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30 August 2021

Dear Dr Barckow,

IASB Discussion Paper DP/2020/2 *Business Combinations under Common Control*

The Australian Accounting Standards Board (AASB) is pleased to provide our comments on the IASB's Discussion Paper DP/2020/2 *Business Combinations under Common Control*. In formulating these comments, we sought and considered the views of Australian stakeholders, including through:

- consultation with the AASB's User Advisory Committee and Business Combinations/Equity Method Project Advisory Panel. These advisory committees comprise subject matter experts across a range of stakeholder groups; and
- a roundtable and other targeted outreach activity seeking feedback on the proposals.

The AASB would like to acknowledge the efforts of the IASB to address an area of diversity in reporting and identify common ground in stakeholder views. Overall, we support the project as standardisation of requirements in this area will improve transparency and provide users with more relevant and more comparable information in reporting business combinations under common control. In our opinion, ultimately, the accounting treatment must not limit business strategy and commercial activity. Financial reporting requirements should reflect the effects of transactions rather than serve to manage or constrain the undertaking of transactions. Consequently, we encourage the IASB to give further consideration whether, for wholly-owned receiving companies and those transfers to which the proposed related party exception applies, there are additional situations for which the acquisition method, or choice in selecting a measurement method, is warranted.

In addition, as a general comment, we would encourage the IASB to consider extending its preliminary views to reporting entity forms that are not companies or do not necessarily have equity holders. Such action will assist jurisdictions such as Australia, where IFRS-equivalent requirements apply to managed investment schemes and other types of reporting entities.

Our detailed responses to the specific questions posed in the Discussion Paper are included in the Appendix to this letter. If you have any questions regarding this letter, please contact myself or Helena Simkova, AASB Deputy Technical Director (hsimkova@aasb.gov.au).

Yours sincerely,

Dr Keith Kendall
AASB Chair

APPENDIX A – Responses to questions raised in DP/2020/2 *Business Combinations under Common Control*

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?

We support the scope of the IASB project, including the proposed scope-in of (1) transfers for which control might be transitory due to the sale of one or more of the combining companies following the combination and (2) group restructuring activity that would not meet the definition of a 'business combination' (see, however, our response to Question 2). Introducing requirements in this regard will improve comparability in the reporting of such combinations, and as such, provide more useful information to users of the receiving company's financial statements.

We note, however, that the different use of the term 'business combination' in this project from that defined in IFRS 3 has the potential to create confusion. Consequently, we would encourage the IASB to consider how it could provide better clarity in this regard during drafting.

In addition, we think the IASB should also:

(a) address the accounting for transfers of interests in an equity-accounted associate to another entity within the group. In situations where the ownership of the associate asset changes from one entity to another within the same group, the existing IFRS Standards would appear to require the excess of the receiving company's share of the net fair value of the transferred investee's identifiable net assets over the consideration paid (cost of the investment) to be recognised in the income statement. Such accounting is inconsistent with the IASB's preliminary views for the book-value method applicable to transfers of subsidiaries within a wholly-owned group – in our view, the transactions appear conceptually similar and might warrant similar accounting; and

(b) develop proposals for the reporting by the transferring company for all transfers of a business under common control. While we appreciate that IFRS 10 *Consolidated Financial Statements* already specifies the reporting by the transferring company, we think that it would be useful for this project to:

    (i) have regard to the appropriateness of the existing 'loss of control' accounting by the transferring company given the lack of symmetry otherwise resulting from the IASB's preliminary views. While we are cognisant that other instances exist where the accounting is not symmetrical between the parties to the transaction, we think that it would be appropriate for the IASB to revisit whether accounting specifying the recognition of a gain or loss faithfully represents the substance of a sale of a business to an entity under common control; and

(ii) develop application guidance or illustrative examples responding to concerns that we heard as part of our outreach activity. Some of our stakeholders sought clarification of operation of the group consolidation processes, including confirmation that previously acquired goodwill and other adjustments that might have been otherwise processed by the transferring entity (as part of the group's consolidation processes) would now only be processed by the ultimate controlling party.

