BUSINESSEUROPE

International Accounting Standards
Board (IASB)
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1 September 2021

Dear Board Member,

Re: Discussion Paper on Business Combinations under Common Control

BUSINESSEUROPE is pleased to have the opportunity to respond to the IASB Discussion Paper on *Business Combinations under Common Control* (the `DP'). We agree with the Board's approach to cover all business combinations under common control on the basis that the "gap" currently existing in IFRS standards results in diversity in practice and is sometimes both burdensome for preparers and difficult to understand for users.

However, we believe that the application of the book value method or the acquisition method should be based on an accounting policy choice by the reporting entity. The criteria set out in the DP to determine whether either method should be applied are based on an assumption that non-controlling shareholders of public and private entities have different means of information. We think that is too general.

We would also like to highlight that the proposal to use the book values of the transferred entity may not be the most practical approach. Entities may not provide IFRS information if this is not required under local regulations. IFRS information may only be available on a higher level, e.g. the parent company. Hence, we propose to consider IFRS information of the group. This may also prove to be beneficial and more comparable when combined financial statements are prepared.

Reponses to the individual questions of the Consultation are included in the appendix. If you require any further information upon these matters, please do not hesitate to contact us.

Yours sincerely,

Erik Berggren
Senior Adviser

<u>Appendix</u>

Question 1

Paragraphs 1.10–1.23 discuss the Board's preliminary view that it should develop proposals that cover reporting by the receiving company for all transfers of a business under common control (in the Discussion Paper, collectively called business combinations under common control) even if the transfer:
(a) is preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies to an external party (that is, a party outside the group); or
(b) is conditional on a sale of the combining companies to an external party, such as in an initial public offering.
Do you agree with the Board's preliminary view on the scope of the proposals it should develop? Why or why not? If you disagree, what transactions do you suggest that the Board consider and why?

We agree with the Board's approach to cover all business combinations under common control on the basis that the "gap" currently existing in IFRS standards results in diversity in practice and is sometimes both burdensome for preparers and difficult to understand for users.

We also agree that no exemption should be made to cases, where the transaction under common control is preceded of followed by an external transaction, as this would make the requirements more complex to apply and harder to understand.

Question 2

Paragraphs 2.15–2.34 discuss the Board's preliminary views that:
(a) neither the acquisition method nor a book-value method should be applied to all business combinations under common control.
Do you agree? Why or why not? If you disagree, which method do you think should be applied to all such combinations and why?
(b) in principle, the acquisition method should be applied if the business combination under common control affects non-controlling shareholders of the receiving company, subject to the cost–benefit trade-off and other practical considerations discussed in paragraphs 2.35–2.47 (see Question 3).
Do you agree? Why or why not? If you disagree, in your view, when should the acquisition method be applied and why?
(c) a book-value method should be applied to all other business combinations under common control, including all combinations between wholly-owned companies.
Do you agree? Why or why not? If you disagree, in your view, when should a book-value method be applied and why?

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General comment:

The discussion paper reiterates how business combinations under common control should be accounted for in the financial statements of the receiving company. We note that for the consolidated financial statements of the parent company, this transaction would rather be a relocation of economic resources, regardless of whether non-controlling shareholders are involved.

In our view, a crucial element has not been taken into consideration and that is the consistency of such transaction compared with transactions that have a similar outcome. In terms of comparability, structuring a transaction in different ways should lead to the same outcome as the economic substance is identical. One example could be the timing of the initial application of IFRS. Referring to diagram 2.4 of the DP, it should not make a difference whether business combinations under common control occur immediately before the receiving entity becoming a first time adopter or afterwards.

If the business combination under common control happens before the initial application of IFRS of the receiving entity, then following the Board's proposal, if no non-controlling shareholders are involved, the receiving entity would apply the book value approach. The business combination would then rely on local GAAP book values since IFRS would not be applied. At the point in time when the receiving entity first presents its IFRS financial statements, it again may choose to apply IFRS in full or refer to the book values of the parent company's consolidated financial statements as laid out in IFRS 1.D16.

