ASC

ACCOUNTING STANDARDS COUNCIL
SINGAPORE

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(By online submission)

Dear Andreas

RESPONSE TO DISCUSSION PAPER ON BUSINESS COMBINATIONS UNDER COMMON CONTROL

The Singapore Accounting Standards Council appreciates the opportunity to comment on the Discussion Paper on *Business Combinations under Common Control* (the DP) issued by the International Accounting Standards Board (the IASB or the Board) in November 2020.

We welcome the IASB's work on business combinations under common control, with the objective of reducing practice diversity and providing better information in response to the lack of specific requirements in IFRS Standards for such combinations. The objectives and economic effects of business combinations under common control vary across such combinations, and often differ from business combinations covered by IFRS 3 *Business Combinations*. Accounting for business combinations under common control applying either the requirements in IFRS 3 or various accounting policies developed in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* not only reduces comparability, but also affects the quality and understandability of information provided about such combinations.

The IASB's preliminary views in the DP provide a good starting point from which the IASB could further develop the accounting model for business combinations under common control, and consider potential improvements to address concerns about specific aspects of those views. In this regard, our comments on the IASB's preliminary views are as follows:

Question 1: Project scope
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

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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?

The reporting entity

We are supportive of the IASB's preliminary view that the accounting model for business combinations under common control should cover reporting by the receiving entity.

IFRS 3 excludes from its scope the accounting for business combinations under common control by the receiving entity. In contrast, the controlling entity and the transferring entity account for such transactions applying IFRS 10 *Consolidated Financial Statements*, which does not contain scope exclusions for transactions under common control. The transferred entity does not require specific accounting when its parent changes.

In addition, the accounting model should cover all types of financial statements prepared by the receiving entity, other than its separate financial statements in which the receiving entity accounts for an incorporated business under common control as an investment in a subsidiary applying IAS 27 *Separate Financial Statements*.

For the cost model, IFRS Standards generally do not specify scope exclusions and different measurement requirements for transactions under common control. The same is true for the equity method as described in IAS 28 *Investments in Associates and Joint Ventures*, which is essentially a cost-accumulation model. That said, IAS 28 specifies that the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture. Notwithstanding so, it would be premature to extend the scope of the project to the acquisition of associates and joint ventures from parties under common control, in view of the IASB's existing research project on the equity method. The IASB could consider revisiting this topic at some point in the future.

Business combinations under common control

<u>Types of business combinations</u>

We are supportive of the IASB's preliminary view that the project should cover transfers of a business under common control that do not meet the definition of business combinations in IFRS 3.

In particular, transfers of a business under common control often involve a transfer to a new entity or similar forms of group restructuring. Generally, such transfers do not meet the definition of business combinations in IFRS 3 if the new entity is identified as the accounting acquiree. This is often the case in transfers that involve consideration in the form of equity interests issued by the new entity.

In order to achieve its objectives, the project should address a wide range of transfers of a business under common control, including transfers do not meet the definition of business combinations in IFRS 3. That said, the project scope only determines the types of transfers for which the IASB would develop an accounting model, and does not prevent the IASB from determining that a particular accounting model should not apply to some of such transfers.

Definition of common control

We are supportive of the IASB's decision to specifically address transfers of a business under common control that is potentially 'transitory'.

IFRS 3 defines business combinations under common control in a way that precludes transitory control. However, it does not provide any definition or guidance to help entities to determine if the control is not transitory. In practice, there are different views on whether control needs to be transitory both before and after a combination in order for an entity to conclude that the combination is not a business combination under common control because the control is transitory.

In principle, we are supportive of the IASB's preliminary view that the accounting model should also cover transfers of a business under common control that either: (1) are preceded by an acquisition from an external party; or (2) are followed by, or conditional on, a sale to an external party, including in an initial public offering.

As long as a transfer involves a business under common control, the objectives and economic effects of the transfer can differ from business combinations covered by IFRS 3, regardless of whether the transfer is preceded or followed by an external acquisition or sale. Therefore, the transfer may be subject to the same accounting issues that affect business combinations under common control in the strictest sense.

However, the drafting of the IASB's preliminary view implies that the accounting model does not cover a transfer that is both preceded by an acquisition from an external party and followed by, or conditional on, a sale to an external party. The IASB should explain its rationale underlying this view. On one hand, it may address the risk of a receiving entity structuring transfers to avoid applying the acquisition method in accordance with IFRS 3. However, it appears to be at odds with the IASB's preliminary view, which implies that the accounting for a transfer does not depend on whether or not the transfer is followed by, or conditional on, an external sale of one or more of the combining businesses.

In order to achieve its objectives, the project should address a range of transitory control, including a transfer that is both preceded by an acquisition from an external party and followed by, or conditional on, a sale to an external party.

As the IASB develops the accounting model, it then considers whether and what specific requirements are necessary for particular types of transitory control, and whether specific scope exclusions are necessary to avoid similar transfers being accounted for differently or structuring opportunities. This may be the case, for example: (1) when the external acquisition and subsequent sale are linked transactions, which may include specific cases in which an external acquisition is conditional on an initial public offering of the combined businesses; or (2) when external acquisitions are structured through common control entities with the objective of avoiding application of the acquisition method in IFRS 3 to those acquisitions.

Question 2: Selecting the measurement method
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?

In principle, we are supportive of the IASB's preliminary views.

Whether and when business combinations under common control are similar to business combinations covered by IFRS 3

We generally agree with the IASB's analysis that not all business combinations under common control are different from business combinations covered by IFRS 3, and that a key differentiating factor is whether *a business combination under common control affects non-controlling shareholders of the receiving entity*. For the purpose of this comment letter, the italicised description includes combinations that affect non-controlling shareholders that have indirect ownership interests in the receiving entity, including through the immediate parent that owns all the ownership interests in the receiving entity.

When a receiving entity has non-controlling shareholders, the combination not only has economic substance for the receiving entity, but also results in non-controlling shareholders of the receiving entity acquiring an ownership interest in the economic resources of the transferred business with a corresponding reduction in the controlling party's ownership interest in those economic resources (hereinafter referred to simply as an exchange of value). This is true even if non-controlling shareholders only have indirect ownership interests in the receiving entity, for example when the receiving entity is wholly owned by another receiving entity that itself has non-controlling shareholders.

In contrast, when a receiving entity does not have non-controlling shareholders—whether directly or indirectly, the combination simply reallocates the economic resources of the transferred business from the transferring entity to the receiving entity, without changing any ownership interests of any direct or indirect non-controlling shareholders in the receiving entity in those economic resources.

In addition, we are inclined to agree with the IASB's analysis that the selection of the measurement method should not be based on an evaluation of how similar a business combination under common control is to business combinations covered by IFRS 3. We recognise the difficulty of developing a workable set of indicators for receiving entities to use in making such an evaluation, and the subjectivity involved in making such an evaluation.

User information needs

In line with the *Conceptual Framework for Financial Reporting*, we agree that the project should focus on the information needs of those existing and potential shareholders, lenders and other creditors who must rely on the receiving entity's financial statements for much of their information needs.

Existing and potential investors

Although the accounting model gives specific accounting considerations to business combinations between parties under common control, the accounting is not necessarily determined from the perspective of the controlling entity. Rather, the presence of common control in such a combination may affect its objectives and economic effects, and therefore, the receiving entity's financial position, financial performance and cash flows. It follows that the accounting ought to be determined from the receiving entity's perspective, with the objective of providing useful information to users that must rely on the receiving entity's financial statements.

This means that, in developing the accounting model, the information needs of the controlling entity are given lower priority when they conflict with the information needs of other users. Regardless of whether it is the controlling party that directs a receiving entity to undertake a business combination under common control, the controlling party is expected to have information about the combination by virtue of its control of the combining entities.

