This paper provides the technical advice from EFRAG TEG to the EFRAG Board, following EFRAG TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in EFRAG Update. EFRAG positions as approved by the EFRAG Board are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

EFRAG Comment Letter

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

[XX October 2021]

Dear Mr Barckow

Re: Business Combinations under Common Control

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Discussion Paper DP/2020/2 *Business Combinations under Common Control,* issued by the IASB on 30 November 2020 (the 'DP').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG welcomes the IASB's discussion paper *Business Combinations under Common Control* ('BCUCC'). BCUCC are frequently undertaken for many different reasons to achieve purposes that vary from business combinations of entities not under common control. For example, they may take place to re-organise group activities with an aim to achieve synergies, spin-offs in preparation for an initial public offering (IPO) or to obtain tax efficiency within the group. The often-complex structures and arrangements to effect such changes raise considerable challenges for financial reporting. As IFRS Standards are currently silent on how the entity receiving a BCUCC should account for the transaction, there is diversity in practice which warrants attention.

Therefore, EFRAG welcomes the IASB's efforts to explore possible reporting requirements for a receiving company that would reduce diversity in practice, improve comparability and consistency of reporting and provide more relevant information for users of financial statements.

Project scope

EFRAG agrees with the scope proposed by the IASB in its DP as defined in paragraphs 1.10 to 1.23 of the DP. In particular, EFRAG welcomes that both BCUCC and group restructurings are in the scope of this project.

However, EFRAG considers that the IASB should avoid identifying or labelling group restructurings as a BCUCC, particularly when the arrangement does not meet the description of a business combination in IFRS 3 *Business Combinations* (i.e., group restructurings that are not business combinations). EFRAG suggests that more guidance on the definition of 'group restructurings' is required to support the appropriate application of the proposals on scope. Instead, the IASB could use the terminology in IFRS 3 "combination of entities or businesses under common control" to encompass all types of transactions in the scope of the project. However, if this description is used, there is a

need to improve it (e.g., clarify the meaning of “transitory control”) and/or align it with the definition used in this project to avoid confusion for stakeholders.

EFRAG recommends the IASB to provide further clarification whether certain types of transactions are captured by the scope of the project. Appendix 2 provides a list of such transactions.

Finally, EFRAG considers that other common control transactions (e.g., transfer of a group of assets that does not meet the definition of a business, acquisition of an interest in an associate or joint venture from an entity under common control) are important and need to be discussed in the future in a comprehensive project, including effects on separate financial statements, while transfer of equity investments in subsidiaries under common control in the separate financial statements should be included in the scope of this project.

Selecting the measurement method

EFRAG agrees that a single measurement approach is not appropriate for all BCUCC. Some BCUCC have common features with business combinations within the scope of IFRS 3 and therefore should be accounted for similarly. Other BCUCC are more akin to reallocations of economic resources across the reporting group without changing the ownership interest in those resources.

EFRAG also supports that the acquisition method is applied to BCUCC which affect the non-controlling shareholders of the publicly traded receiving company subject to the cost-benefit and other practical considerations. EFRAG also agrees that a book-value method should be applied to all other BCUCC where the controlling party’s ownership interest is unchanged. However, EFRAG recommends the IASB to conceptually align the book-value method with the measurement bases under the *Conceptual Framework* and re-assess the scope of the book-value method for privately-held entities, which have publicly listed debt instruments.

EFRAG considers that establishing an appropriate dividing line between applying the acquisition method and a book-value method to BCUCC is crucial for achieving the project’s objectives. BCUCC transactions are effected for various reasons and reflecting their economic substance is a superior approach to capture the underlying drivers for such transactions. However, due to practical considerations, EFRAG accepts that the IASB’s decision tree may offer a reasonable proxy to operationalise the decision about which measurement method to apply. EFRAG also recommends the IASB to further consider the interests of other stakeholders, like lenders and other creditors, when determining the measurement method. Additionally, EFRAG recommends the IASB to clarify and provide guidance on the criterion ‘affect non-controlling shareholders’ and on identifying the receiving company to ensure appropriate application of the proposals. Furthermore, EFRAG notes that selecting the measurement method will depend heavily on the definition of a public market which may not be sufficiently robust. EFRAG suggests that the IASB clarifies the meaning of the term ‘traded’ as used in the DP, in light of non-regulated markets.

