Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Business Combinations under Common Control**	**Meeting:**	AASB June 2021 (M181)
Topic:	**Summary of AASB Virtual Roundtable on AASB ITC 42 *Business Combinations under Common Control***	**Agenda Item:**	11.1
		Date:	3 June 2021
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		Decision-Making:	None – for information only
		Project Status:	Develop Board response to IASB DP

Background and the objective of this agenda item

1 In November 2020, the International Accounting Standards Board (IASB) published the IASB Discussion Paper *DP/2020/2 Business Combinations under Common Control* (IASB DP or DP) for comment by 1 September 2021. The corresponding AASB Invitation to Comment, ITC 42 *Business Combinations under Common Control*, was issued in December 2020. The ITC 42 comment period closes on 17 July 2021.

2 The IASB DP sets out the IASB's preliminary views on possible reporting requirements that would help companies provide better information about business combinations under common control (BCUCC). The DP is the first step in the IASB's project to filling the gap caused by excluding BCUCC from the scope of IFRS 3 *Business Combinations* (IFRS 3 para 2c). The Board's proposals are expected to reduce the existing diversity in accounting for BCUCC.

3 The IASB DP is divided into 5 distinct sections with specific questions for comments (see Appendix for the questions):

a) Section 1 – Objective, scope, and purpose (Question 1);

b) Section 2 – Selecting the measurement method (Question 2-4);

c) Section 3 – Applying the acquisition method (Question 5);

d) Section 4 – Applying a book-value method (Questions 6-10); and

e) Section 5 – Disclosure requirements (Questions 11-12)[1].

4 At its 24-25 February 2021 meeting, the Board agreed to make a submission to the IASB on the DP (refer also to the project summary).

5 Staff have since conducted a number of outreach events to gather views from stakeholders.

[1] Due to time limitation, the virtual roundtable did not discuss Section 1 and Section 5 of the DP.

6 The objective of this agenda item is to provide the Board with a summary of the preliminary feedback received at the various outreach events. However, the focus of this paper is on the AASB virtual roundtable event held on 5 May 2021 on the discussion paper.

Attachment

7 Agenda Paper 11.2 AASB virtual roundtable participants (Board Only)

AASB outreach and educational sessions

8 To date, staff have conducted the following educational and outreach activities:

(a) 4 March and 1 June 2021 – User Advisory Committee (UAC) meeting

The DP was first discussed with the UAC members on 4 March 2021. At the March meeting, two UAC members commented in principle that the acquisition method should be applied to all BCUCC scenarios; however, they acknowledged that the book method is also acceptable, considering the costs of applying the acquisition method may outweigh the benefits in different scenarios.

Staff brought the topic back to the June 2021 UAC meeting to gather further feedback. In particular, the discussion aimed to obtain views from members on the IASB's preliminary view that pre-combination restatement and disclosures are not required if book-value method is used for BCUCC. 8 members attended the meeting. 4 of the members agreed and 1 member disagreed with the IASB's preliminary views. A number of UAC members (including the member who disagreed with IASB's preliminary views) commented that they tend to focus on the group consolidated financial statements for decision making which often are not impacted by BCUCC.

The DP proposes an optional exemption from the acquisition method if the receiving company's shares are privately held and it has informed all of its non-controlling shareholders that it proposes using a book-value method with no objection ('optional exemption'). A number of members raised concerns about the exemption as the option may not provide consistent and comparable financial information.

(b) 30 March 2021 – IASB and AASB webinar (educational session)

Over 140 individuals from Asia-Oceania region attending the IASB and AASB webinar. Hosted by the AASB, IASB staff and members presented the education session, including the relevant academic research and findings on the topic. No specific feedback was received during the session as the focus of the session was to introduce to the stakeholders some of the key IASB's proposals in the DP.

