

26 April 2012

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Dear Sir/Madam

**SAICA SUBMISSION ON THE EUROPEAN FINANCIAL REPORTING  
ADVISORY GROUP (EFRAG) AND ORGANISMO ITALIANO DI  
CONTABILITÀ (OIC) DISCUSSION PAPER ON ACCOUNTING FOR  
BUSINESS COMBINATIONS UNDER COMMON CONTROL**

In response to your request for comments on the EFRAG and OIC's Discussion Paper on *Accounting for Business Combinations under Common Control*, attached is the comment letter prepared by Accounting Practices Committee (APC) of The South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of the APC, which comprises members from reporting organisations, regulators, auditors, IFRS specialists and academics.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

**Sue Ludolph**  
**Project Director – Financial Reporting**

cc: Paul O'Flaherty (Chairman of the Accounting Practices Committee)

# **SAICA SUBMISSION ON THE EFRAG's DISCUSSION PAPER ON ACCOUNTING FOR BUSINESS COMBINATIONS UNDER COMMON CONTROL**

## **GENERAL COMMENTS**

We commend the EFRAG and the OIC for publishing this discussion paper that addresses the accounting for Business Combinations under Common Control (BCUCC) and to deal with the inconsistencies in practice in accounting for these transactions. This concern was raised as an issue by our preparers and we included this in our response to the IASB on the Agenda Consultation.

## **SPECIFIC COMMENTS**

### **Question 1.1 – Concerns about BCUCC transactions**

*Chapter 1 refers to concerns expressed by the European Commission and others regarding the diversity in accounting practice that exists in relation to BCUCC because of the scope exemption in IFRS 3. BCUCC raise a number of significant financial reporting issues that needs to be addressed in the IFRS literature. This diversity in practice is evidenced by recent submissions to the IFRS Interpretations Committee and the significant amount of guidance produced by accounting firms (e.g. Deloitte 2010, Ernst & Young 2010, KPMG 2010, PricewaterhouseCoopers 2010). Do you think that the concerns have been accurately described in relation to the issues arising from accounting for BCUCC transactions? If not, please could you suggest other significant concerns that have not been addressed?*

Yes, we believe that the concerns in relation to the accounting for BCUCC transactions have been accurately described in the discussion paper.

### **Question 1.2 – The approaches in practice**

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

*In your experience, what approaches are typically applied by preparers in practice for BCUCC transactions and what justification is provided to support their application of these approaches?*

The majority of the preparers in our jurisdiction typically apply the predecessor accounting to BCUCC transactions. The motivations provided for adopting this accounting approach include:

- A lack of evidence to demonstrate that the BCUCC transaction has been concluded at fair value;
- BCUCC transactions are often entered into to facilitate group reorganisations and therefore there is less of a need to meet external reporting requirements; and
- It is often seen to be more cost effective and it is easier to apply in most instances, as fair value determination is not required.

Our constituents believe that there may be instances where fair value may be appropriate, for example:

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- When the entity will be subject to a spin off or Initial Public Offer after the BCUCC;
- The entity has significant non-controlling shareholders; and
- The transaction is performed for a specific purpose, for example, in South Africa many BCUCC are performed just before a black economic empowerment, as defined in the Broad-based Black Economic Empowerment Act No.53 of 2003, transaction.

Whilst fair value may be appropriate in such circumstances, we are not convinced IFRS 3 would be the appropriate method.

### **Question 2.1 – The scope of the project**

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

*Are there any issues not included in the scope of the DP that, in your view, need to be addressed in developing an approach to accounting for BCUCC in the consolidated financial statements of the transferee?*

In developing an appropriate accounting approach for BCUCC transactions, we request that consideration be given to exploring the different types of predecessor accounting methods that are being applied in practice. Whilst predecessor accounting is generally applied, the application of BCUCC is not always consistent. An example is the application date for a BCUCC. If the Group's year end is June and a BCUCC takes place on 1 October, would the transaction be accounted from this date or would the prior year need to be restated so as to assume the entity had always existed in this form.

Whilst certain BCUCC do exist on consolidation, these are few and the majority of the BCUCC occur in the separate or individual financial statements, where businesses are transferred from one subsidiary to another. This has been addressed further under question 2.2 below.

