustments by the transferor.

Question 2

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

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

If you disagree, in your view, when should the acquisition method be applied and why?

(c) a book-value method should be applied to all other business combinations under common control, including all combinations between wholly owned companies. Do you agree? Why or why not? If you disagree, in your view, when should a book-value method be applied and why?

We agree with the Board's preliminary view that the accounting for all the different types of BCUCC should not be restricted to one method. The selection of an accounting method should seek to strike an appropriate balance between the cost-benefit trade-off and the specific circumstances and stakeholder information needs arising from a particular BCUCC.

However, the current proposals would require a wholly owned privately held company to always apply the book value method. We believe there may be circumstances where the underlying economic rationale for the BCUCC warrants using the acquisition method rather than the book value method. For example, where the restructure is being undertaken to facilitate the sale of the receiving company sub-group to an external party or to facilitate an Initial Public Offering (IPO). We therefore suggest the Board gives further consideration to such underlying economic reasons for which the acquisition method may be a better reflection of the BCUCC.

Two suggestions for improvements in relation to the discussion on this issue are:

- The term "do/does not affect non-controlling shareholders" is used throughout the DP, particularly in determining when the book value method is applicable (e.g., paragraph 2.33, diagram 2.5). We are concerned that it is possible to interpret this wording as referring to situations where there are non-controlling shareholders in the receiving company but, for some reason, they are not impacted by the BCUCC. We do not believe this is the intended meaning of the term, and in fact the words are meant to address situations where receiving companies do not actually have any non-controlling shareholders (as referenced in paragraph 2.24). We therefore suggest that this terminology more clearly reflects the binary nature of existence/non-existence of non-controlling shareholders.

- Under the section "Main considerations in selecting the measurement method", paragraph 2.17 discusses circumstances where the receiving company has non-controlling shareholders who acquire an ownership interest they did not previously have, whereas the controlling party's ownership interest is reduced. While we agree with this, the discussion does not extend to addressing the impact of any purchase consideration paid by the receiving company, which should have the opposite effect. An analysis that includes this aspect would be beneficial to stakeholders in understanding the complete underlying economic transactions associated with such BCUCC.

We also note that the DP proposes that the book value method be applicable to non-publicly traded companies, which are likely to be private companies or unlisted public companies. The DP presumes that these companies will be using IFRS, including any forthcoming amendments arising from these proposals. However, such non-publicly traded companies may be using IFRS for SMEs or could be impacted by any standard-setting initiative arising from the "Disclosure Initiative – Subsidiaries without Public Accountability: Disclosures" project. Therefore, we suggest that the Board gives consideration to the developments arising from this consultation when progressing the "Second Comprehensive Review of the IFRS for SMEs Standard" project and "Disclosure Initiative – Subsidiaries without Public Accountability: Disclosures" project.

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Question 3

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

(a) In the Board's preliminary view, the acquisition method should be *required* if the receiving company's shares are traded in a public market. Do you agree? Why or why not?

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

(i) the receiving company should be *permitted* to use a book-value method if it has informed all of its non-controlling shareholders that it proposes to use a book-value method and they have not objected (the optional exemption from the acquisition method). Do you agree with this exemption? Why or why not? Do you believe that the exemption will be workable in practice? If not, in your view, how should such an exemption be designed so that it is workable in practice?

(ii) the receiving company should be *required* to use a book-value method if all of its non-controlling shareholders are related parties of the company (the related-party exception to the acquisition method). Do you agree with this exception? Why or why not?

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

We agree with the Board's proposals to require the acquisition method when the receiving company's shares are traded in a public market. This is because there are likely to be a wide cross-section of users relying on the information. In such circumstances we support requiring the acquisition method prescribed by IFRS 3.

We also support the inclusion of the optional exemption to permit the use of the book value method when all non-controlling shareholders are informed and none of them object to the book value method. However, we suggest that the proposals should clarify, potentially through application guidance, the process by which agreement of the non-controlling shareholders is obtained and documented. Such guidance may need to consider non-contactable shareholders, timing of notification etc.

Additionally, we are concerned about the practicality of the proposals to require the receiving company to adopt the book-value method when all non-controlling shareholders are related parties, regardless of whether a related party objects to the book-value method.

Given the broad definition of the term "related parties" under IAS 24 *Related Party Disclosures*, we question the assumption that all related parties would accept the book value method of accounting for BCUCC. Therefore, this approach has the potential to disadvantage some related parties, such as employee shareholders, who may prefer that the acquisition method be applied for the BCUCC. We therefore suggest that the Board considers whether related parties should be given the same option as other non-controlling shareholders when determining whether the book value method or the fair value method is used.

We note that the DP focuses on simple capital structures comprising only ordinary shares that meet the definition of an equity instrument as defined in IAS 32 *Financial Instruments: Presentation*. We also note that the Board will consider the implications of more complex instruments in the next phase of the project (page 75, definition of "shares"). However, we believe it is critical for the Board to clearly establish who is included in the term "non-controlling shareholders" as this could have a bearing on the direction of these proposals.