(c) 5 May 2021 – AASB virtual roundtable

The virtual roundtable was attended by 16 participants from big- and mid-tier audit firms, professional bodies, regulators, and preparers. In addition to AASB staff and Alison White (AASB Board member), Ann Tarca (IASB Board member) and IASB project staff were in attendance to directly hear the Australian stakeholders' feedback. Following sections in this paper provide the summary of the feedback received at the virtual roundtable.

Summary of virtual roundtable feedback

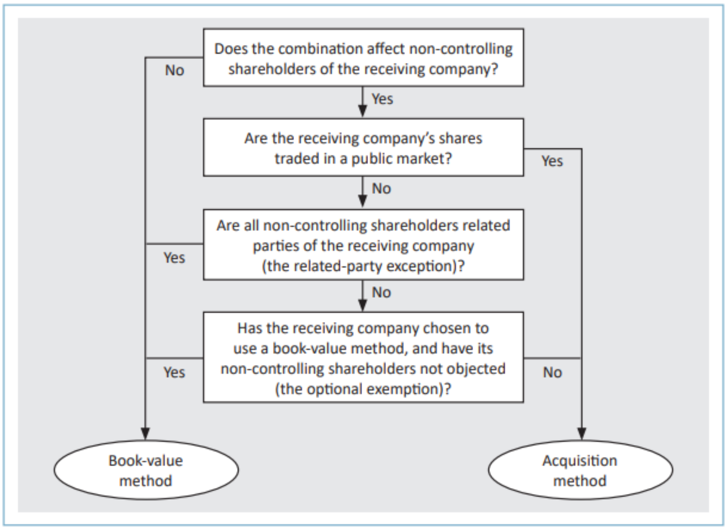
9 Having regard to the length of the meeting (90 minutes), staff did not seek feedback on Section 1 - Objective, scope and purpose (Question 1 of the DP) and Section 5 - Disclosure requirements (Question 11 and Question 12 of the DP). However, participants were invited to share any feedback they had in this regard with the AASB outside the roundtable session.

10 In general, the feedback revealed reserved support for some of the IASB's proposals, with participants generally not expressing a definite view on the questions posed in the DP. Roundtable participants had concerns about the suitability, practical implementation, and usefulness of the detailed proposals.

Section 2: Selecting the measurement method (IASB DP/2020/2 Questions 2 – 4)

11 The image below, extracted from IASB DP/2020/2 illustrates the IASB proposals pertaining to the selection of the measurement method:

Diagram IN.2—Summary of the Board's preliminary views



12 Question 2 of the DP is related to whether stakeholders agree with the DP that:

(a) neither the acquisition method nor a book-value method should be applied to all BCUCC;

(b) in principle, the acquisition method should be applied if the BCUCC affects non-controlling shareholders of the receiving company, subject to the cost-benefit trade-off and other practical considerations discussed in the DP;

(c) a book-value method should be applied to all other BCUCC, including all combinations between wholly-owned companies.

13 13 participants responded to the question. While 11 respondents indicated agreement with the IASB's preliminary view, 2 participants observed they were unsure whether this was an appropriate approach. However, neither of the two participants provided further feedback to explain their responses.

14 Several participants voiced concerns about how the DP approaches the selection of the measurement method. Participants made the following observations:

(a) the IASB has, in specifying the measurement requirement, departed from a principle-based approach used in developing accounting standards;

(b) it is unclear why the accounting should be different for the receiving company with existing non-controlling shareholders vs with potential shareholders. For example, for restructurings conditional on an IPO (which will result in the existence of non-controlling shareholders);

(c) it appears that form is driving the accounting outcome;

(d) more groups might want to use the acquisition method than as allowed under the proposals and that users might prefer fair value information. A participant noted that professional services entities in some circumstances might advise their clients to use acquisition method to meet their user needs.