We note that the discussion paper focuses solely on the accounting of the BCUCC transaction by the transferee in the consolidated financial statements. A minority of the constituents felt that whilst IFRS addresses accounting in the transferor's financial statements, it would be worth examining whether current accounting of BCUCC transactions in the financial statements of the transferor is still appropriate, but this consideration should not cause unnecessary delays in this project.

### **Question 2.2 – Separate and individual financial statements of the transferee**

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

*There are a number of questions that relate to separate and individual financial statements. For instance, it may be questioned whether information needs of users of separate and individual financial statements differ from those of consolidated*

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*financial statements and whether those different user needs justify different accounting at initial recognition and measurement.*

*Do you believe that there are any specific issues to be addressed in the initial recognition and measurement of BCUCC in the separate and individual financial statements? If so, please explain what those issues are and how they should be addressed?*

Whilst we understand the rationale for the issues relating to the initial recognition and measurement in the separate financial statements to be dealt with as a separate EFRAG proactive project, we believe the principle applied should be consistent. Whether the purchase of the business relates to an acquisition of equity instruments or purchase of assets and liabilities of an entity, the principle applied in the separate or individual financial statements should effectively be the same as applied to the consolidated financial statements.

### **Question 2.3 – Disclosures**

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

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

We believe it is appropriate to provide disclosure for BCUCC and information provided should be specific and useful so as to not burden the preparer of financial statements, whilst still providing decision useful information.

In terms of BCUCC we believe the disclosure of the group relationship, objective of the transactions and the details of the assets and liabilities as well as the consideration payable should be provided.

### **Question 3.1 – Addressing the information needs of primary users**

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

*Do you agree that an important step is to understand the information needs of users in the financial reporting of a BCUCC transaction? If not, how else would you set out an approach that satisfies the objective of financial reporting?*

We do not agree with the proposed approach with respect to the consideration of the users. Our main concern is the subjectivity involved in determining who the users of the financial statements are. We would propose classifying such transactions between those that arise from internal group reorganisations and those that arise from other transactions as noted above in our response to 1.2. In considering the substance of the

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transaction, this will naturally meet the user's requirements for decision useful information.

### **Question 3.2 – The transferee is a reporting entity**

*The analysis in the DP looks at financial reporting from the perspective of the transferee consistent with the entity perspective. It also assumes that the transferee is a reporting entity. It is noted above that the analysis in this DP is taken from the perspective of the transferee (entity perspective) as opposed to the perspective of the owners (proprietary perspective).*

*Do you agree that, to be consistent with existing IFRS, the entity perspective should be dominant when considering BCUCC? If not, why not?*

We agree that the transferee is a reporting entity. We did however not fully understand the intention or what the intention of this question was.

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

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

- a) is consistent with the Conceptual Framework, particularly with the objective of financial reporting; and*
- b) achieves consistency with other parts of the existing IFRS literature, which deal with measurement.*

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

*Do you agree with applying the 'logic' of the IAS 8 hierarchy in developing an approach to accounting for BCUCC transactions? If not, what alternative would you propose and how would you reconcile that approach with existing IFRS?*

We acknowledge that the IAS 8 hierarchy provides a sound basis for developing an accounting approach for BCUCC transactions that are currently scoped out of IFRS 3. The DP seems to then infer that IFRS 3 is appropriate. We believe an accounting standard should be developed which deals with BCUCC and we believe the standard should consider the substance of the transaction (i.e. internal group reorganisation or other transaction). Currently, the guidance under United States Generally Accepted Accounting Principles (US GAAP) and Generally Accepted Accounting Practice in the United Kingdom (UK GAAP) is followed for BCUCC. But again as the guidance is not very detailed, inconsistent application of predecessor accounting does occur.

### **Questions 3.4 and 3.5 – Initial recognition and measurement**

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

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

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*financial information that is relevant and a faithful representation of the underlying BCUCC.*

*Do you agree that if and when an analogy to IFRS 3 is considered to apply, it is appropriate to assume that fair value at initial recognition provides information that is more decision-useful than values based on previously recognised amounts or any other measurement attribute? If not, please explain why?*

IFRS 3 has been applied in limited circumstances in South Africa. Generally preparers would consider the least cost and effort in the preparation whilst still providing decision useful information. Some constituents believe IFRS 3 should never be applied to BCUCC as economically these transactions are never at arm's length and have very different purposes. Refer to the example on page 13 and 14 demonstrating when accounting under IFRS 3 may be appropriate and when not.