On the other hand, non-controlling shareholders of the receiving entity are likely to have similar information needs as any existing investors of an acquirer in a business combination covered by IFRS 3. In particular, non-controlling shareholders of the receiving entity acquire an ownership interest in the economic resources of the transferred business in exchange for the consideration paid. Therefore, those shareholders need information to assess the effects of that exchange of value on the receiving entity's financial position, financial performance and cash flows, and to hold management to account for its acquisition decision[1]. Arguably, holders of equity instruments that represent potential ownership interests in the receiving entity also require similar information to help them to assess the returns from a residual interest in the receiving entity's net assets.

Potential shareholders arguably need similar information about business combinations under common control and business combinations covered by IFRS 3. Specifically, potential shareholders may consider information about the combined entity to be more useful, if the receiving entity applies an accounting that does not depend on how the combination is legally structured, such as by using the same recognition and measurement bases for all the combining entities. For example, if the receiving entity measures the assets and liabilities of the combined entity using the acquisition-date fair value or the book value of the combining entities, the history of the combined entity begins with either the combination, or the inception of the combining entities as if the combined entity had grown organically.

Existing and potential lenders and other creditors

Existing and potential lenders and other creditors primarily need information about a receiving entity's cash flows and debt commitments in order to assess the receiving entity's ability to service its existing debt and to raise new debt. This is consistent with the feedback received by the IASB that the outcome of credit analysis would not depend greatly on whether the acquisition method or a book-value method is applied to business combinations under common control.

However, some debt instruments contain equity conversion features, and the holders in effect hold equity instruments that represent potential ownership interests in the receiving entity. Therefore, those holders are likely to need information to help them to assess the returns from a residual interest in the receiving entity's net assets.

Types of measurement method and the basis for selection

Following from our above analysis, we agree that neither the acquisition method nor a book-value method should be applied to all business combinations under common control. Instead, we see merit in basing the selection of measurement methods on whether there is a change in the ownership interests of any direct or indirect non-controlling shareholders of the receiving entity in the economic resources of the transferred business, taking into the cost-benefit trade-off and other practical considerations.

[1] In developing our comments, we have considered the possible improvements to IFRS 3 as discussed in DP/2020/1 *Business Combinations—Disclosures, Goodwill and Impairment*. Those improvements include improved disclosure requirements that would help users of financial statements to assess an acquisition's subsequent performance against the acquisition-date expectations, thereby holding management to account for its acquisition decision.

The acquisition method

Applying the basis for selection, we are supportive of the principle that the acquisition method should be applied to combinations that affect non-controlling shareholders of the receiving entity, subject to practical considerations. For this purpose, we believe that non-controlling shareholders should include holders of equity instruments that represent potential ownership interests.

The acquisition method is expected to provide useful information about such combinations to the non-controlling shareholders, as it does for business combinations covered by IFRS 3. For both types of combinations, the receiving entity's non-controlling shareholders acquire an ownership interest in the economic resources of the transferred business regardless of whether ultimate control of the transferred business changes, for which similar information is likely to be required. Besides, applying the acquisition method would improve comparability and understandability of the information provided about both types of combinations for the non-controlling shareholders.

For potential shareholders, it is debatable whether the acquisition method necessarily provides more useful information about a business combination under common control in comparison with alternative methods that do not result in different accounting outcomes depending on the legal structure chosen for the combination. While this is true even for business combinations covered by IFRS 3, we note that the IASB did not receive feedback indicating significant concerns about a loss of useful information from its post-implementation review of IFRS 3.

A book-value method

As indicated in our above comments, we are in principle supportive of applying a book-value method to particular business combinations under common control that affect non-controlling shareholders of the receiving entity (including holders of equity instruments that represent potential ownership interests in the receiving entity) because of practical considerations. Please refer to our comments to Question 3 for the details.

Additionally, we are in principle supportive of applying a book-value method to all other business combinations under common control, including all combinations in which the receiving entity is wholly-owned by the controlling party.

For combinations in which the receiving entity is wholly-owned by the controlling party, there is little benefit from an application of the acquisition method. The controlling party is unlikely to view the resulting information as useful because the controlling party continues to control the economic resources of the transferred business after the combination, and the combination does not change its ownership interest in those economic resources if the transferring entity is also wholly-owned by the controlling party. There are no non-controlling shareholders that require the resulting information, and the potential shareholders can obtain useful information that facilitates trend analysis from a book-value method that is less costly to apply.

Moreover, the acquisition method is not designed for business combinations under common control that are significantly different from business combinations covered by IFRS 3, and the modifications or compromises that are necessary for such combinations may not be justified on cost-benefit grounds. For example, such combinations are often not transacted at a consideration that would have been determined in an arm's length negotiation, which may tilt the balance of the cost-benefit analysis for the modified acquisition method as described in the DP.

Notwithstanding our above comments, consistent with IFRS 3's objective for requiring common control to be 'not transitory', as the IASB develops its proposals, it should consider whether combinations involving particular types of transitory control should be prohibited from applying the book-value method, to reduce structuring opportunities intended to avoid application of the acquisition method.

Question 3: Selecting the measurement method

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?

In determining the particular business combinations affecting non-controlling shareholders to which a book-value method is to be applied, we are supportive of an approach that leverages on conditions already used in IFRS Standards, while avoiding arbitrary distinction and thresholds. Therefore, we see merit in using the conditions ‘traded in public market’ and ‘no objection from non-controlling shareholders’ as a starting point for this purpose.

Acquisition method for publicly traded receiving entities

We are supportive of requiring the acquisition method if a receiving entity’s shares are traded in a public market.

We acknowledge the IASB’s analysis that the listing requirements and capital markets regulations for public trading in many jurisdictions typically prevent the listing of shares when the ownership interest of non-controlling shareholders in an entity is insignificant. Therefore, the condition has the potential to address concerns about the cost outweighing the benefit of requiring a receiving entity to apply the acquisition method if the ownership interest of non-controlling shareholders is insignificant, without added subjectivity.

Importantly, the condition is currently used in IFRS Standards as a scope exclusion for the exemption from applying consolidation and the equity method, and as a basis for requiring additional disclosures such as earnings per share and operating segments. Arguably, an entity that meets the condition are held to higher standards of accountability because of the need to protect a broad group of non-controlling shareholders who must rely on financial statements for most of their information needs. For this reason, the acquisition method should be applied to business combinations under common control to provide information that enables non-controlling shareholders to understand the effects of an exchange of value between them and the controlling party and to hold management to account for the combinations, particularly when such combinations are often directed by the controlling party.

Optional exemption from the acquisition method for privately held receiving entities

From a cost-benefit perspective, we are supportive of permitting the use of a book-value method by receiving entities whose shares are not traded in a public market, on the condition that all direct non-controlling shareholders of a receiving entity (including holders of equity instruments that represent potential ownership interests in the receiving entity) have been informed about, and have not objected to, the use of a book-value method. The cost of applying the acquisition method is unlikely to be justified if the non-controlling shareholders do not rely on the resulting information for their information needs. Besides, the condition is currently used in IFRS Standards and is expected to be operational. The condition does not need to require that all indirect non-controlling shareholders do not object to the receiving entity using a book-value method. This is because any of those non-controlling shareholders that have an objection can prevent the parent receiving entity from applying the option, and therefore, the parent receiving entity is likely to direct the subsidiary receiving entity to apply the acquisition method.

Related party exception requiring a book-value method

We remain to be persuaded of a need to introduce an exception to the acquisition method for combinations in which all non-controlling shareholders of a receiving entity are related parties as defined in IAS 24 *Related Party Disclosures*.