(e) one participant observed that while not in disagreement with the proposal that a listed entity should be required to account for the BCUCC transaction using the acquisition method, the participant noted that this 'rule' creates challenges for comparability between listed and non-listed companies; and

(f) one participant expressed a preference for the use of the acquisition method in more instances, including debt-funded acquisitions. In the participant's view, an investor-user might need fair value information about the acquired entity as this reflects what the acquirer paid for, and it is important for management accountability after the acquisition. The participant considered that a 'true' internal restructure should be accounted for using a book-value method.

15 In response to an IASB staff query whether the disclosure of fair value information would satisfy user needs in instances where the book-value method is used, a participant observed that such disclosure might provide useful information in the year of the transaction, but the information would not be available in subsequent periods. Consequently, users will not have the same assessment ability as they would have, had the fair values been recognised.

16 One participant observed that the IASB DP appears to focus on public and private companies. That participant questioned how the DP's proposals might be extendable to other forms of Australian reporting entities.

17 Question 3 of the DP is related to whether stakeholders agree with the DP that:

(a) the acquisition method should be required if the receiving company's shares are traded in a public market;

(b) it provides the optional exemption from the acquisition method if the receiving company's shares are privately held and it has informed all of its non-controlling shareholders that it proposes to use a book-value method with no objection ('optional exemption)'; and

(c) it provides the related-party exception whereby 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 ('related party exception').

18 Question 4 of the DP asks whether stakeholders agree that the optional exemption and related party exception should not apply to publicly traded receiving companies.

19 Staff did not hear any vocal support from roundtable participants for the related party exception for non-listed companies to be retained, whether in its current form or in a modified manner.

20 Some stakeholders noted that identifying all related parties might be challenging in some situations. In their view, this could result in the application complexity of the proposal. For example, a preparer and an auditor might disagree whether a particular shareholder is a related party of the entity in order to achieve a specific accounting outcome;

21 A stakeholder observed that the related party exception may potentially be more relevant in jurisdictions where a broader population (compared to Australia) of companies is required to prepare IFRS-compliant financial statements, as the exception would give more entities access to a book-value method.

22 One participant indicated they support the optional exemption.

23 Other participants did not express a definitive view but made the following general observations:

(a) that, under the proposal, a shareholder holding a single share could force the receiving company to apply the acquisition method;

(b) that the IASB's proposals do not necessarily enhance comparability; and

(c) that the measurement decision-making ignores debtholder needs.

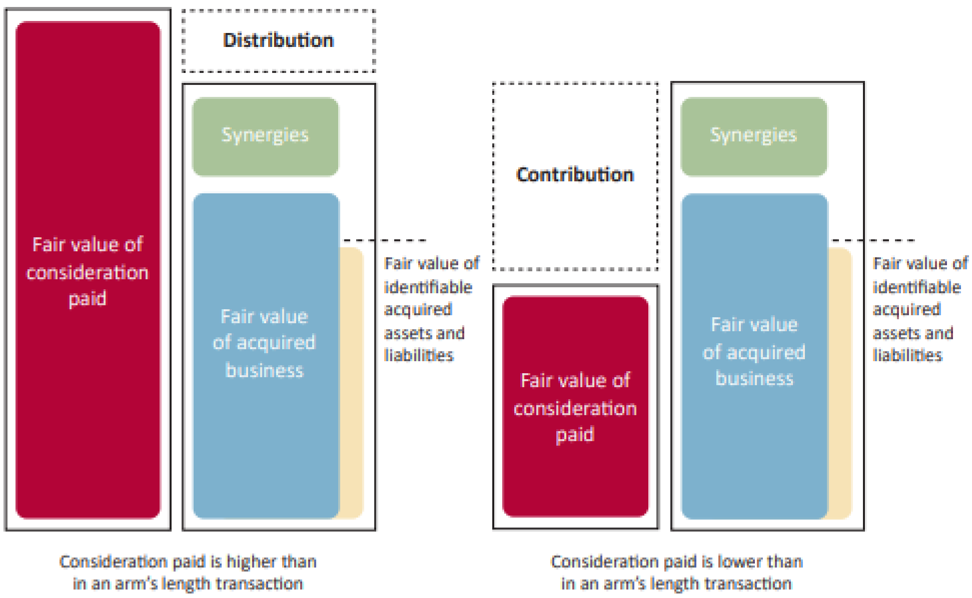
Section 3: Applying the acquisition method (IASB DP/2020/2 Question 5)