*Do you agree that if the analogy to IFRS 3 does not apply, defining an appropriate measurement attribute should be guided by an analysis of the information needs of users? If not, why not?*

As noted above, we believe if the substance of the transaction was considered and the accounting is therefore determined by the substance, the needs of the users would naturally be met.

### **Questions 4.1 and 4.2 – The unique features of a BCUCC transaction**

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

- a) purpose of the transaction: the purpose of the transaction does not alter its economic substance; however, it can play a significant role in selecting a measurement attribute to apply to the BCUCC at initial measurement that results in decision-useful information for users of the transferee consolidated financial statements.*
- b) the absence of the market conditions: the lack of a market-based transaction challenges the assumption in IFRS 3 that the transaction price is deemed to represent fair value; and*
- c) nature of the consideration: it does not alter the economic substance of the BCUCC transaction. The nature of the consideration could in some circumstances have no effect on previous decisions taken regarding the entity's prospects for generating future cash flows (e.g. in a share-for-share exchange).*

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

We agree with the main features of BCUCC identified above.

*It is noted above that BCUCC can be substantially different in nature from business combinations between unrelated parties. Do you agree that a BCUCC can be different to a business combination under IFRS 3? If so, describe examples you have encountered in practice that verifies this. If not, please explain why?*

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We agree that BCUCC are substantially different in nature from business combinations. For example, in many instances the purchase consideration for BCUCC is the net carrying value of the business (i.e. net asset value). Clearly, neither the consideration nor the assets are at fair value and it would seem unusual to then apply IFRS 3 in such transaction. The economic rationale for a BCUCC is substantially different to that of a business combination.

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

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

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

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

Similar to our response to question 3.1 above, we do not agree with the proposed approach which seeks to develop an accounting approach only on the basis of the information needs of the users of the financial statements.

### **Questions 4.4 and 4.5 – Identification of an acquirer**

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

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

**View B:** *an acquirer can always be identified. However, the ultimate parent entity can select the accounting acquirer and direct an entity to acquire a business within the ultimate reporting entity group with an objective to achieve an optimal accounting outcome that does not represent a neutral depiction. According to the Conceptual Framework (QC14), “A neutral depiction is without bias in the selection or presentation of financial information. A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users”. It could be viewed that this problem arises due to the asymmetry in accounting that result from applying the measurement principle in IFRS 3.*

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*Do you think that with BCUCC it may be difficult in some circumstances to identify an acquirer (View A) or do you believe that an acquirer can always be identified (View B)? If you believe that an acquirer can always be identified in a BCUCC, do you think that an analogy to IFRS 3 is not valid because the ultimate parent entity can direct the identification of an acquirer so that the accounting outcome is not a faithful representation of the underlying BCUCC transaction?*

As we do not believe that IFRS 3 is the guidance that should be applied in accounting for BCUCC transactions, we therefore do not support either of the views noted above.

### **Question 4.6 – Obtaining control over one or more businesses**

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

*This principle could be considered to be flawed for a BCUCC because the current ability to direct the relevant activities (i.e. the power element of the control definition in IFRS 10 of the acquired/transferred business is retained before and after the BCUCC by the ultimate reporting entity. In other words, the ability to control the transferred does not change. However, this line of reasoning may be inconsistent with the control notion in IFRS 10, which defines control from the perspective of the separate reporting entity and not the ultimate reporting entity.*

*Do you agree with the analysis above that under IFRS 10 ‘control’ should be assessed from the perspective of the reporting entity and not from that of the ultimate parent entity? If not, why not?*

We agree that for consolidation purposes it is relevant to apply IFRS 10 and therefore control should be assessed from the perspective of the reporting entity.

However, often in group reorganisations, associates and joint ventures are also transferred. In developing a new accounting guidance, it should be clarified if such transactions are included.

### **Question 4.7 – Acquisition of a business**

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

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

We agree that BCUCC should be defined as a business, as contemplated in IFRS 3 and this has been applied consistently in practice.