Subject to its cautious support for the IASB’s decision tree when selecting the measurement method, EFRAG considers the remaining proposals included in the DP. EFRAG supports the optional exemption from the acquisition method for privately-held entities based on a cost-benefit consideration. However, EFRAG considers that additional guidance is necessary to make the exemption workable in practice. EFRAG agrees that the optional exemption should not be extended to publicly traded companies because such companies usually have a significant number of non-controlling shareholders whose composition changes frequently and mainly rely on the receiving company’s general purpose financial statements for their information needs.

EFRAG also supports the related-party exception to the acquisition method for BCUCC affecting the non-controlling shareholders of a privately-held receiving entity based on a cost-benefit consideration. However, EFRAG considers that the related-party exception

should be optional rather than required. EFRAG agrees that the exception should not be extended to publicly traded companies because situations in which all non-controlling shareholders are related parties to a publicly traded receiving company are not common in Europe and extending the exception will have a very limited application.

EFRAG suggests the IASB to provide further guidance on the practical application of the exemption and the exception when there are different levels of receiving companies with NCS.

Applying the acquisition method

EFRAG welcomes the IASB's discussions on the notion of distributions from and contributions to equity but acknowledges that these are unlikely to occur in practice.

If a distribution from equity occurs in practice, EFRAG agrees that the IASB should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity when applying the acquisition method to BCUCC. Instead, EFRAG considers that any difference between the fair value of consideration paid and the fair value of identifiable acquired assets and liabilities should be recognised entirely as goodwill. This would be consistent with IFRS 3 and also result in less complexity and costs.

In addition, EFRAG's consultation and outreach resulted in mixed views regarding when the consideration paid is lower than the identifiable assets and liabilities acquired in the business combination. Some preferred recognition in equity while others preferred consistency with IFRS 3, i.e., recognition in profit or loss. EFRAG sees merit in using each of these recognition approaches. Therefore, EFRAG suggests the IASB to further explore these approaches in order to provide relevant information to users of financial statements.

Finally, EFRAG suggests that the IASB provides guidance on identifying the acquirer, both when entities apply the acquisition method and when they apply a book-value method.

Applying a book-value method

EFRAG considers that both the use of the carrying amounts in the consolidated financial statements of the transferred company's controlling party and use of the carrying amounts in the financial statements of the transferred company can provide decision-useful information for users. Furthermore, EFRAG considers that using one or the other approach would depend on facts and circumstances of the receiving company including cost/benefit considerations. Therefore, EFRAG proposes an accounting policy option to allow the use of the carrying amounts in the consolidated financial statements of the transferred company's controlling party. EFRAG further suggests that the accounting policy choice should be applied on a transaction-by-transaction basis and be supported by additional disclosures explaining that choice.

In terms of measuring the consideration paid, EFRAG agrees not to prescribe how the receiving company should measure the consideration paid in its own shares. EFRAG also agrees with the measurement proposed in the DP for both consideration paid in assets and consideration paid by incurring or assuming liabilities. However, EFRAG observes that the consideration paid in assets is not consistent with the requirements of IFRIC 17 *Distributions of Non-cash Assets to Owners* on how to measure non-cash assets distributed as dividends. Therefore, EFRAG suggests that the IASB considers allowing the use of fair value measurement for consideration paid in assets as the information may be relevant for creditors and other lenders.

EFRAG agrees to recognise within equity, any difference between the consideration paid and the book value of the assets and liabilities received. EFRAG also agrees with not specifying in which component(s) of equity the difference between consideration paid and assets and liabilities received should be presented as this is commonly addressed via local legislation.