24 The image below, extracted from IASB DP/2020/2 illustrates that in BCUCC the consideration paid may be different than an amount paid in an arm's length transaction and:

(a) If the consideration paid is higher, that excess constitutes a distribution from equity by the receiving company to the transferring company, and ultimately to the controlling party; and

(b) If the consideration paid is lower, that difference constitutes a contribution to equity of the receiving company from the transferring company, and ultimately from the controlling party.

Diagram 3.2—Distribution from equity or contribution to equity



25 Question 5 of the DP is related to whether stakeholders agree with the DP that:

(a) 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 BCUCC; and

(b) 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 BCUCC.

26 One participant observed that the IASB proposal results in an (undesirable) inconsistency in treatment between the transferring entity – which recognises a gain or loss on sale in profit or loss – and the receiving company. Another participant suggested that the same principle should be applied to both contributions and distributions.

27 Another participant noted that in situations when consideration paid is higher than in an arm's length transactions, some of the excess consideration paid may not represent a distribution to the transferring entity. This participant observed that the transferring entity may not be wholly owned by the controlling party, and that rather than a transaction with owners acting in their capacity as owners, the transferring entity's non-controlling interest share of the excess is a cost to the group. Consequently, the participant considered that that portion should be expensed as the group does not receive a benefit from that portion of the excess consideration.

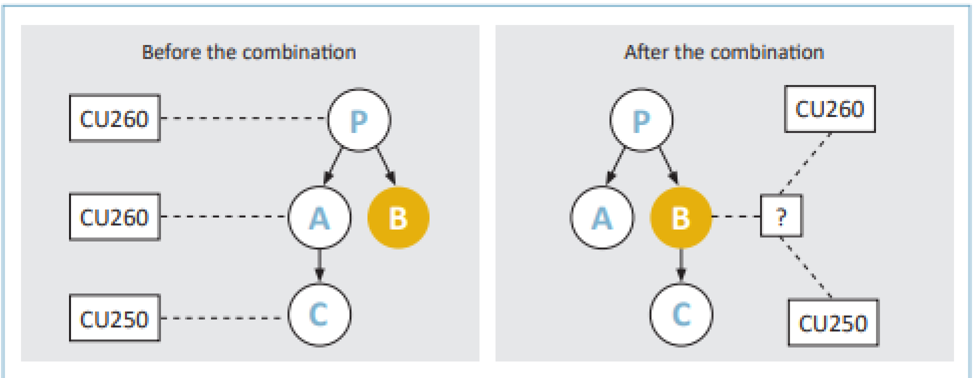
28 In addition, the acquisition method requires the identification of the fair value of the identifiable net assets of the entity being sold. One participant observed that it may be challenging to apply such requirement in practice given the BCUCC nature of the transaction.

Section 4: Applying a book-value method (IASB DP/2020/2 Questions 6 to 10)

29 Because of the limited time at the virtual roundtable, the discussion focused on questions 6 and 10.

30 The image below, extracted from IASB DP/2020/2 illustrates whether the receiving company (B) should measure the assets and liabilities received at the transferred company's book-values (C, i.e. CU250) or at the controlling party's book-values (A or B, i.e. CU260).

Diagram 4.1—Book values in a business combination under common control



31 Question 6 of the DP asks whether stakeholders agree that when applying a book-value method to a BCUCC, the receiving company should measure the assets and liabilities received using the transferred company's book-values.