Firstly, some related parties may need to rely on the receiving entity's financial statements for most of their information needs. IAS 24 defines related parties broadly, with the objective of drawing attention to the possibility that an entity's financial position and performance may have been affected by the existence of, and the transactions as well as balances with, related parties. It follows that the same definition is not necessarily suitable as a basis for providing an exception to the acquisition method. For example, it is debatable whether non-controlling shareholders that are related to a receiving entity in ways other than through common control or joint control can always obtain information from the receiving entity to meet their information needs.

Secondly, we do not have a significant concern about the opportunity for accounting arbitrage, when business combinations under common control are structured to affect non-controlling shareholders that are all related parties. We acknowledge the possibility of structuring solely for the purpose of applying the acquisition method to recognise internally generated intangible assets and measure assets at fair value that would have been prohibited if the receiving entity had always owned the transferred business. However, the merit of the acquisition method is not in question, regardless of whether a business combination is under common control.

In particular, even if a receiving entity structures a combination to affect non-controlling shareholders that are all related parties, there is an exchange of value between the controlling party and the non-controlling shareholders, as long as those related parties are not wholly owned by the controlling party. Indeed, the acquisition method is designed to capture the effects of that exchange. Although there is a higher possibility that the consideration paid for such a combination may differ from a price determined in an arm's length negotiation, applying the acquisition method as described in IFRS 3 based on an amount of consideration paid that is an arm's length price should reflect the effects of the off-market price in a way that would be useful to the non-controlling shareholders.

On balance, the related party exception does not appear to be justified. Instead, we see more merit in extending the optional exemption to receiving entities of which non-controlling shareholders are all related parties, as long as those related parties are not wholly owned by the controlling party. That said, we recognise that it would increase the population of business combinations under common control that are not transacted at an arm's length price but are accounted for applying the modified acquisition method. Therefore, this implication needs to be considered in the cost-benefit analysis for the modifications to the acquisition method (refer to our comments to Question 5).

Question 4: Selecting the measurement method
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 are supportive of the IASB's preliminary view that both the optional exemption and the related party exception should not be extended to publicly traded receiving entities.

Optional exemption

Foremost, there is an expectation that publicly traded entities are held to higher standards of accountability to protect a broad group of non-controlling shareholders who must rely on financial statements for most of their information needs. Moreover, publicly traded entities often have many shareholders, with frequent changes in share ownership. Therefore, it would be more difficult to justify the optional exemption on cost-benefit grounds for publicly traded entities. For example:

(a) Business combinations under common control are often directed by the controlling party. Therefore, a broad group of non-controlling shareholders would need information to evaluate the effects of an exchange of value between them and the controlling party, and to hold management to account for its acquisition decision. That information need is not negated by listing requirements and capital markets regulations that require any consideration paid to approximate an arm's length price.

(b) The non-controlling shareholders who will use the information about the combination may not be the same, and may not have the same response, as the shareholders who were consulted when the receiving entity proposed to use a book-value method.

(c) The optional exemption reduces comparability across publicly traded entities, and may result in a publicly traded receiving entity applying different measurement methods to its combinations depending on the responses of its non-controlling shareholders at each particular point in time. As a result, the reported information may be less understandable for a broad group of non-controlling shareholders.

Related party exception

We agree with the IASB's analysis that extending the related party exception to publicly traded entities may have little practical impact.

In particular, the listing requirements or capital market regulations in many jurisdictions limit how many shares of a publicly traded entity can be held by related parties. Therefore, it would be unusual for all the non-controlling shareholders of a publicly traded receiving entity to be related parties of that entity.

Question 5: Applying the acquisition method

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?

Purchase consideration at off-market price

We agree with the IASB's analysis that a key issue of applying the acquisition method as described in IFRS 3 to business combinations under common control is that the consideration paid may differ from an arm's length price that would have been negotiated between unrelated parties.

Specifically, the acquisition method is based on the premise that the consideration paid is determined in an arm's length negotiation, reflecting the fair value of the acquired business and the price paid for any synergies expected from the combination. A consideration paid that differs from an arm's length price would impact the measurement of goodwill arising from the combination.

We recognise that the issue may not be a concern for many publicly traded receiving entities because many jurisdictions have listing requirements and capital market regulations that are designed to protect the interests of non-controlling shareholders. The same is true for any privately held receiving entities that are subject to enforceable clauses in laws, regulations or constitution documents that protect the interests of non-controlling shareholders.

Nevertheless, the acquisition method may be applied by particular privately held receiving entities under the optional exemption, which has the potential to be extended to particular privately held receiving entities of which non-controlling shareholders are all related parties (refer to our comments to Question 3). The optional exemption would expand the population of combinations with off-market price to which the acquisition method may apply.

The approaches to addressing off-market price

We have reservations about the IASB's preliminary view to not modify the measurement requirements for goodwill in IFRS 3.

Theoretically, when the consideration paid for a business combination under common control differs from an arm's length price, the combination includes an additional component that is a transaction with the owners acting in their capacity as owners. Therefore, any excess or shortfall of the consideration paid vis-à-vis the amount of net identifiable assets and liabilities recognised should be attributed between the following components: (1) goodwill or bargain purchase gain (which is in turn recognised as a component of equity because it arises from a transaction with owners, but is not prevented from separate disclosure); and (2) distribution from equity or contribution to equity.

However, in reality, determining a hypothetical arm's length price would be highly subjective, if not impracticable. This is because an arm's length price would include not only the fair value of the acquired business, but also the price that the acquirer would pay for entity-specific synergies expected from the combination. Therefore, the acquirer needs to determine a specific amount that represents the value of entity-specific synergies in determining the hypothetical arm's length price, unlike in an arm's length negotiation where the acquirer typically estimates a range of acceptable values that guides the negotiation of an arm's length price.

Recognising the practical challenges, we have considered the various approaches to dealing with the attribution issue as described in the DP, but have concerns—albeit to different degrees—about each of those approaches.

(a) The IASB's preliminary view

The approach as described in the IASB's preliminary view does not distinguish goodwill or bargain purchase gain from distribution from equity or contribution to equity. The accounting outcome is that any excess of the consideration paid over the amount of net identifiable assets and liabilities recognised is recognised within goodwill, whereas any shortfall is recognised as contribution to equity.

Goodwill represents a residual component in a combination and cannot be measured directly. This means that there is a greater need for the initial measurement of goodwill to reflect the value of the acquired business as a going concern and the expected synergies of the combination as much as it could practicably, subject to an overall balance of costs and benefits. However, the IASB's approach would result in accounting outcomes that do not meet that need. Besides, the approach would result in asymmetrical accounting outcomes between excesses and shortfalls, which would reduce the understandability of the reported information.

In the case of excess consideration paid, the impairment test cannot be a substitute for an appropriate initial measurement of goodwill and can result in an overstatement of goodwill that may remain in the financial statements for a very long time. This is because the shielding effect of the headroom that exists in the acquirer's cash-generating units that are expected to contain the goodwill would mask any distribution from equity. Moreover, any amounts that are not supported by the recoverable amount of the acquirer's cash-generating units would be recognised as an impairment of goodwill instead of a distribution from equity, which is inconsistent with the IASB's analysis that the combination includes an additional component that is a transaction with owners. Indeed, these issues pose a bigger concern than the current lack of requirements to identify and measure an overpayment in a business combination covered by IFRS 3 despite an arm's length price, which an acquirer does not ordinarily expect at the acquisition date. Consequently, the approach would exacerbate existing concerns about goodwill accounting and impairment.

On the other hand, when the consideration paid is less than the amount of identifiable assets and liabilities recognised, it is debatable whether: (1) in comparison with a book-value method, there are substantial added benefits of measuring individual assets acquired and liabilities assumed generally at fair value without recognising the value of the acquired business as a going concern; and (2) those benefits would justify the related costs.