On transaction costs, EFRAG agrees with the reasoning of the treatment of transaction costs under IFRS 3 and considers that the same reasoning can be applied for BCUCC transactions. Therefore, EFRAG agrees with the proposals in the DP for transaction costs.

The EFRAG [TEG] members expressed mixed views with respect to providing pre-combination information under the book-value method. The majority of members agree with the IASB proposals that 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, based on a cost-benefit consideration and the feedback received during the consultation process. While a minority of members disagree with the IASB's view that the retrospective approach would be more costly to apply than a prospective approach as some jurisdictions already require to restate comparatives due to local regulations. Therefore, those members suggest an accounting policy choice and support for retrospective application until the beginning of the reporting period, if the receiving entity chooses this option.

Disclosure requirements

EFRAG considers that the proposed disclosure requirements for BCUCC accounted for under both the acquisition method and the book-value method would provide relevant information about the BCUCC transactions.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Ioana Kiss or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix 1 - EFRAG's responses to the questions raised in the DP

Contents

EFRAG Comment Letter 1
Re: Business Combinations under Common Control 1
Appendix 1 - EFRAG's responses to the questions raised in the DP.....................................5
Section 1: Objective, Scope and Focus..6
Section 2: Selecting the measurement method 9
Section 3: Applying the acquisition method 17
Section 4: Applying a book-value method 19
Section 5: Disclosure requirements 26
Appendix 2 – List of transactions requiring clarification whether they are captured by the scope of the BCUCC project 28

Section 1: Objective, Scope and Focus

Question 1

Paragraphs 1.10–1.23 discuss the IASB'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 IASB'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 IASB consider and why?

EFRAG's response

EFRAG agrees with the scope proposed by the IASB in its Discussion Paper as defined in paragraphs 1.10 to 1.23 of the DP. In particular, EFRAG welcomes that both BCUCC and group restructurings are in the scope of this project.

However, EFRAG considers that the IASB should avoid identifying or labelling "group restructurings" as a BCUCC, particularly when the arrangement does not meet the definition of a business combination in IFRS 3. EFRAG suggests that more guidance on the definition of 'group restructurings' is required to support the appropriate application of the proposals on scope.

EFRAG also considers that the IASB should, as result of this project, examine the description of "combination of entities or businesses under common control" in IFRS 3. In particular, EFRAG recommends clarifying the notion of 'transitory control' and consider whether BCUCC followed by an external sale with loss of control shall be captured by the scope of the project.

EFRAG recommends the IASB to provide further clarification on whether certain types of transactions are captured by the scope of the project. Appendix 2 includes a list of such fact patterns.

Finally, EFRAG considers that other common control transactions (e.g., transfer of a group of assets that does not meet the definition of a business, acquisition of an interest in an associate or joint venture from an entity under common control in the individual and separate financial statements) are important and need to be discussed in the future in a comprehensive project, while transfer of equity investments in subsidiaries under common control in the separate financial statements should be included in the scope of this project.

General comments

1 EFRAG welcomes the IASB's discussion paper on BCUCC and supports the general objective of the DP to provide users of financial statements with information that is more relevant and comparable.

2 EFRAG agrees that there is a need to address the existing diversity in practice in the way entities account for BCUCC transactions and the difficulties for users of financial statements in comparing the effects of BCUCC on entities' financial position and financial performance.

Definition of business combinations under common control

3 In paragraph 1.15 of the DP, the IASB refers to BCUCC as those that involve the transfer of a business under common control, even if the transfer is preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies (i.e., the receiving company and the transferred company) to an external party; or is conditional on a sale of the combining companies to an external party.

4 In the DP, the notion of BCUCC is different from and wider than the notion of "combinations of entities or businesses under common control" in IFRS 3. This is because the definition of BCUCC in the DP also includes transfers of a business under common control when the transfer does not meet the description of a business combination in IFRS 3 (such as in group restructurings).