Question 4

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

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

We agree with the Board's preliminary view that the optional exemption should not be available to publicly traded entities. These entities have public accountability and may have a significant number of non-controlling shareholders and other users of the financial statements who rely on General Purpose Financial Statements (GPFS). The information needs of such users are likely to be best satisfied by the objective, consistent and comparable information that arises from applying the acquisition method set out in IFRS 3 to BCUCC that are undertaken by a publicly traded receiving entity.

Question 5

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

(a) In the Board's preliminary view, it should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity when applying the acquisition method to a business combination under common control. Do you agree? Why or why not? If you disagree, what approach for identifying and measuring a distribution from equity do you recommend and why? In particular, do you recommend either of the two approaches discussed in Appendix C or do you have a different recommendation?
(b) In the Board's preliminary view, it should develop a requirement for the receiving company to recognise any excess fair value of the identifiable acquired assets and liabilities over the consideration paid as a contribution to equity, not as a bargain purchase gain in the statement of profit or loss, when applying the acquisition method to a business combination under common control. Do you agree? Why or why not? If you disagree, what approach do you recommend and why?
(c) Do you recommend that the Board develop any other special requirements for the receiving company on how to apply the acquisition method to business combinations under common control? If so, what requirements should be developed and why are any such requirements needed?

We agree with the Board's preliminary views and with the reasons set out in the DP.

Question 6

Paragraphs 4.10–4.19 discuss the Board's preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should measure the assets and liabilities received using the transferred company's book values. Do you agree with the Board's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

Feedback we have received from our members indicates that there may be merit in using the book values of the ultimate parent company, rather than the book values of the transferred company as proposed. We note the rationale provided in paragraphs 4.12—4.13 of the DP as to why the book values of the transferred company are more appropriate. However, this presumes that the book values used by the transferred company are prepared under IFRS Standards or another recognised accounting framework, which may not always be the case.

Accordingly, in our view, the values of assets and liabilities recognised in the ultimate parent company's consolidated financial statements is a more appropriate and reliable reflection of the values relevant to the group as a whole, including the receiving company.

Question 7

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

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

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

We support the Board's preliminary views that the Board should not prescribe how the receiving company should measure the consideration paid in its own shares when applying a book-value method. Since this method is only applicable to receiving companies that are privately held, the cost of measuring the fair value of shares paid as consideration is likely to outweigh any benefits arising from this exercise.

However, feedback we have received from our members indicates that the Board's proposed approach for the measurement of consideration paid in assets at book value:
- may not reflect the economic substance of the underlying transaction; and
- means that the cost of acquiring fair value information in respect of such assets may not necessarily exceed the benefits associated as part of the BCUCC.

Accordingly, we suggest the Board gives consideration to revisiting its preliminary views that any consideration paid in assets should be measured at the book values of the receiving company.

Question 8

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

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

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

We believe further consideration should be given to the impact arising from BCUCC on the equity of the receiving company. For example, the transferred company may have carried non-financial assets at fair value, with a revaluation reserve included in equity reflecting the movements in fair value. Under the current proposals, the receiving company could decide not to separately recognise such a revaluation reserve in equity, which could result in a loss of information.

We suggest the Board gives further consideration to such components of equity transferred across in developing its proposals further, with a view to providing guidance on how to account for such components of equity. As stated in our response to Question 6, we prefer the use of the book values of the ultimate parent company. Our comments are applicable to this scenario as well.

Question 9

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

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

Yes, we support the consistent application of IFRS Standards as proposed.

Question 10

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

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

The Board has reached a preliminary view that the receiving company should combine the transferred company's assets, liabilities, income and expenses using the book-value method prospectively from the combination date, without restating pre-combination information. This view has been reached on the basis that the benefits of the information provided by a retrospective approach that includes comparative information for the transferred company may be limited and may not outweigh the costs of providing that information.

The feedback we have received from our members indicates that in some jurisdictions, comparative information for previous years is needed, particularly where companies are preparing for an Initial Public Offering (IPO). Therefore, it may be useful if the Board, in developing the proposals further, allowed comparative information to be included as optional additional disclosures in the notes.

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Question 11

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

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

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

We agree with the Board's proposed disclosures in all of these areas, which we consider are important to obtaining a clear understanding of the BCUCC transaction. We also support the need to consider improving these disclosures further in response to the Board's work on goodwill and impairment in order to promote ongoing consistency and transparency for these transactions.

Question 12

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

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

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

We support the proposed disclosure requirements. However, we note that in paragraph 5.19 relating to the application of the book-value method, there are no disclosure requirements for consideration paid by the receiving company. We believe that this information would be useful in understanding the business combination and should be included in the required disclosures.

We also refer to our response to Question 10 concerning the need for optional comparative disclosures when IPOs are involved.

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