In addition, when there are non-controlling interests in the acquiree, the acquirer may elect to measure non-controlling interests at fair value. It would result in an accounting transfer to non-controlling interests through a reduction to the amount of contribution to equity, which arises solely because the going concern value is included in the fair value of non-controlling interests but not in the aggregated amount of the identifiable assets and liabilities recognised.

Should the IASB confirm its preliminary views, we would agree that an acquirer should not recognise a bargain purchase gain in profit or loss on its business combination under common control. Any transfer of wealth from the controlling party to non-controlling shareholders of the acquirer is a transaction with owners.

(b) The fair-value-based approach

The fair-value-based approach would include any price paid for entity-specific synergies expected from a combination in the measurement of distribution from equity, instead of goodwill.

Although the amount of goodwill recognised would not reflect the above component, that amount would nonetheless provide more useful information in comparison with the IASB's preliminary view. Specifically, the acquirer would generally report the fair value of individual assets acquired and liabilities assumed, and the going concern value of the acquired business. The information collectively could help non-controlling shareholders of the acquirer to assess whether the consideration paid had been reasonable, taking into consideration the expected synergies that would be disclosed if the IASB were to proceed with the improved disclosures as described in DP/2020/1.

The amount of goodwill that had not been recognised would create additional headroom that increases the shielding of goodwill from future impairment. That said, any additional delay in the recognition of impairment loss relates to unrecognised goodwill that was previously included in a deduction from equity. Nevertheless, that additional delay potentially diminishes the confirmatory value of any impairment loss recognised as an evidence that an impairment of the goodwill had occurred.

(c) The impairment-based approach

The impairment-based approach would include any headroom that exists in an acquirer's cash-generating units that are expected to contain the goodwill arising from the combination in the measurement of that goodwill. In effect, it would result in the recognition of the acquirer's internally generated intangible assets—including internally generated goodwill—and the fair value uplift relating to the acquirer's recognised net assets that would have been prohibited applying IFRS Standards.

On balance, we are more supportive of the following approaches:

(i) The acquisition method as described in IFRS 3, if there are enforceable clauses in laws, regulations or constitution documents that require the consideration paid for a business combination under common control to be an arm's length price. However, any bargain purchase gain should be recognised as contribution to equity instead.

(ii) The fair-value-based approach to other combinations, drawing reference from IFRS 3 that already requires the approach to be applied in determining the amount of goodwill in a business combination that is achieved without the transfer of consideration. Any excess of the fair value of the acquired business over the consideration paid should be recognised as contribution to equity, instead of a bargain purchase gain in profit or loss.

Other special requirements for the acquisition method

We have identified the following areas for which the IASB may need to consider developing potential special requirements:

Identification of an acquirer

IFRS 3 requires an acquirer to be identified in a business combination because the accounting for the assets and liabilities of the acquirer and the acquiree differs significantly. However, it may be difficult to determine the acquirer in a business combination under common control effected by exchanging equity interests, when it is not obvious that one of combining entities is significantly larger in size than the other(s). Contrary to the analysis in the DP, this may be the case, even if non-controlling shareholders have acquired an ownership interest in the economic resources transferred in the combination.

For example, applying the factors in paragraph B15(a)–(d) of IFRS 3 may not enable an entity to identify the acquirer in a way that results in useful information. Unlike business combinations involving external parties, it is the controlling party that retains the largest portion of the voting rights in the combined entity, and also the ability to appoint or remove a majority of the members of the governing body of the combined entity. Similarly, it is typically the management of the controlling party that dominates the management of the combined entity. Those observations would be true, even if the combination affects non-controlling shareholders.

Moreover, the factor in paragraph B15(e) of IFRS 3 may not help in identifying the acquirer when the consideration paid does not reflect an arm's length price, which is often determined independently of the relative fair value of the equity interests of the combining entities.

Therefore, the IASB may need to perform further work to determine whether and what additional guidance would have to be developed to facilitate consistent application of the requirement.

Remeasurement of previously held interest in the acquiree

If a business combination is achieved in stages, IFRS 3 requires an acquirer to measure its previously held equity interest in the acquiree at acquisition-date fair value. The rationale is that obtaining control in a business combination is a significant economic event that causes the cessation of an investor-investee relationship, and the beginning of a parent-subsidiary relationship that warrants the initial recognition and measurement of all the assets acquired and liabilities assumed in the business combination.

However, the remeasurement of previously held interest may no longer be conceptually supportable, when the consideration paid in a business combination under common control is not an arm's length price and the accounting does not reflect the going concern value, such as under the modified acquisition method as described in the IASB's preliminary view. This is because the acquirer does not obtain control of the acquired business in an arm's length transaction, and therefore, there is no compelling reason to account for the deemed consideration paid from derecognition of previously held interest as if it had been an arm's length price.

Besides, the mixed approach to determining the total consideration deemed to be paid would further diminish the usefulness of the reported amount of goodwill, while adding conceptual challenges to the recognition of contribution to equity for any shortfall of the total consideration deemed to be paid over the amount of identifiable assets and liabilities recognised.

Should the IASB confirm its preliminary view, it would have to consider how the above challenges can be overcome.

Business combinations under common control that are reverse acquisitions

The concept of 'control' determines both the 'receiving entity' in a business combination under common control and the 'acquirer' in a business combination covered by IFRS 3. IFRS 3 further specifies that an acquirer may be the legal acquiree in some business combinations, such as reverse acquisitions.

In view of the difficulty of identifying an acquirer in particular business combinations under common control, the IASB may not intend that the receiving entity is to be determined by applying the requirements for identifying an acquirer in IFRS 3. This means that a legal receiving entity that has non-controlling shareholders applies the acquisition method to a business combination under common control in accordance with the IASB's preliminary view. If the combination is determined to be a reverse acquisition (upon application of the acquisition method), the acquirer may instead be the transferred entity that did not have direct and indirect non-controlling shareholders immediately prior to the combination.

In effect, an acquirer that did not have direct and indirect non-controlling shareholders immediately prior to the combination may end up applying the acquisition method to a business combination under common control, which contradicts the thinking underlying the IASB's preliminary view. Moreover, this means that non-controlling shareholders of the receiving entity (i.e. accounting acquiree) would not receive the information provided by the acquisition method about the acquired business (i.e. accounting acquirer). Even if the accounting acquirer has direct non-controlling shareholders immediately prior to the combination, there would be little benefit from the information provided by the acquisition method about the receiving entity because those shareholders do not have any equity interest in the receiving entity. Therefore, it appears that there is little benefit from an application of the acquisition method to business combinations under common control that are reverse acquisitions (unless the accounting acquirer has indirect non-controlling shareholders immediately prior to the combination). In contrast, applying the acquisition method to business combinations covered by IFRS 3 that are reverse acquisitions would provide useful information about the legal acquirer to former owners of the accounting acquirer that now hold equity interests in the legal acquirer.

In order to avoid those issues, the accounting acquirer can be required to perform an additional assessment of whether it is permitted to apply the acquisition method, based on whether the transferring entity, which now holds equity interests in the receiving entity, have any direct or indirect non-controlling shareholders. However, it adds complexity to the accounting for business combinations under common control that are reverse acquisitions.

In addition, the acquisition method is not applied to certain business combinations under common control that are reverse acquisitions, for example, combinations in which the legal acquirer is a new entity, and potentially combinations in which the transferring entity has direct and/or indirect non-controlling shareholders. For such combinations, it is unclear what an appropriate accounting would be—for example, the requirements in paragraph 2(b) of IFRS 3, a book-value method, or another method of accounting.

Therefore, the IASB needs to perform further work to address the above issues.

Question 6: Applying a book-value method
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?

Approach to determining the book-value method

An analysis of how a receiving entity should apply a book-value method is likely to be linked to the view on when and why the receiving entity should apply that method.