5 This approach has the advantage of addressing a wider range of transfers of businesses (e.g., group restructurings) and avoids past discussions on the description of combinations of entities or businesses under common control in IFRS 3 (e.g., Transitory common control, IFRIC Update—March 2006). However, this approach has the disadvantage of creating two definitions of a BCUCC in IFRS Standards, with one of them (from the DP) including transfers of a business under common control even when the transfer does not meet the definition of a business combination in IFRS 3. EFRAG is concerned that this will be confusing to stakeholders.

6 Therefore, EFRAG considers that it would be useful to:

(a) have both BCUCC and group restructurings in the scope of this project but avoid identifying or labelling group restructurings that are not a business combination as a BCUCC. More specifically, when the arrangement does not meet the definition of a business combination in IFRS 3 (e.g., when a business is transferred to a new established parent company and the latter does not meet the definition of a business), EFRAG considers that such transactions should be labelled, defined and analysed separately in this project;

(b) align the definition of BCUCC in the DP with the description of 'combination of entities or businesses under common control' in IFRS 3 to avoid confusion for preparers. To examine the description of "combination of entities or businesses under common control" in IFRS 3, in particular whether there is a need to clarify the existing definition (e.g., clarify the meaning of "transitory control") and/or align it with the definition used in this project;

(c) clarify the notion of 'transitory control' and, in that context, consider whether BCUCC followed by an external sale with loss of control shall be captured by the scope of the project;

(d) clarify whether certain types of BCUCC transactions are captured by the scope of the project (i.e. transactions where unrelated parties hold an ownership interest in two joint ventures; transactions in which shareholders before and after a restructuring are exactly the same and there is no contractual arrangement arranging control; transfers of an ownership interest in an entity under common control which on its own does not constitute a transfer of a business from the transferor's perspective). Appendix 2 includes a detailed list of fact patterns that require further clarification whether such transactions are within the scope of the project.

7 Finally, EFRAG suggests that the IASB uses the terms "entities" or "businesses" rather than "companies" in the DP, as the transfer of businesses may involve a transfer of an unincorporated business (for example, a business operated by an individual person and not within a corporate structure) or of a business that was an unincorporated branch or other part of a company, rather than an entire company.

Transactions within the scope of the project

8 EFRAG agrees with the scope proposed by the IASB in its DP as defined in paragraphs 1.10 to 1.23 of the DP.

9 In particular, EFRAG welcomes that group restructurings in which control remains within the original group (e.g., transfer of a business into a newly formed entities), are within the scope of the project. This is because many questions arise where a common control transaction involves the establishment of a new parent entity within the group (e.g., IFRS Interpretation discussions on "transitory common control", "business combinations involving newly formed entities" and "factors affecting the identification of the acquirer").

10 Nonetheless, EFRAG notes that 'group restructurings' is not a defined term and that the description used in paragraph 1.15 of the DP is very generic. EFRAG would welcome more guidance on the definition of 'group restructurings' to support the appropriate application of the proposals on scope that would describe the type of transactions that it would include (e.g., demergers, such as a spin-off of a subsidiary or business).

Transactions outside the scope of the project

11 EFRAG notes that "common control transactions" is a wide notion that encompasses more than business combinations. For example, it includes:

(a) the transfer of a group of assets that does not meet the definition of a business;

(b) the transfer of an associate to an entity in the same group; and

(c) acquisition of equity investments in subsidiaries, associates and joint ventures from entities under common control in the separate financial statements, particularly when considering the IASB's proposals on BCUCC that involve the transfer of an unincorporated business.

12 Common control transactions may have a significant impact in the receiving company's financial statements, particularly in its separate and individual financial statements, as these transactions may not be subject to market forces (e.g., contribution or sale of assets for a low price between entities within the same group).

13 For these transactions, an entity has to apply the general principles in IFRS Standards, including IAS 24 *Related Party Disclosures* for common control transactions. This raises measurement questions, including those related to contributions or distributions of equity.