Our preference is for the IASB to consider these aspects as part of its current project, given their relationship to the subject matter within scope. However, we acknowledge that this might require the project timeline to be unacceptably extended. An alternative might be a multi-phased project approach, i.e. for these aspects to be addressed as part of a separate project following the issue of final proposals limited to the current project scope.

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 preliminary view that neither the acquisition method nor a book-value method should be applied to all business combinations under common control. We also agree that in principle, the acquisition method should be applied if the business combination under common control affects non-controlling shareholders of the receiving company.

We acknowledge that establishing an appropriate 'dividing line' is challenging and that a perfect discriminator is unlikely to be identified for accounting business combinations under common control. Consequently, there are merits to the IASB's proposed approach requiring certain business combinations always to be measured using an acquisition method or book-value method whilst providing flexibility in selecting measurement methods for other combinations. We are supportive of the IASB's objective to improve consistency in accounting for business combinations under common control, subject to cost-benefit considerations.

Under the proposals, the book-value method must always be applied to account for transfers of businesses between wholly-owned companies and transfers involving a receiving company that is wholly-owned by a common ultimate parent and related parties of the receiving company. In our opinion, and based on the feedback communicated to us during our outreach activity, we think that the IASB should give further

consideration as to whether certain of these combinations also warrant application of the acquisition measurement or flexibility in the selection of the measurement method. These might include the accounting for:

- pre-IPO restructuring transfers undertaken (or contingent on occurrence of the IPO) in the expectation that there will be non-controlling shareholders following the combination (i.e. potential non-controlling shareholders with interest in the financial report of the reporting entity); and
- transfers that impact listed debtholders of the receiving company.

We acknowledge that the IASB has explained in the Discussion Paper how its preliminary views in such regard were reached. However, we observe that an acquisition method may be currently used, for example:

- to provide potential shareholders with a more accurate reflection of a pre-IPO consolidated entity; and/or
- to 'unlock' value, in the expectation that this will result in an improved (substantiated) market valuation and/or greater future economic benefits flow to the entity, and which in turn would enable the entity to improve its return to shareholders.

In these circumstances, some consider that fair value measurements may continue to provide more relevant information to users, rather than the proposed book-value method.

With regards to transfers that impact listed debtholders of the receiving company, we note that some stakeholders contend these transfers should be treated consistently to transfers that impact listed shareholders of the receiving company, for reason that fair value information might be similarly relevant for listed debtholder investment decision-making.

In our opinion, ultimately, the specified accounting treatment must **not** limit business strategy and commercial activity. The objective of financial reporting requirements must be to reflect the effects of transactions rather than serve to manage or constrain the undertaking of transactions.

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?

Refer our response to Question 2.

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?

Refer our response to Question 2.

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 support the IASB proposals:

- not to 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, for the reasons described in the Discussion Paper; and
- to require 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 when applying the acquisition method to a business combination under common control. We think that the costs of accounting for any bargain purchase gain component separately from the transaction with owners in their capacity as owners will be greater than the benefits of having this information. In our opinion, treating the excess as a transaction with owners in their capacity as owners rather than a gain in profit or loss acknowledges that the consideration in a business combination under common control may be set on terms different to that had the combination occurred between unrelated parties.

In addition, we observe that the consideration paid for the combination might include a component representative of a distribution to external parties (in instances where the transferring company is not a wholly-owned group entity). We think that this component should also be acknowledged by the IASB in forming its views about the accounting for the difference between the consideration paid and the fair value of the identifiable acquired assets and liabilities.

We have not identified any other special requirements necessary for the receiving company to apply the acquisition method to business combinations under common control.

<u>Accounting by the transferring company</u>

In our outreach, stakeholders were concerned about complexity introduced through inconsistency with existing IFRS 3 requirements and inconsistency in recognition rules (1) for transactions with owners acting in their capacity as owners and (2) between the transferring company and the receiving company. Under the proposals, there will be a lack of symmetry in treatment between the transferring company – which recognises a gain or loss on sale in profit or loss – and the receiving company. As noted in our response to Question 1, we think the scope of this project should extend to the IASB considering whether that accounting remains valid as this aspect does not yet appear to have been considered.