### **Questions 4.8 and 4.9 – Applying the ‘mechanics’ of IFRS 3 – the recognition and measurement principle**

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

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

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

*An important principle in IFRS is that similar transactions should be accounted for in a similar way. A possible view was stated that the three building blocks could equally apply to BCUCC. Accordingly, there is a view that it is difficult to justify not applying the IFRS 3 measurement principle to the extent that an IFRS 3 accounting outcome is relevant to the users of the financial statements of the acquirer. The unique characteristics of a BCUCC do not invalidate the analogy to IFRS 3 but it could lead to some assets not being recognised due to the absence of a market-based transaction. Do you think the absence of a market-based transaction can have consequences when applying the recognition principle in IFRS 3 because of a lack of measurement reliability? If so, do you agree with the analysis? If not, why not?*

As noted above, we do not believe IFRS 3 is appropriate. Our reasons relate mostly to determining the purchase consideration at fair value as required under IFRS 3. Certain constituents felt IFRS 3 could be applied in certain instances, but these were limited.

*Do you think it is appropriate to apply the measurement principle in IFRS 3 to BCUCC when the analogy to IFRS 3 is valid? If not, why not?*

As noted above, in most instances the substance of the transaction should be determined and in most instances IFRS 3 would not be appropriate.

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

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

*There are three variants to consider:*

**Variant one:** *The recognition and measurement principle in IFRS 3 should equally apply to BCUCC. There is no justification to apply different recognition and measurement principles because, the fair value of the business acquired can be reliably measured on the basis of Level 3 inputs and it does not undermine the reliability of measurement. However, if the transaction price is not subject to market forces it may be difficult to determine its fair value. In such cases the consideration transferred should be referenced against the fair value of the business acquired. Similarly, where the transaction price is greater than fair value of the business acquired, it should be bifurcated into 1) a distribution to the ultimate parent entity and 2) the consideration transferred being measured at the fair value of the business acquired.*

**Variant two:** *Goodwill should not be recognised in the balance sheet of the transferee. This is justified on the basis that goodwill cannot be faithfully represented due to the absence of a market-based transaction. Under this approach, the*

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*consideration transferred would not be referenced against the fair value of the business acquired. As the transaction is not a proxy for the fair value of the business acquired then it is possible that the transaction price could either be greater or less than the fair value of the acquired net identifiable assets.*

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

*Do you believe that the transaction price should be referenced against the fair value of the business acquired and bifurcated (when the transaction price exceeds the fair value of the business acquired) if the transaction price does not reflect a proxy for fair value? This ensures the BCUCC transaction reflects two transactions: a) a contribution from (distribution to) the ultimate parent entity, and b) a business combination.*

*Do you believe that goodwill and/or identifiable intangible assets should not be recognised in the balance sheet of the acquirer on the basis that they cannot be reliably measured?*

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

*Do you believe that where the consideration transferred is lower than the fair value of the net assets acquired, the difference should reflect a contribution from the ultimate parent entity or recognised as income?*

We do not agree that IFRS 3 should always be applied by analogy to BCUCC transactions. The substance of the transaction needs to be considered before using IFRS 3 for BCUCC.

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

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

*Two accounting treatments could be applied under these unique circumstances: 'fresh start' accounting and a predecessor basis of accounting. The selection of an accounting treatment is dependent upon who the users are and their information*

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*needs. That is 'fresh start accounting' could apply where users deem that the assessment of the prospects of future net cash inflows is best reflected through fair value measurement. A predecessor basis of accounting could be applied when the information needs of users are best served through a historical trend analysis of the income and cash flow statements and the statement of financial position.*

*Where the analogy to IFRS 3 is not applicable then the BCUCC could be characterised as the 'transfer' of a business rather than the acquisition of a business. Do you think that the BCUCC should be viewed as a 'transfer' of a business rather than an acquisition of a business when the analogy to IFRS 3 can never be applied?*

*Do you believe that all the arguments and views presented are valid when it is not appropriate to apply an analogy to IFRS 3?*

A minority of the participants believe that IFRS 3 should never be applied by analogy to BCUCC transactions. In their view, fresh start accounting would be the preferred approach in situations where the substance was not that of a group reorganisation. The majority view was that the substance of the transaction should be considered as a method for determining an appropriate approach and there may well be instances when IFRS 3 is appropriate.