14 Therefore, consideration should be given in the future as to whether IFRS Standards need to be modified when dealing with common control transactions such as:

(a) a transfer of a group of assets that does not meet the definition of a business (*the revised definition of a 'business' in IFRS 3 issued on 22 October 2018 (with effective date 1 January 2020) might result in fewer transactions being accounted for as a transfer of a business as opposed to group of assets. The tension between the definition of a 'business' and group of assets, including exercising judgement in a different way, might create structuring opportunities*);

(b) acquisition of an interest in an associate or joint venture from an entity under common control (*IFRIC Update—May 2013: IAS 28 Investments in Associates and Joint Ventures and IFRS 3 Business Combinations—Associates and common control*).

15 EFRAG sees this DP as a first step in that direction as the conclusions the IASB reaches on this project may have implications for the analysis of the accounting for other transactions under common control and the broader issues of transfer pricing.

16 For example, whether it is appropriate to recognise any assets transferred or services rendered between group entities at their fair values rather than at the transaction price, or whether such assets transferred or services rendered should be accounted for at the predecessor value.

17 Furthermore, EFRAG recommends the IASB to consider the effects of common control transactions on the individual and separate financial statements of the receiving company. In some jurisdictions, BCUCC have an impact on the individual and separate accounts with material effects on corporate tax, dividends and capital requirements.

18 EFRAG notes that the scope of the BCUCC project does not include accounting for a transfer of investments in subsidiaries under common control in the separate financial statements as such guidance is contained in IAS 27 *Separate Financial Statements*. EFRAG observes that this approach will result in substantial difference in accounting for common control transactions in the consolidated and separate financial statements depending on whether the transaction involves a transfer of incorporated or not incorporated business. EFRAG consider that equity investments in subsidiaries under common control in the separate financial statements should be included in the scope of this project. Furthermore, the DP's scope shall also consider accounting for legal mergers between a parent company and its existing subsidiaries in the separate financial statements of the parent.

19 Alternately, if the IASB confirms that this transaction must be accounted for in accordance with IAS 27, then it should clarify how the cost of the acquired investment should be measured when the consideration paid was different from its fair value, in particular:

(a) the cost of the investment acquired shall be measured at fair value of the consideration paid; or

(b) the cost of the investment acquired is its fair value and the difference between the consideration paid and the fair value of the acquired subsidiary shall be recognised in equity as contribution or distribution from equity.

Section 2: Selecting the measurement method

Main considerations in selecting the measurement method

Question 2

Paragraphs 2.15–2.34 of the DP discuss the IASB'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 of the DP.

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?

EFRAG's response

EFRAG agrees that a single measurement approach is not appropriate for all BCUCC. Some BCUCC have features in common with business combination within the scope of IFRS 3 and therefore should be accounted for similarly. Other BCUCC are more akin to reallocations of economic resources across the reporting group without changing the ownership interest in those resources.

BCUCC transactions are effected for various reasons and reflecting their economic substance is a superior approach to capture the underlying drivers for such transactions. However, due to practical considerations, EFRAG accepts that the IASB's decision tree may offer a reasonable proxy to operationalise the decision about which measurement method to apply. Furthermore, EFRAG recommends the IASB to clarify and provide guidance on the criterion 'affect non-controlling shareholders' and on identifying the receiving company to ensure appropriate application of the proposals.

Finally, EFRAG considers that applying a book-value method to all other BCUCC where ownership interest of the controlling party is unchanged would produce more relevant information about the transaction at lower costs. EFRAG further recommends that the IASB re-assesses the application of the book-value method in situations when a private entity has publicly listed debt instruments as suggested in paragraph 35.

Neither acquisition method nor book-value method applied to all BCUCC

20 EFRAG supports the use of more than one measurement method and considers that a single measurement approach is not appropriate for all BCUCC. BCUCC transactions are usually governed by the controlling party and may have a different economic substance. EFRAG notes that although the ultimate controlling party retains control over the transferred business, in some BCUCC transactions the ownership interest of the controlling party might change as a result of the transfer. Therefore, it is necessary to consider the different economic substance of those transactions in order to apply an appropriate measurement method.