On the other hand, of the initial application of IFRS occurs prior to a (potentially already planned) transaction, then, in accordance with the Board's proposal, the receiving entity would apply the acquisition method. In both cases, the non-controlling shareholders, while having the same interest in the same economic resources, are presented with different financial information not only on occurrence of the transaction date but also subsequently, e.g. by amounts representing the amortization of fair value adjustments of assets with a definite useful life.

Consequentially we wonder whether the requirements in IFRS 1 should be elaborated in more detail in the DP and whether it may be useful to not prescribe when a measurement method should be applied but rather referring to an option based model as provided by IFRS 1.D16.

a) We agree that the Board should not prescribe one measurement model to be applied to all business combinations under common control. We also agree with the argument presented, that applying the acquisition method is costly and requires effort that needs to be justified by the benefits it would provide to users.

b) In our opinion, a cost-benefit analysis requires a substantial amount of judgement and is based on many assumptions. It may therefore be detrimental towards the comparability as it would not help to solve diversity in practice.

c) In our view, the Board should allow for an accounting policy choice of the receiving entity to either apply the acquisition method or the book value approach. Combined with additional disclosures for entities applying the book value approach, we think that this would be consistent with the current requirements from IFRS 1 (and could even be linked to the policy choice made when becoming a first-time adopter) and would be acceptable from an cost-benefit perspective while not putting non-controlling shareholders in a disadvantageous position.

Question 3
Paragraphs 2.35–2.47 discuss the cost–benefit trade-off and other practical considerations for business combinations under common control that affect non-controlling shareholders of the receiving company.
(a) In the Board's preliminary view, the acquisition method should be required if the receiving company's shares are traded in a public market.
Do you agree? Why or why not?
(b) In the Board's preliminary view, if the receiving company's shares are privately held:
(i) the receiving company should be permitted to use a book-value method if it has informed all of its non-controlling shareholders that it proposes to use a book-value method and they have not objected (the optional exemption from the acquisition method).
Do you agree with this exemption? Why or why not? Do you believe that the exemption will be workable in practice? If not, in your view, how should such an exemption be designed so that it is workable in practice?
(ii) the receiving company should be required to use a book-value method if all of its non-controlling shareholders are related parties of the company (the related-party exception to the acquisition method).
Do you agree with this exception? Why or why not?
(c) If you disagree with the optional exemption (Question 3(b)(i)) or the related-party exception (Question 3(b)(ii)), in your view, how should the benefits of applying the acquisition method be balanced against the costs of applying that method for privately held companies?

a) In our view, IFRS requirements should not be any different between publicly listed and privately held companies. IFRS should require a robust accounting treatment irrespective of the structure and characteristic of non-controlling shareholders. The assumption, that shareholders of privately held companies have different means of information with regards to a receiving entity may be too general and may leave an information gap. Hence, we refer to our answer above and propose to implement an accounting policy choice of the receiving company combined with sufficient disclosure to meet a minimum need of information by <u>all</u> shareholders.

b)i) In general, we support the option based application of either the book value method or the acquisition accounting. However, placing this decision at the shareholder meeting seems inadequate for an accounting policy choice. In our view, it can be assumed that private shareholders would rather opt for an exemption towards preparing consolidated financial statements as than to decide on individual accounting policies. Hence, we do not believe that this scenario is of larger relevance.

b)ii) we disagree with the requirement to use the book-value approach mandatorily in case that all shareholders of the receiving entity are related parties. In our view, the assumption made in our answer to b)i) above may apply as well. We agree with the Board's reasoning in 2.45 stating that costs are likely to outweigh the benefits of using the acquisition method. The receiving entity could mitigate this by choosing to apply the book-value method instead. However, there may be circumstances when using the acquisition method would be beneficial, e.g. when non-controlling shareholder do not have access to financial information through different means or if it has been elected that financial statements shall be the means of communication.