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

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

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

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

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

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

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

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

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

*Do you believe that the diversity in the information needs of users when compared to a business combination and the cost constraint in financial reporting provide justification to consider whether or not the recognition and measurement principle in IFRS 3 are appropriate when accounting for BCUCC?*

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

As noted above we believe there may be instances where IFRS 3 is appropriate, but generally either fresh start accounting or predecessor accounting are the preferred options. In determining the approach, we believe:

- A distinction should be made between group reorganisations and other transactions.
- Predecessor accounting is the preferred approach for the majority of BCUCC transactions, as the majority are group reorganisations.
- Fresh start accounting could be considered appropriate in some instances, for example setting up a newly formed entity to list the business.

### **OTHER COMMENTS**

In setting out our concerns about using IFRS 3 we prepared the following example.

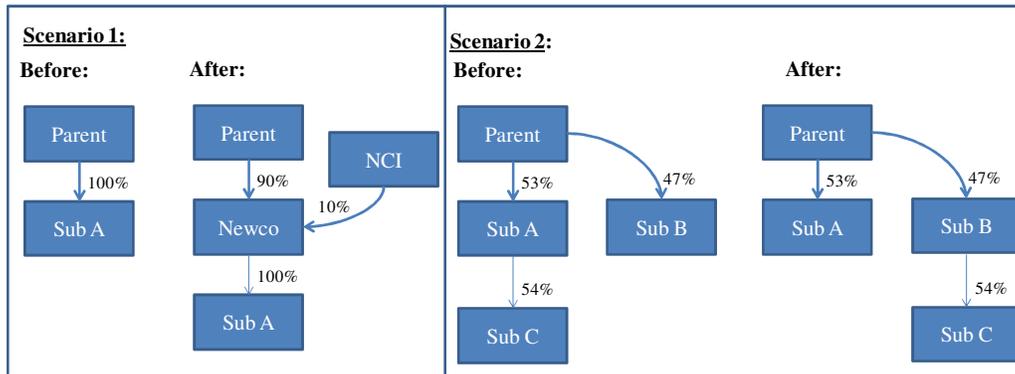
In scenario 1, Parent sets up Newco and transfers a direct subsidiary, Sub A from Parent to Newco. Newco prepares consolidated financial statements. The rationale of the transaction was purely for tax reasons. The purchase consideration was the net asset value of Sub A.

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In scenario 2, both the Parent entity and Sub A are listed entities. Due to the size and nature of the transaction, a fair value exercise was performed to ensure that none of the shareholders were in anyway prejudiced due to the transaction.

**Scenario 1**

**Scenario 2**



In the above scenarios if IFRS 3 would be applied the following would need to be performed:

Determining the acquirer:

*Scenario 1:*

The acquirer would be extremely difficult to determine as the transaction essentially has no substance and therefore it may result in Sub A being the acquired as opposed to Newco. From a user's perspective, this would not provide decision useful information to the non-controlling interest (NCI).

*Scenario 2:*

The acquirer can be identified to be Sub B Due to the minorities involved, the transaction has substance and will most likely be negotiated at a market value especially in light of the requirements of ensuring that all shareholders are treated fairly.

Determining the fair value of the purchase consideration:

*Scenario 1:*

A detailed fair value would need to be determined if it could be demonstrated that Newco is the acquirer. This would not provide decision useful information to the Parent or the Tax authorities.

*Scenario 2:*

Due to the minorities involved, the transaction will most likely be negotiated at a market value especially in light of the requirements of ensuring that all shareholders are treated fairly. Determining the fair value of assets and liabilities:

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*Scenario 1:*

Accounting for the assets and liabilities at different values and raising assets which would not normally be raised, for example, brand names and other intangible assets, is counterintuitive to the requirements of IFRS. In some instances this could be misleading. For example, the transaction was performed to recognise a brand name to obtain a tax deduction. This may then result in tax avoidance.

*Scenario 2:*

Accounting for the assets and liabilities of Sub C at fair value could be seen as providing decision useful information for sub-group A. However, from Parent's perspective, all fair value information will be eliminated.

Conclusion:

These are merely some of the issues noted but several more may be applicable. These examples illustrate that IFRS 3 might be more relevant in certain circumstances, i.e. where transactions are completed on a more arm's length basis. However, where the transaction is merely a group reorganisation, applying the principles of IFRS 3 results in information that is not useful.

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