21 EFRAG is of the view that the application of the acquisition method is appropriate when the substance of the BCUCC transactions is similar to business combinations within the scope of IFRS 3, for example, when the ownership interest of the ultimate controlling party has changed. The application of the acquisition method to such BCUCC transactions will result in similar transactions being accounted for in a similar manner. Additionally, the acquisition method is already described in IFRS 3 and is well understood by both users and preparers. However, EFRAG observes that the application of the acquisition method may be costly to apply and a cost-benefit trade-off should be considered.

22 In other BCUCC transactions, where non-controlling shareholders are not affected and there is only a transfer of economic resources within the reporting group and no change of ownership interest of the controlling party, a book-value method would be more appropriate to apply. Such transactions represent simple reallocation of resources within the group and book values will provide more relevant information to users of the receiving company's financial statements. A book-value method allows users to continue performing a trend analysis of the combining companies. EFRAG also observes that a book-value method, as described in the DP, would generally be less costly to apply to BCUCC transactions than the acquisition method.

23 EFRAG acknowledges that there is a need to have a clear dividing line between when to apply the acquisition method and when to apply a book-value method to BCUCC transactions. It is also important that this dividing line appropriately

distinguishes between BCUCC with different economic substance and an appropriate measurement method is applied to each BCUCC.

24 EFRAG considers that conceptually the starting point for selecting the measurement method should be to assess the economic substance of the BCUCC transaction: such transactions are effected for various reasons and reflecting their economic substance when selecting the measurement method is superior approach to capture the underlying drivers for the transactions.

25 However, considering the variety of possible transactions that impact economic substance, EFRAG assesses that developing a principles-based approach based on economic substance would be difficult to apply in practice, including due to the level of judgement involved and possible divergence in practice. This is consistent with the feedback EFRAG has got from its previous proactive research on the same topic in the past years and with evidence from jurisdictions that currently already apply an approach based on economic substance. Therefore, based on practical considerations, EFRAG accepts that the IASB's decision tree may provide a reasonable proxy to operationalise the decision of when to apply the acquisition method and when to apply the book-value method.

26 However, EFRAG cautions that the decision approach proposed in the DP might create structuring opportunities for entities to apply either the acquisition method or a book-value method. For example, for the purpose of applying particular measurement method to a BCUCC, an entity might introduce minority shareholders who would hold only a few shares with a pre-agreed deal to buy those shares back afterwards.

27 Furthermore, EFRAG notes that applying the acquisition method to BCUCC transactions would inflict a fair value uplift of the transferred company's net assets that might create structuring opportunities. Similarly, EFRAG observes that the DP's approach for selecting the measurement method would result in similar transactions being reported differently depending on whether the shares of the receiving entity are publicly traded or not. EFRAG is of the view that, in general, regardless of the way the BCUCC transaction is structured, it should result in the same outcome, if the economic substance is identical. In order to enhance the proposed approach, EFRAG makes some suggestions in paragraph 32 below.

28 In addition, the definition of a receiving company in the DP and the definition of the acquirer in IFRS 3 are not identical which raises uncertainty and further clarifications are necessary in this respect. EFRAG notes that the DP considers that the receiving company under the acquisition method is the acquirer in a BCUCC. However, applying the current requirements in IFRS 3 in situations where a Newco is created to execute a BCUCC transaction creates an uncertainty whether the Newco can be identified as the acquirer. Conversely, if the Newco is considered acquiree, EFRAG questions whether the information provided under the IASB's decision tree would be relevant to users of financial statements.

29 Furthermore, EFRAG observes that, in practice, regulators or local law may enforce certain accounting treatment as to whether book values or fair values are used for BCUCC. This creates potential tension between BCUCC requirements in IFRS Standards and existing regulatory requirements and local law, such as tax and insolvency laws.