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?

We disagree with the preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should measure the assets and liabilities received using the transferred company's book values. Allowing the business combination to be measured using a book-value method already regards the business combination under common control as being conceptually different from other business combinations. In our opinion, consequently, the book value determination does not need to necessarily have regard only to the parties to the combination.

We think the assets and liabilities transferred should be measured at the IFRS book values applying to the financial statements of the controlling party of the group under common control (i.e. the book values relevant to the ultimate parent's IFRS consolidated financial statements), as this recognises the different 'nature' of a business combination under common control. It would allow the assets and liabilities (or fair value adjustments thereof) previously recognised by the group to continue being recognised at a level lower than that of the ultimate parent's consolidated financial statements. Therefore, the resultant excess may be more representative of the 'true' transaction with owners acting in their capacity as owners' components associated with the combination.

Feedback from our outreach activity suggests that these combinations are more frequently accounted for using the book values of the controlling party. Based on the feedback received, we think that stakeholders prefer using the book values of the controlling party for practical reasons as it allows for consolidation adjustments to be captured and managed at a level more immediate to the transferred entity being consolidated rather than only as part of the preparation of the ultimate parent's consolidated financial statements. Using the book values of the transferred entity is likely to require a different set of consolidation adjustments to be prepared, which would then have to be reversed as part of preparation of the ultimate parent's consolidated financial statements.

In the event the IASB progresses its proposal to require the receiving company to measure the assets and liabilities received using the transferred company's book values, we would encourage the IASB to consider whether an 'impracticable out' or other exception should be developed. We note that the transferred entity might not be material in the context of the wider consolidated group, but be material in the context of the consolidated financial statements of the receiving entity. However, the costs of requiring the receiving entity to prepare consolidated financial statements using values differing from those used in the preparation of the ultimate parent's consolidated financial statements may exceed the benefits of that information.

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 agree with the IASB's preliminary views in this regard. We do not necessarily concur with the IASB's assertion in paragraph 4.35 of the Discussion Paper that information about a gain or loss on disposal may be of limited use to users of the financial statements. We note that recognition in profit or loss may affect the extent of profit distributable in the form of dividends, which could be relevant to the decisions users make. However, we think that requiring fair value measurements for consideration in the form of assets or liabilities would not necessarily improve the relevance of the reported 'investment', excess, or understandability of the financial statements when considered in context of other proposals. Consequently,

for cost/benefit reasons, it appears reasonable to use the measurements that are already available or specified by IFRS for both, consideration paid in the form of assets or liabilities incurred or assumed.

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 agree with the IASB's preliminary views. We think that the costs of segregating the difference between the consideration paid and the book value of the assets and liabilities received into its component parts would exceed the benefits of that information, and agree that equity appears to be the most appropriate place to recognise this excess.

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?

We agree with the IASB's preliminary view. We are not aware of any reason for the transaction costs to be treated differently from transaction costs incurred in other business combinations.

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?

We agree with the IASB's preliminary view. In our opinion, including assets, liabilities, income and expenses of the transferred company in the receiving entity's financial statements before the combination date would not be a faithful representation of the economic entity that is the receiving entity.

In our outreach activity, some stakeholders observed that pre-combination information might provide useful information to users in certain situations, for example, where a new holding company is introduced. In

acknowledgement of the stakeholders' observation, we would encourage the IASB to permit voluntary disclosure in the notes to the financial statements of the financial performance and financial position of the new group 'had the structure always been in place' (see also our response to Question 12). We note, however, that the ability of such disclosure to provide meaningful information may be impacted by the IASB's decisions on the book values to use.

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?