32 **Use of transferred entity's book-values.** Several participants commented on the proposal to measure the assets and liabilities received using the transferred company's book-values. One participant observed that it may be simpler to require the receiving company to consolidate using the transferring entity's (the group's) book-values for the transferred entity. However, the participant also noted that there is no conceptual basis to justify whether using transferred entity's book-values is more or less appropriate. Two other participants suggested the IASB investigate allowing a rebuttable presumption that the group's book-values could be used, reverting to the transferred entity's book-values where group book-values do not make sense or were difficult to calculate.

33 Observations made in support of allowing the use of the group's book-values at the roundtable included:

(a) the group book-values will already be known from consolidation journal entries and may already be tracked for the purposes of identifying consolidated depreciation and other amounts;

(b) the acquisition method may have previously been used and achieved certain tax positions for the acquired assets and liabilities (e.g. in a non-BCUCC transaction). A participant observed that Australian group members would later not have access to those reset values under the proposals. That participant observed that global acquisitions involving Australian subsidiaries often involve some reorganisation following the acquisition – whether it takes place immediately or in few years – and that an IFRS requirement to use the (lower) book-values of the transferred entity for the subsequent BCUCC transaction will 'change the playing field'. The participant acknowledged that IFRS requirements pertaining to transitory control (within the scope of the project but not yet discussed by the IASB) may go some way to alleviating the concern, but that this would put the onus on the group to perform such reorganisation activity in a timely manner;

(c) requiring only a single specified book-value could be problematic, as the transferred company's/group's book-values may not always be available, e.g. if the entity in question is not required to prepare financial statements, or not required to prepare IFRS-compliant financial statements.

34 Question 10 asks whether stakeholders agree that when applying a book-value method to a BCUCC, 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.

35 **Prospective application.** Participants generally concurred with the proposal to account for the transferred company prospectively from the combination date rather than restating comparative information. However, concerns were raised about transaction consistency and the loss of information; for example, in cases involving a 'NewCo', or in carve-out financial statements/ prospectuses:

(a) a participant observed that, in some cases, a newly created NewCo which immediately becomes the ultimate parent entity of a group (and is a receiving entity) should prepare consolidated financial statements that provide comparative information, or pre-combination information, of its subsidiaries (i.e. transferred entities). If book-value method is used as proposed, no comparatives would be presented in such case;

(b) a participant suggested the IASB consider allowing the preparer to identify the accounting acquirer/receiving company, rather than requiring, where the book-value method is used, the legal acquirer to be identified as the accounting acquirer;

(c) a participant raised a concern that there is a general perception in the market that the requirement of only prospective financial information (i.e. not allowed to restate comparatives) may give rise to “non-IFRS compliant” financial information. The participant also commented that in some cases such as in a pre-IPO scenario, restating comparatives and providing financial information that are being seen as ‘IFRS-compliant’ is important to such entities.

36 One participant observed that in some cases, the restructuring might occur in response to a need to satisfy conditions imposed by a regulator, giving as an example the Australian Prudential Regulatory Authority (APRA) preference for a non-operating holding company (NOHC) (tophat) structure. That participant observed that from a ‘user needs’ perspective, having pre-combination information on the face of the financial statements may be preferable, as disclosure does not compensate recognition and measurement.

37 A participant was keen for a framework to be established with regards to proforma financial information: for example, for the entity to present ‘combined’ financial statements up to the date of acquisition, and after that, consolidated financial statements.

38 **Other.** Roundtable participants did not indicate any objection to the IASB’s proposals on how to treat transaction costs of the business combination. Participants did not make any specific comment on other aspects of the book-value method.

Next steps

39 Staff expect to continue to conduct further outreach activities and to bring a summary of outreach feedback and draft comment letter to the Board’s future meeting.

Question to the Board Do Board members have any questions or comments on the feedback received?

APPENDIX: Questions included in IASB DP/2020/2

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?

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?

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?

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?

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?

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?

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?

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?

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?

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?

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?

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?