A key reason for developing a book-value method is that the information needs of users of financial statements are different, when a business combination under common control does not affect non-controlling shareholders of the receiving entity. However, as a result of cost-benefit reasons, the IASB's preliminary view is that a book-value method may be applied to particular business combinations under common control for which users have information needs similar to business combinations covered by IFRS 3.

Accordingly, as a starting point, the book-value method should be developed based on the information needs relating to business combinations under common control that do not affect non-controlling shareholders of the receiving entity. Thereafter, consideration should be given to special requirements that are necessary to address specific issues arising from combinations that affect non-controlling shareholders of the receiving entity when the book-value method is applied under specified conditions.

Basis for measuring assets and liabilities received

In principle, we are supportive of measuring the assets and liabilities received using the transferred entity's book values, subject to adjustments to ensure conformity with the receiving entity's accounting policies for like transactions and events in similar circumstances.

In line with our comments to Question 2, we believe that the book-value method should be determined from the perspective of the receiving entity rather than the controlling party, with the objective of providing useful information to users that must rely on the receiving entity's financial statements.

From the perspective of potential shareholders, a measurement basis that uses the transferred entity's book values has the potential to treat the assets and liabilities of the combining entities on the same basis, and to avoid accounting outcomes that depend on how the combination is legally structured. Depending on which transferred entity's book values are used, the approach can produce an accounting outcome as if the combining entities had been combined since the inception of any organically grown business, or if the combining entities include any subsidiaries acquired by the receiving entity or transferred entity under business combinations covered by IFRS 3, since the acquisition date of those subsidiaries. It improves comparability between combined entities that were the subject of business combinations under common control and entities that had grown organically, and provides uninterrupted historical information about the transferred business that is useful in analysing trends. It also eliminates the need to identify an 'acquirer' in the combination, which may be difficult because of the presence of common control and can add complexity to the book-value method.

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The book-value method may require a measurement basis that uses the book values of the transferred entity that is directly transferred to the receiving entity. However, different accounting outcomes may result depending on how the combination is legally structured, if the combining entities include any subsidiaries that were previously acquired under a business combination covered by IFRS 3. In particular, the assets and liabilities of an externally acquired subsidiary of a parent transferred entity are measured at either its own book values or the parent's book values that included the effects of the acquisition method previously applied, depending on whether the subsidiary is transferred to the receiving entity directly or through the parent. In the former structure, the measurement basis also results in different accounting outcomes in comparison with the assets and liabilities of an externally acquired subsidiary of the receiving entity, which are measured at the receiving entity's book values that included the effects of the acquisition method previously applied.

In order to achieve structure neutrality, the measurement basis should use the parent transferred entity's book values, regardless of the legal structure of the combination. Applying that measurement basis, the receiving entity would include any goodwill recognised by the parent transferred entity for a prior business combination covered by IFRS 3. However, the synergies that made up that goodwill may be substantially replaced by new synergies from the current business combination under common control. That said, this is an existing issue associated with impairment testing of goodwill, including in situations when an entity performs reorganisation that changes the composition of its cash-generating units, which could affect the combined entity even if the combining entities had always been combined.

In contrast, a measurement basis that uses the controlling party's book values would not provide more useful information about the transferred entity to other users of the receiving entity's financial statements.

Firstly, measuring the assets and liabilities of the transferred entity as if the receiving entity had been the vehicle through which they were acquired by the controlling party would have little or no relevance to the combination of the receiving entity and the transferred entity, unless the transferred entity was acquired from external parties soon before and in anticipation of the combination.

Secondly, the amount of goodwill in the transferred entity recognised by the controlling party may include synergies beyond those expected from combining the receiving entity and the transferred entity, even after applying the requirements in IAS 36 *Impairment of Assets* for the reallocation of goodwill that is itself challenging as discussed in our comment letter to DP/2020/1. The receiving entity would not be able to separate and exclude those other synergies applying the impairment test due to the shielding effect of both the headroom that exists in the receiving entity's cash-generating units that contain the transferred entity, and the headroom that has built up in the transferred entity since its acquisition by the controlling party.

Besides, the controlling party does not necessarily prepare consolidated financial statements, such as when the controlling party comprises one or more individuals. Providing an exception to the measurement basis in such situations would reduce the understandability of information provided by the book-value method.

Additional considerations for the book-value method

We have identified the following aspects relating to the measurement of assets and liabilities received that may warrant further consideration:

(a) Unincorporated business

An unincorporated business typically does not prepare financial statements. When the transferred business is an unincorporated business, the receiving entity may have to measure the assets and liabilities in the transferred business using the transferring entity's book values instead, subject to adjustments to ensure conformity with the receiving entity's accounting policies for like transactions and events in similar circumstances.

Moreover, if the transferred business was previously acquired by the transferring entity in a business combination covered by IFRS 3, neither the controlling party nor the transferring party would have the pre-combination book values of the assets and liabilities in the transferred business.

Therefore, in applying the transferring entity's book values, the receiving entity would in effect account for the assets and liabilities in the transferred business, including the resulting goodwill, as if it had been the acquirer in that previous combination applying the acquisition method. As a result, the accounting outcome reported by the receiving entity would differ depending on whether the transferred business is an unincorporated or incorporated business.

(b) Non-availability of IFRS-compliant book values

The transferred entity may not prepare financial statements that comply with IFRS Standards.

In such cases, the IASB may consider paragraph D16(a) of IFRS 1 *First-time Adoption of International Financial Reporting Standards* as a starting point for further work to develop the measurement requirements for the assets and liabilities of the transferred entity. With some modification, the approach may enable the receiving entity to measure those assets and liabilities at the carrying amounts, based on the earliest date of transition to IFRS Standards by any intermediate parent of the transferred entity that are included in the consolidated financial statements containing those carrying amounts.

In contrast, there may be less merit in applying paragraph D16(b) of IFRS 1. The approach does not align well with the intended accounting outcome for business combinations under common control—for example, the use of fair values as deemed cost for the cost model applicable to specified assets. It also reduces comparability between combined entities, and between similar assets and liabilities within a combined entity, as a result of various exemptions provided by IFRS 1.

Specific issues relating to combinations affecting non-controlling shareholders of the receiving entity

We have not identified specific issues relating to the measurement of assets and liabilities received that may warrant further consideration.

Question 8: Applying a book-value method
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?

Measurement of consideration paid

Consideration paid in assets and by incurring or assuming liabilities

In principle, we are supportive of the IASB's preliminary view to measure the consideration paid in assets at the receiving entity's book values of those assets, and the consideration paid by incurring or assuming liabilities at the amount determined on initial recognition of those liabilities applying IFRS Standards.

A key benefit of a book-value method that uses the transferred entity's book values to measure the assets and liabilities received is that it can produce an accounting outcome as if the combining entities had been combined since the inception of any organically grown business, or if the combining entities include any subsidiaries acquired by the receiving entity or transferred entity under business combinations covered by IFRS 3, since the acquisition date of those subsidiaries.

In line with this accounting outcome, there is more merit in measuring the consideration paid at the receiving entity's book values of the assets given up and the liabilities incurred/assumed as determined in accordance with the applicable IFRS Standards, rather than the fair value of those assets and liabilities. If the combining entities had always been combined, the receiving entity would not have held those assets on which a gain or loss could be recognised, and it would have already recognised and measured those liabilities in accordance with the applicable IFRS Standards. Besides, the book-value method of accounting for business combinations under common control differs from asset purchases to which the notion of cost applies. Therefore, there is no compelling reason to align with an existing requirement in IFRS Standards to measure the cost of an asset acquired in an exchange for non-monetary asset generally using the fair value of the asset given up.