Question 4
Paragraphs 2.48–2.54 discuss suggestions from some stakeholders that the optional exemption from and the related-party exception to the acquisition method should also apply to publicly traded companies. However, in the Board's preliminary view, publicly traded receiving companies should always apply the acquisition method.
(a) Do you agree that the optional exemption from the acquisition method should not be available for publicly traded receiving companies? Why or why not? If you disagree, in your view, how should such an exemption be designed so that it is workable in practice?
(b) Do you agree that the related-party exception to the acquisition method should not apply to publicly traded receiving companies? Why or why not?

a) As stated above we believe that the option to either apply the book-value approach or the acquisition method should not be based on whether the receiving entity is a publicly listed entity. For the reasons stated above, we believe that the receiving entity should have an accounting policy choice to provide for stable financial reports. Further, we would find it counterintuitive if a receiving entity, that formerly was not a listed one, applied the book-value method to business combinations and then changes to the acquisition method (potentially retrospective in accordance with IAS 8.19) solely because it becomes a publicly listed entity.

b) see a) above.

Question 5
Paragraphs 3.11–3.20 discuss how to apply the acquisition method to business combinations under common control.
(a) In the Board's preliminary view, it should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity when applying the acquisition method to a business combination under common control.
Do you agree? Why or why not? If you disagree, what approach for identifying and measuring a distribution from equity do you recommend and why? In particular, do you recommend either of the two approaches discussed in Appendix C or do you have a different recommendation?
(b) In the Board's preliminary view, it should develop a requirement for the receiving company to recognise any excess fair value of the identifiable acquired assets and liabilities over the consideration paid as a contribution to equity, not as a bargain purchase gain in the statement of profit or loss, when applying the acquisition method to a business combination under common control.
Do you agree? Why or why not? If you disagree, what approach do you recommend and why?
(c) Do you recommend that the Board develop any other special requirements for the receiving company on how to apply the acquisition method to business combinations under common control? If so, what requirements should be developed and why are any such requirements needed?

a) We agree with the Board's proposal not to develop specific requirements for the receiving company with regard to potential distribution from equity when using the acquisition method. In our view, it should be a very rare case that a receiving company, that has a controlling shareholder and non-controlling shareholders, overpays in a business combination. Not only is it expected that certain transfer price rulings would apply, but also non-controlling shareholders would pay attention to such agreements as it would effectively decrease the value of their investment. In our view, if there are clear indications that the price paid is not in line with the fair value of the transferred business, then the consideration paid would be for something outside of the scope of the business combination and treated in accordance with IFRS 3.51. Any overpayment would consequentially be treated in accordance with applicable IFRS (i.e. IAS 32).

b) As stated above, we believe that setting a price that is not approximately the fair value of the transferred business will occur only in rare cases, as noted above. In contrast to the above mentioned, it would the controlling shareholder that would effectively give away economic benefits to non-controlling shareholders by setting a price below the fair value. Hence, in our understanding IFRS 3.51 would apply as well is such rare circumstances, where the purchase price includes a capital injection besides the actual transaction. This would lead automatically to the outcome that the Board proposes.

c) We have no comment.

Question 6
Paragraphs 4.10–4.19 discuss the Board's preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should measure the assets and liabilities received using the transferred company's book values.
Do you agree with the Board's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

We do not agree with the Board's preliminary view. In many cases, the company's books will not be prepared in accordance with IFRS prior to the combination. As such, the book values prepared under a local GAAP regime may fall short of IFRS requirements and therefore lack the necessary information value. It seems unsound to use book values that may be significantly different to book value derived under IFRS for IFRS financial statements of the receiving company and would fall short of the requirements of comparability and consistency and may even be detrimental to the provision of useful information.

In our view, it seems more plausible to refer to the Group's book values prepared under IFRS to enhance comparability, consistency and compliance with IFRS. The Group's book values are prepared by applying IFRS and can – to some extend – be examined by looking into prior financial statements of the Group. It would also provide the benefit that assets and liabilities that were identified with the acquisition of the transferred company would be reflected in the book values.