<u>(a) Disclosure requirements</u>

We support the IASB preliminary view that a receiving company should comply with the disclosure requirements in IFRS 3 *Business Combinations*, including any improvements to those requirements resulting from IASB DP/2020/1 *Business Combinations — Disclosures, Goodwill and Impairment*. However, in our view, the disclosure proposed as part of IASB DP/2020/1 reflects the presumption that the combination has occurred on arms'-length terms (as the Discussion Paper regards synergy-generation as reason for the price paid for the combination). The consideration paid in a business combination involving entities under common control may not be as correlated to synergy generation. Whilst we have not received any specific stakeholder feedback in this regard, we question whether such information would be sufficient to meet the IASB-identified user demand for information in order to make assessments of whether the consideration paid includes an overpayment.

In addition, we note that paragraph 5.18 of the Discussion Paper suggests that to meet the general business combination disclosure objectives, a receiving company undertaking a business combination to which a book-value method applies might need to report information about synergies and other benefits for the controlling party and the group it controls. The Discussion Paper explains that such disclosure might be necessary for users of the receiving company's financial statements to understand the nature and effect of the combination. However, in our opinion, a business combination under common control measured using the acquisition method may have similarly been undertaken to create synergies and other benefits at a group rather than receiving company level. Consequently, we encourage the IASB to consider whether such disclosure should also be required of business combinations under common control to which the acquisition method applies.

Further, we note the IASB has active projects on reduced disclosures for subsidiaries that are small or medium-sized entities and a proposed new approach to disclosures. We expect that those projects will inform the future disclosure proposals of this project.

<u>(b) Application guidance</u>

We support the IASB developing application guidance on how to apply business combination disclosure

requirements together with the disclosure requirements in IAS 24 when providing information about business combinations under common control. However, whilst we have not received specific stakeholder feedback in this regard, we think the IASB should develop application guidance that assists preparers in applying business combination disclosure requirements together with IAS 24 disclosure requirements to all business combinations involving a reporting entity's related parties, rather than developing application guidance that is limited to transfers of a business between entities under common control. This is because a subsidiary may be acquired from a related party that is not a parent or subsidiary of the group; for example, a group might acquire a director-controlled entity or additional interest in an associate in a step acquisition. We think that application guidance in this regard would similarly be helpful to preparers undertaking such business combinations.

In addition, we note that the Discussion Paper contemplates that disclosure of the terms of the combination is required under existing IFRS Standards. However, we think that information about the terms of the business combination, including that contemplated by the example in the Discussion Paper, might be beyond the disclosures currently specified by IFRS 3, IAS 24, and those proposed by IASB DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment*. In particular, we note that paragraph 18 of IAS 24 requires disclosure of the terms and conditions of any outstanding balances relating to the business combination rather than the terms of a business combination itself.

Question 12

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

(a) some, but not all, of the disclosure requirements in IFRS 3 *Business Combinations*, including any improvements to those requirements resulting from the Discussion Paper *Business Combinations — Disclosures, Goodwill and Impairment*, are appropriate (as summarised in paragraphs 5.17 and 5.19);

(b) the Board should not require the disclosure of pre-combination information; and

(c) the receiving company should disclose:

 (i) the amount recognised in equity for any difference between the consideration paid and the book value of the assets and liabilities received; and

 (ii) the component, or components, of equity that includes this difference.

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

We agree with the IASB preliminary views as to the specified information that should be provided. Additionally, whilst not informed by specific stakeholder feedback in this regard, we consider that it may be useful to users to have information about:

- the consideration paid (and disclosure of each major class of consideration). Similar IAS 7 requirements already exist in this regard. The IFRS 3 requirement could be re-expressed for appropriateness to a book-value method;
- contingent consideration and indemnification assets; and
- measurement adjustments.

Noting the above, and also having regard to proposals in the IASB's *Disclosure Initiative – Targeted Standards-level Review of Disclosures* project, we encourage the IASB to consider whether materiality

judgement would suffice to render some disclosure unnecessary, rather than proposed 'carve out' approach to specified disclosures.

Pre-combination information

We agree that the disclosure of pre-combination information should not be required. However, in acknowledgement of stakeholder feedback that such information could be useful, we think the IASB should explicitly permit the disclosure of pre-combination information to be made within the notes to the consolidated financial statements. Requirements should be developed to provide consistency in how this information is prepared.