Moreover, measuring the assets and liabilities in the consideration paid at fair value would result in the receiving entity recognising an amount representing the difference between the fair value of consideration paid and the book values of assets and liabilities received. The

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mixed measurement basis is unlikely to provide more useful information about the economics of that difference, while increasing the cost of application. This is true, even if the combination affects non-controlling shareholders of the receiving entity that would ordinarily consider current values to be more useful for business combinations under common control.

We acknowledge that the IASB's preliminary view would result in different accounting outcomes depending on the structure of the transaction—specifically, whether the receiving entity transfers the assets as consideration paid for the combination, or sells the assets and uses the proceeds to pay for the consideration.

However, those transactions differ in terms of the economic effect to the controlling party. This is because the controlling party retains an ownership interest in the transferred assets after the former transaction, unlike the disposed assets in the latter transaction. Although we acknowledge that the analysis ought to focus on the information needs of non-controlling shareholders and potential shareholders of the receiving entity, that difference lends weight to the reasons supporting the different accounting outcomes.

That said, both transactions involve an exchange of value between the controlling party and the non-controlling shareholders. However, the book-value method is permitted to be applied to particular business combinations under common control that affect non-controlling shareholders of the receiving entity simply for cost-benefit reasons, and therefore, is designed to meet objectives that do not necessarily result in information reflecting the economics of that exchange of value.

On balance, we are less concerned about the opportunity for structuring than the potential for inherent tension within the book-value method that results in less useful and understandable information.

Consideration paid in own shares

We are supportive of the IASB's preliminary view to not prescribe how the receiving entity should measure the consideration paid in its own shares.

As mentioned in our above analysis, there is no compelling reason to measure the consideration paid at fair value.

Instead, consideration paid in own shares may be measured at an amount determined on initial recognition of those equity instruments applying IFRS Standards, which is consistent with consideration paid by incurring or assuming liabilities. However, IFRS Standards generally do not specify the measurement basis for equity instruments issued by an entity, other than at their fair value in limited particular transactions. Representing a residual interest, equity instruments issued generally follow the measurement applied to the asset received in the exchange for those instruments. If the amount of issued shares is affected by national requirements and regulations, any difference between that amount and the measure required to be reported in financial statements is generally recognised as a component of equity.

That said, in the case of business combinations under common control, there is an added interaction between the question of how to measure the consideration paid and the question of how to report any difference between that consideration paid and the book value of assets and liabilities received. If the receiving entity is to recognise that difference in equity, there is little benefit in prescribing the measurement basis for the consideration paid in own shares. This is because the different measurement bases simply affect the amounts reported within the receiving entity's equity, but not the amounts of assets, liabilities, income or expenses, and total equity of the receiving entity.

Reporting the difference between the consideration paid and the amount of assets and liabilities received

We are supportive of the IASB's preliminary view to require recognition within equity of any difference between the consideration paid and the book values of the assets and liabilities received, but not prescribe within which component of equity that difference should be presented.

In the case of business combinations under common control, the difference may include one or more of the following components: (1) the fair value uplift from assets and liabilities recognised; (2) unrecognised assets and liabilities, including the value of going concern in the transferred business and the synergies expected from the combination; and (3) any difference between the consideration paid and an arm's length price.

Separate accounting for those components would require the receiving entity to determine which components and the corresponding amounts to which the difference relates. Not only do the challenges of addressing off-market price as described in our comments to Question 5 apply to components (2) and (3), the accounting for component (1) also directly contradicts the IASB's preliminary view to measure the assets and liabilities received using the transferred entity's book values.

Instead, recognising the difference in its entirety within equity would better align with the view on when and why a book-value method should be applied. Specifically, a book-value method would be applied to business combinations under common control which might not be subject to any regulations applicable to related party transactions, and might therefore include a contribution to or distribution from the receiving entity's equity.

For items recognised outside the statement of comprehensive income, the component of equity within which such items are presented generally does not affect the information needs of non-controlling shareholders and potential shareholders. Indeed, IFRS Standards generally do not prescribe within which component of equity particular amounts should be presented. In practice, the presentation of equity components often depends on national laws, regulations or other requirements in particular jurisdictions, including any restriction on the payment of dividends and other capital distributions.

Additional considerations

Additional considerations for the book-value method

We have identified the following aspects relating to the components of equity that may warrant further consideration:

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(a) Non-controlling interests in transferred entity

In some business combinations under common control, shareholders other than the receiving entity continue to hold equity interests in the transferred entity after the combination, which the receiving entity recognises as non-controlling interests in the transferred entity.

The IASB may consider following measurement requirements for those non-controlling interests, in line with the principles underlying the book-value method using the transferred entity's book values:

(i) Non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the net assets: Such non-controlling interests are measured at the proportionate share in the book values of the assets and liabilities received.

(ii) Other non-controlling interests are measured using the transferred entity's book values.

(b) Business combinations achieved in stages

If a receiving entity obtains control of its joint venture or associate in a business combination under common control, it is unclear how the IASB's preliminary views on the book-value value method would interact with the accounting requirements in IAS 28 relating to discontinuation of the use of the equity method.

For example, IAS 28 specifies that when an entity discontinues the use of the equity method, the entity shall account for all amounts previously recognised in other comprehensive income on the same basis as if the investee had directly disposed of the related assets or liabilities. However, this requirement appears at odds with the principles underlying the book-value method using the transferred entity's book values, which is intended to reflect an accounting outcome as if the combining entities had always been combined.

Therefore, the IASB needs to consider potential interactions between the book-value method and other IFRS Standards arising from business combinations under common control that are achieved in stages.

Specific issues relating to combinations affecting non-controlling shareholders of the receiving entity

We have not identified any specific issues relating to the components of equity that may warrant further consideration, other than disclosures that are particularly useful to non-controlling shareholders as described in our comments to Question 12.

Question 9: Applying a book-value method
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 are supportive of the IASB's preliminary view that transaction costs should be recognised as an expense as incurred, except that the costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS Standards.

In the analysis, costs incurred in transferring a business should be distinguished from costs incurred in funding the transfer, which may or may not be incurred depending on how the transfer is funded.

Costs incurred in transferring a business are not part of the exchange between the buyer and seller for the business. Rather, those costs are separate transactions in which the buyer pays for the value of services received, regardless of whether the services are performed by external parties or internal staff of the buyer. Therefore, the IASB's basis for conclusions in relation to business combinations covered by IFRS 3 similarly applies, notwithstanding that the exchange between the buyer and seller for a business under common control may not reflect an arm's length price.

Even if the exchange does not reflect an arm's length's price, such costs are not transactions with owners of the receiving entity. The approach is consistent with the accounting outcome of the book-value method—such costs would not have been incurred if the combining entities had been combined since the inception of any organically grown business (or if the combining entities include any subsidiaries acquired by the receiving entity or transferred entity under business combinations covered by IFRS 3, since the acquisition date of those subsidiaries), and therefore, should be recognised as an expense to reflect a decrease in assets or an increase in liabilities that reduces equity of the combined entity. Moreover, there is little conceptual reason to align the accounting for transaction costs between the book-value method and the cost model because of their fundamental differences.

Costs incurred in funding the transfer, such as costs of issuing shares or debt instruments, are also separate from the exchange between the buyer and seller for the business. In particular, such costs are not necessarily incurred in business combinations under common control depending on how the funding is structured, but are incurred on all funding involving similar structure regardless of what transactions are funded. In order to account for similar costs incurred in similar funding structures in a similar way, the receiving entity should account for costs of issuing shares or debt instruments applying the applicable IFRS Standards.

Question 10: Applying a book-value method

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?

In our view, the IASB needs to conduct further work on the relative costs and benefits of applying the book-value method using either a retrospective approach or a modified retrospective approach for combinations in preparation for, or conditional on, an initial public offer, as discussed in our below comments.

Retrospective application with restatement of comparative information

An analysis of whether a receiving entity applying the book-value method should restate comparative information to present pre-combination information is linked to the view on when, why and how the receiving entity should apply that method.