Additionally, in cases of preparation of combined Financial Statements prior to divestment of part of the business of an entity, some entities would prefer to use the historical net book values extracted from that entity's consolidation (which corresponds to the easiest and less expensive approach considering usually tight deadlines and changes in combination scope throughout the process) but - following the proposal - when the combination actually happens, then the new combined entity would need to prepare the financial statements measuring the assets and liabilities received using the transferred company's book values which might have a different basis. Thus, there will be a break in the continuity of the financial statements prepared.

Further, the proposal would result in adding a new layer of book values as these *transferred* book values would subsequently be prepared under IFRS and not under local GAAP. This seems unjustified given the availability of Group IFRS book values.

Question 7
Paragraphs 4.20–4.43 discuss the Board's preliminary views that:
(a) the Board should not prescribe how the receiving company should measure the consideration paid in its own shares when applying a book-value method to a business combination under common control; and
(b) when applying that method, the receiving company should measure the consideration paid as follows:
(i) consideration paid in assets—at the receiving company's book values of those assets at the combination date; and
(ii) consideration paid by incurring or assuming liabilities—at the amount determined on initial recognition of the liability at the combination date applying IFRS Standards.
Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

a) In general, we believe that the exchange of assets and liabilities received and the consideration paid will be of equal value because of the aforementioned rules on transfer pricing. If a receiving entity elects to use the book value method, we think that it would be sound to measure the corresponding issuance of share to the transferring party at the same amount as the assets and liabilities received. This would also be a sound alignment to IFRS 2.10 where the value of the received goods determines the corresponding adjustment in equity.

b) i) we agree with the Board's proposal to measure the consideration paid in assets at book values. It is sound from our perspective to apply the book value approach consistently to received and transferred items consistently. We also refer to our answer above and ask the Board to require Group book values for the aforementioned reasons.

b) ii) we agree with the Board's preliminary view. We think cases should be considered when the receiving entity agrees to incur non-financial liabilities (e.g. the delivery of goods and services) that should be measured in accordance with applicable standards. Any difference between the liability assumed and the assets and liabilities received should form a contribution to or distribution from equity.

There may also be cases where a financial liability was assumed to finance a specific asset. We wonder whether such liabilities should be transferred on the same basis as the related assets, i.e. at book values.

Question 8
Paragraphs 4.44–4.50 discuss the Board's preliminary views that:
(a) when applying a book-value method to a business combination under common control, the receiving company should recognise within equity any difference between the consideration paid and the book value of the assets and liabilities received; and
(b) the Board should not prescribe in which component, or components, of equity the receiving company should present that difference.
Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

We agree.

Question 9
Paragraphs 4.51–4.56 discuss the Board's preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should recognise transaction costs as an expense in the period in which they are incurred, except that the costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS Standards.
Do you agree with the Board's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

We note that the recognition of transaction costs directly as an expense is a peculiarity of IFRS 5.53. Many other standards require the capitalization of such costs as an addition to the carrying amount of assets or deduction from the carrying amounts of liabilities. As IFRS 3 is explicitly not applied when the receiving company elects to apply the book value approach, we wonder whether expensing theses acquisition related costs directly rather than include them in the initial carrying amounts.

Within BusinessEurope, there are split views on the accounting for transaction costs. On the one hand, some think it may be more understandable and sound towards users if the standard approach (i.e. capitalizing these costs) would be applied. However, others note that capitalizing transactions costs as an addition to the book values would itself lead to differences in the book values between the receiving entity and the Group.

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Question 10
Paragraphs 4.57–4.65 discuss the Board's preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should include in its financial statements the assets, liabilities, income and expenses of the transferred company prospectively from the combination date, without restating pre-combination information.
Do you agree with the Board's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

BusinessEurope supports not to require pre-combination information. In many cases, we believe that the costs of providing that information would outweigh the benefits. However, we also note that combined financial statements that are prepared using the extraction method would include such precombination information. In order to present sound and understandable financial information, we support the option (but not the requirement) to present pre-combination information. This may be very beneficial for investors when they want to assess the past performance to estimate the future financial performance. Any disclosure of pre-combination information should be located in the notes, if entities choose to provide such information.