As mentioned in our earlier comments, a key benefit of the book-value method based on the IASB's preliminary views as described in Questions 6–8 is that it can produce an accounting outcome as if the combining entities had been combined since the inception of any organically grown business, or if the combining entities include any subsidiaries acquired by the receiving entity or transferred entity under business combinations covered by IFRS 3, since the acquisition date of those subsidiaries.

In line with this accounting outcome, there is more conceptual merit in requiring retrospective application of the book-value method, with restatement of comparative information to present pre-combination information. Potential shareholders are the primary beneficiary of information about business combinations under common control that do not affect non-controlling shareholders. Potential shareholders would consider the restated comparative information to be useful in analysing trends for the combined entity over time, and against other entities that have grown organically. In particular, the pre-combination information reflects the effects of synergies on the historical financial performance of the combining entities under common control. That said, the information also captures the effects of synergies with other entities under common control that are not combined, which may affect any analysis to predict future net cash flows of the combined entity.

However, we acknowledge that there are issues associated with retrospective application that need to be addressed. For example:

(a) IFRS Standards generally do not require or permit comparative information to be restated for transactions that did not then exist. That said, consolidated financial statements, and financial statements in which the equity method is applied, are prepared from an economic entity's perspective. It follows that restatement of comparative information is not necessarily precluded, if such restatement would reflect the financial position, financial performance and cash flows of the economic entity. However, the same may not be true for the reporting of combinations involving unincorporated business in separate financial statements. Separate financial statements are prepared

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from a legal entity's perspective[2], and often pursuant to national laws and regulations for purposes such as the payment of dividends and other capital distributions. Therefore, restatement of comparative information for a business that did not then exist not only is conceptually problematic, but may have implications arising from an interaction with national laws and regulations.

(b) In some circumstances, retrospective application can be difficult with significant costs and efforts involved, or even impracticable. For example:

(i) Alignment of accounting policies: The transferred entities had been acquired under business combinations covered by IFRS 3, and adjustments were made at the group level to align the accounting policies for their assets and liabilities to which the acquisition method had been applied. Those adjustments cannot be readily used in measuring the assets and liabilities received at the transferred entities' book values.

(ii) Non-controlling interests in transferred entities: It is unclear how non-controlling interests in a transferred entity ought to be determined prior to the combination—for example, on inception of the transferred entity, during any period up to the date the transferred entity came under the control of the controlling party, and on occurrence of changes to the proportion of equity held by non-controlling interests. The approach to determining non-controlling interests affects the amount of previously recognised other comprehensive income relating to the assets and liabilities received that was attributed to non-controlling interests and that will be subsequently reclassified to profit or loss when specific conditions are met. That amount in turn affects the attribution of profit or loss between non-controlling interests and owners of the receiving entity when that reclassification occurs. An approach may be to determine non-controlling interests based on the relative shareholdings of any parent and other shareholders of the transferred entity at each relevant point in time. However, this approach requires the combined entity to track and account for any changes to the relative shareholdings, which is likely to result in costs that outweigh the benefits in some cases. An alternative approach is to determine non-controlling interests as if the relative shareholdings of the receiving entity and other shareholders of the transferred entity immediately after the combination had been in place since the inception of the transferred entity. However, this approach may not align well with the concept of retrospective application, particularly if there were prior changes to the relative shareholdings of the transferring entity and other shareholders of the transferred entity.

(iii) Unrealised gain or loss arising from transactions between combining entities: The combining entities have to trace such transactions, and determine the adjustments to the book values of assets, liabilities and equity components. Those transactions may affect long-life assets and liabilities that continue to affect the combined

[2] For example, the accounting for investments in and dividends from subsidiaries, associates and joint ventures focuses on the performance of those investees as investments, rather than those investees as being part of the reporting entity. Although IAS 27 was amended to permit such investees to be accounted for using the equity method in separate financial statements, that amendment was intended to reduce compliance costs without a loss of information, rather than to refute the view that such investees are the reporting entity's investments.

entity's profit or loss years after the combination. The transactions may have occurred many years ago before the combining entities came under common control, and therefore, may not be recorded by the controlling party for the purpose of determining the consolidation adjustments.

(c) The combining entities may have to keep multiple sets of financial records for the purpose of preparing entity-level financial statements, and determining the adjustments separately for the book-value method applied by the receiving entity and the acquisition method applied by the controlling party.

Moreover, retrospective application may have limited benefits in reality. Unless a receiving entity enters into a combination in preparation for or conditional on an initial public offer, most privately held receiving entities that are wholly owned by the controlling party do not expect to have new non-controlling shareholders in normal circumstances. It weakens any argument supporting retrospective application of the book-value method to meet the information needs of potential shareholders.

On the whole, the costs of retrospective application may not outweigh the resulting benefits in most circumstances.

Prospective application

Prospective application of the book-value method from the date of the combination is simple to apply, and can avoid many of the issues associated with retrospective application.

However, prospective application provides pre-combination information for the receiving entity only, and therefore, would result in different pre-combination information depending on how the combination is legally structured.

Moreover, prospective application results in accounting outcomes that are different from what the combined entity would have reported if the combining entities had always been combined, which may result in a loss of useful information in future periods. For example, the transferred entity may have recognised prior to the combination items of income or expense in other comprehensive income relating to the assets and liabilities received, but the combined entity does not subsequently reclassify those equity components to profit or loss on derecognition of the related assets and liabilities. In addition, the combining entities may have transactions with one another that resulted in gains and losses that were unrealised at the date of the combination, but the combined entity does not eliminate the unrealised gain or loss, which in turn affects the reporting of financial performance after the combination.

On balance, we can accept prospective application from the date of the combination on cost-benefit grounds for combinations other than those in preparation for, or conditional on, an initial public offer, subject to additional disclosures as described in our comments on Question 12.

<u>Exception for combinations in preparation for, or conditional on, an initial public offer</u>

When an entity enters into a business combination under common control in preparation for or conditional on an initial public offer, information about the combination is provided primarily for the benefit of potential shareholders to decide whether they would subscribe to the initial public offer for an ownership interest in the combined entity.

National listing requirements often place an emphasis on the track record of an issuer, for example, in the listing criteria and the information required to be presented in the offering documents. Those requirements may specify that the historical financial information for the track record period must include all combining entities under common control—this is the case even for periods before the combination date as long as the combining entities are controlled by the same party.

IFRS Standards contain more stringent requirements for entities that file, or are in the process of filing, financial statements with a securities commission or other regulatory organisation for the purpose of issuing instruments in a public market. Arguably, an entity that meets the condition are held to higher standards of accountability to protect a broad group of potential shareholders who must rely on financial statements for most of their information needs.

For similar reason, the IASB should consider the following approaches to applying the book-value method to combinations in preparation for, or conditional on, an initial public offer:

(a) Retrospectively

The approach most aligns with the view on when, why and how a book-value method should be applied. The information that potential shareholders need to analyse trends over time and against other entities may justify retrospective application, if stakeholders' feedback indicates that the difficulty of retrospective application can be overcome with targeted reliefs.

(b) Retrospectively to each transferred entity as if the transfer had occurred at the date of control by the controlling party

The approach would avoid the presentation issue relating to pre-combination information that depends on the legal structure of the combination, if all combining entities had come under common control before the beginning of the earliest period presented. It would also avoid the issue of the combined entity continuing to report the effects of unrealised gain or loss arising from transactions between the combining entities after the combination.

Importantly, the approach would provide useful information about the historical financial performance of the combining entities under common control as described under the retrospective application approach, albeit without the effects of subsequent reclassification of items of other comprehensive income that each transferred entity had recognised before the date that entity came under common control.