Question 11
Paragraphs 5.5–5.12 discuss the Board's preliminary views that for business combinations under common control to which the acquisition method applies:
(a) the receiving company should be required to comply with the disclosure requirements in IFRS 3 Business Combinations, including any improvements to those requirements resulting from the Discussion Paper Business Combinations—Disclosures, Goodwill and Impairment; and
(b) the Board should provide application guidance on how to apply those disclosure requirements together with the disclosure requirements in IAS 24 Related Party Disclosures when providing information about these combinations, particularly information about the terms of the combination.
Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

a) We agree in principle, that – if the acquisition method is applied – it is consistent to require the disclosures set out in IFRS 3. In our view, it may not be necessary to apply the full set of disclosures if non-controlling shareholders have different means of information and thus do not rely on information presented in IFRS financial statements.

Further we suggest to require the information proposed in DP 5.8 not as a standard information but solely when there is evidence that the consideration transferred differs from an arms' length transaction.

With regard to the suggestions made by the IASB in the Discussion Paper DP/2020/1 - *Business Combinations — Disclosures, Goodwill and Impairment*, we would like to reiterate our response to it, dated 7 January 2021, describing a number of concerns that we have:

"The proposals to make mandatory the disclosure of information of a potentially confidential or sensitive nature, including quantitative metrics, could, in our view, be very damaging to certain reporting entities. This will particularly be the case where an individual acquisition is only one step on the path to achieving a business strategy, as such detail may allow competitors to pre-empt the subsequent steps and others to benefit from the targeted economic gains. In addition, the detailed disclosure of objectives and the degree of their achievement might open up the entity to hostile litigation. Finally, where integration is rapidly and effectively achieved, an entity may conclude that onerous monitoring of actual outcomes against theoretical pre-acquisition performance is unnecessary. In such cases, the requirements about providing metrics or explaining their absence will put them under pressure to expend effort carry a monitoring activity that is of no real value. We suggest that information of this nature would be better suited to inclusion in the Management Commentary where judgment about the content can be applied more appropriately."

Further we note that with ED/2021/3 *Disclosure Requirements in IFRS Standards—A Pilot Approach*, the Board explores a new and more principle-based way to develop disclosure requirements. We think that it would be useful to apply that approach also to proposed disclosures for BCUCC and define a clear objective and the information needs of users.

b) BusinessEurope agrees with the Board that application guidance will be useful for preparers. In our view, most transactions under common control will be at arm's length basis since there are rules on transfer pricing in the interest of non-controlling shareholders and other creditors. Hence, we think the IASB should include in its application guidance that the application of e.g. transfer pricing rules should substantiate the arm's length transaction.

Question 12
Paragraphs 5.13–5.28 discuss the Board's preliminary views that for business combinations under common control to which a book-value method applies:
(a) some, but not all, of the disclosure requirements in IFRS 3 Business Combinations, including any improvements to those requirements resulting from the Discussion Paper Business Combinations—Disclosures, Goodwill and Impairment, are appropriate (as summarised in paragraphs 5.17 and 5.19);
(b) the Board should not require the disclosure of pre-combination information; and
(c) the receiving company should disclose:
(i) the amount recognised in equity for any difference between the consideration paid and the book value of the assets and liabilities received; and
(ii) the component, or components, of equity that includes this difference.
Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

a) we agree that for business combinations under common control a reduced set of disclosure requirements should apply especially when the book value method is applied. Regarding the improvements suggested in DP/2020/1 we refer to our comment letter dated 7 January 2021 (see also Question 11 above).

We agree with the proposals made in DP 5.19 (a) and (b). However, we are a bit confused about the proposal in 5.19 (c) of the DP. Where it is stated that the receiving entity should disclose the amount of NCI in the transferred company. We note that the Board preliminary decided to require the book values of the transferred company and that transferred company would not present any NCI in it. Disclosure of NCI transferred would only be sound if the book values of the (ultimate) parent of the transferred company were used.

b) we agree that the Board should not require pre-combination information as the costs would – in many cases – outweigh the benefits. We also agree that such pre-combination must be allowed if the reporting entity elects – on a case-by-case basis – to present such information.

c) we agree.

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