However, the approach appears at odds with the view that the assets and liabilities received should not be measured at the controlling party's book values. Moreover, the earlier the date of control by the controlling party, the more difficult the restatement can be, with similar issues associated with retrospective application.

(c) Retrospectively to each transferred entity as if the transfer had occurred at the later of (b) and the beginning of the earliest period presented

The approach enjoys the key benefits of (b), such as providing useful information about the historical financial performance and avoiding the presentation issue relating to pre-combination information if all combining entities had come under common control before the beginning of the earliest period presented, while avoiding undue costs and efforts of restatement. It also has the potential to accommodate national listing requirements specifying the inclusion of all combining entities under common control in the historical financial information for the track record period.

However, there would be more pronounced effects arising from the issues associated with prospective application from the date of the combination, such as the absence of subsequent reclassification of items of other comprehensive income and the effects of unrealised gain or loss arising from transactions between the combining entities.

Accordingly, the IASB needs to conduct further work on the various approaches including their relative costs and benefits, with the aim of identifying an approach that achieves a better cost-benefit balance for combinations in preparation for, or conditional on, an initial public offer.

Question 11: Disclosure requirements

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 are generally supportive of the IASB's preliminary views.

An analysis of what disclosures are useful for the acquisition method is linked to the view on when, why, and importantly, how that method is to be applied to business combinations under common control that affect non-controlling shareholders of the receiving entity.

As mentioned in our earlier comments, such combinations result in an exchange of value between the non-controlling shareholders and the controlling party in relation to the economic resources of the transferred entity. Consequently, the acquisition method is expected to provide useful information about such combinations to non-controlling shareholders, as it does for business combinations covered by IFRS 3. Following this analysis, the disclosure requirements in IFRS 3, including any improvements resulting from DP/2020/1 (collectively, referred to as IFRS 3 disclosures), can similarly result in information about such combinations that is useful to non-controlling shareholders.

In addition, there is no compelling reason to exclude any of IFRS 3 disclosures being applied to business combinations under common control when the acquisition method is used, other than disclosures relating to bargain purchase gain.

That said, a key factor that differentiates such combinations from business combinations covered by IFRS 3 is that the consideration paid may differ from an arm's length price that would have been negotiated between unrelated parties.

Therefore, non-controlling shareholders are likely to view information about the terms of the combination, including how the consideration paid has been determined, as being particularly useful.

Moreover, non-controlling shareholders are likely to be interested in assessing whether the price paid for the combination either had been reasonable, or had included an element of distribution from or contribution to equity that in effect represented a transfer of wealth between them and the controlling party. The improved disclosures as described in DP/2020/1, such as information about expected synergies, would have been more useful for the assessment, if the issues arising from an off-market price were addressed using the fair-value-based approach instead of the approach as described in the IASB's preliminary views. In particular, non-controlling shareholders are better able to assess whether any consideration paid in excess of the fair value of the acquired business is reasonable based on the disclosures about expected synergies and other factors that make up that excess.

An additional disclosure that the IASB may consider requiring is the significant judgements made in identifying the acquirer when the combination is effected primarily by exchanging equity interests.

Question 12: Disclosure requirements
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 are supportive of the IASB's approach to developing disclosures requirements for the book-value method as described in the DP by: (1) using IFRS 3 disclosures that are applicable to the method, while excluding IFRS 3 disclosures that are incompatible with the method; and (2) identifying other disclosure requirements that are specific to business combinations under common control to which the method applies.

In determining what disclosure requirements are appropriate, the views on when, why and how the book-value method is applied affect the nature and extent of the information necessary to meet common user information needs, and also whether the benefits of disclosing particular information outweigh the associated costs.

IFRS 3 disclosures

In principle, we agree with the IASB's preliminary view that the requirement in IFRS 3, and the related possible requirement discussed in DP/2020/1, for entities to provide information to help users evaluate the nature and financial effect of the combination, and understand the benefits expected from the combination, respectively, are appropriate for business combinations under common control.

Accordingly, we are supportive of requiring the receiving entity to provide those IFRS 3 disclosures listed in paragraph 5.19 of the DP for any business combination under common control to which the book-value method is applied. Those disclosures would provide information about the nature of the combination, and the financial effect of the combination as if the combining entities had been combined since the inception of any organically grown business, or if the combining entities include any subsidiaries acquired by the receiving entity or transferred entity under business combinations covered by IFRS 3, since the acquisition date of those subsidiaries.

Moreover, we agree with the IASB's analysis that the receiving entity should not be required to provide those IFRS 3 disclosures listed in Table 5.1 in the DP, with the exception of pro forma information. In particular, those disclosures: (1) are incompatible with the views on when, why and how the book-value method is applied (e.g. information about goodwill and bargain purchase gain, expected synergies and other benefits from the combination, and subsequent performance of the acquired business against acquisition-date expectations); or (2) do not result in benefits that justify the associated costs (e.g. fair value information of the assets and liabilities received and the consideration paid).

As the IASB performs work on the remaining aspects of the book-value method that are yet to be discussed in the DP, there is a need to consider the associated disclosure requirements, including which IFRS 3 disclosures would be appropriate or what other new disclosure requirements would be necessary.

Pre-combination information

The IASB should consider requiring IFRS 3 disclosures relating to pro forma information as if the combination had occurred at the beginning of the reporting period.

A key benefit of the book-value method is to provide information that is useful in analysing trends for the combined entity over time, and against other entities that have grown organically. The pro forma information of the combined entity can facilitate the analysis, when it is used together with pre-combination information of each of the combining entities in the prior periods and post-combination information of the combined entity in the future periods. Requiring disclosure of specific measures on a pro forma basis that is limited to the beginning of the current period may be justified on cost-benefit grounds.

<u>Additional disclosures for combinations in preparation for, or conditional on, an initial public offer</u>

As mentioned in our comments to Question 10, national listing requirements often place an emphasis on the track record of an issuer, including the provision of historical financial information for the track record period. Such information is particularly useful, if it reflects the effects of synergies amongst the combining entities under common control.

Should the IASB confirm its preliminary view to apply the book-value method prospectively from the date of the combination for such combinations, the combined entity should be permitted to disclose, in the notes to its financial statements, pre-combination information for the track record period determined in accordance with national listing requirements. Such information would provide a basis for potential shareholders to assess future financial performance and cash flows of the combined entity, and decide whether to subscribe to the initial public offer.

Difference between the consideration paid and the book values of assets and liabilities received

We are supportive of providing disclosures about the consideration paid, the amount recognised in equity for any difference between the consideration paid and the book values of assets and liabilities received, and the component of equity that includes the difference. Together with specific IFRS 3 disclosures, those disclosures would provide information about the financial effect of the combination as if the combining entities had been combined since the inception of any organically grown business, or if the combining entities include any subsidiaries acquired by the receiving entity or transferred entity under business combinations covered by IFRS 3, since the acquisition date of those subsidiaries.

The disclosures may be particularly useful to non-controlling shareholders of the receiving entity in business combinations under common control that affect non-controlling shareholders to which the book-value method is applied. In such combinations, that difference may include an amount representing a transfer of wealth between the non-controlling shareholders and the controlling party. The disclosure of the consideration paid, and the recognised amounts of each major class of assets received and liabilities assumed, may help non-controlling shareholders to develop their own estimates of the effects of any transfer of wealth.

Other matters related to disclosure requirements

Similar to the disclosures for business combinations under common control when the acquisition method is applied, there is merit in providing application guidance on how to apply the disclosure requirements in IAS 24 when providing information about these combinations, particularly information about the terms of the combination such as how the consideration paid has been determined.

We hope that our comments will contribute to the IASB's deliberation on the DP. Should you require any further clarification, please contact our project manager Yat Hwa Guan at Guan_Yat_Hwa@asc.gov.sg.

Yours faithfully

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Technical Director
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