Acquisition method to be applied if BCUCC affects non-controlling shareholders of the receiving entity

30 As explained above, EFRAG accepts that the IASB's proposed decision three offers a practical proxy for a more complex approach based on the economic substance. As a result, EFRAG agrees with the application of the acquisition method to BCUCC where there are non-controlling shareholders in the receiving company. This will result in similar accounting applied to similar transactions both under common

control and acquisitions within the scope of IFRS 3, thereby increasing comparability in reporting.

31 EFRAG agrees that when there is a change in the ownership interest of the non-controlling shareholders in the transferred business, the BCUCC is similar in substance to a business combination within the scope of IFRS 3. Applying the acquisition method to such combinations will provide more relevant information to users of the receiving company's financial statements.

32 Furthermore, applying the acquisition method to BCUCC when the non-controlling shareholders of the receiving company are affected by the transfer is practical. However, EFRAG suggests that the IASB further clarify and provide guidance on the criterion 'affect non-controlling shareholders' which sets the diving line between the proposed two measurement methods. In particular:

   (a) it will be useful to consider the notion of *significance* for the change in ownership interest of the NCS as the proposed decision tree might give rise to structuring opportunities;

   (b) to explain how the criterion will apply when the consolidated financial statements are prepared at different consolidated levels of receiving companies; and

   (c) to clarify the scope of 'non-controlling shareholders' with respect to what financial instruments shall be considered as equity instruments in light of the guidance provided in IAS 32 *Financial Instruments: Presentation*.

Book-value to be applied to all other BCUCC

33 EFRAG agrees with applying a book-value method to BCUCC transactions where there are no non-controlling shareholders of the receiving company. In those transactions, the controlling party is the only existing shareholder of the receiving company and neither its control over the combining companies nor its ownership interest changes.

34 Additionally, in a BCUCC where there are no non-controlling shareholders of the receiving company, a book-value method is likely to produce relevant information for users of the receiving company's financial statements at minimal costs. Furthermore, because the controlling party controls the receiving company, it does not need to rely on the receiving company's general purpose financial statements to meet its information needs. Therefore, applying a book-value method would provide relevant information to users at reasonable costs.

35 However, EFRAG recommends that the IASB should further re-assess the application of a book-value method. In particular, under the proposals in the DP, a privately-held entity which has listed debt instruments would qualify to apply a book-value method in a BCUCC. This raises concerns about the lack of relevance of the approach for debt holders.

36 EFRAG considers that more guidance on how to identify the receiving company in a BCUCC both under the acquisition method and a book-value method will be helpful.

37 Finally, EFRAG suggests that the IASB either further aligns the book-value method with the measurement bases under the *Conceptual Framework* or explains the conceptual differences if there is a departure from the *Conceptual Framework*. EFRAG acknowledges that a departure from the *Conceptual Framework* is possible, however, it is important to explain the conceptual differences between a transaction under common control (BCUCC) and acquisition of an asset under IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*.

The cost–benefit trade-off and other practical considerations for combinations that affect non-controlling shareholders

Question 3

Paragraphs 2.35–2.47 of the DP 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 IASB'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 IASB'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?

EFRAG's response

EFRAG considers that establishing an appropriate dividing line between applying the acquisition method and a book-value method to BCUCC is very important for achieving the project's objectives. EFRAG's response to this question has to be read in conjunction with its cautious support for the IASB's decision tree when selecting the measurement method.

The decision tree currently proposed by the IASB applies a measurement method depending on whether the receiving entity's equity instruments are traded in a public market. EFRAG notes that selecting the measurement method will depend heavily on the definition of a public market which may not be robust enough to distinguish between BCUCC transactions with different economic substance. Therefore, EFRAG suggests that the IASB clarifies the meaning of the term 'traded' as used in the DP in light of non-regulated (over-the-counter) markets. EFRAG also recommends the IASB to consider the interests of other stakeholders, like lenders and other creditors, when determining the measurement method.

EFRAG supports the optional exemption from the acquisition method for privately-held entities because it will provide cost relief to such entities from applying the acquisition method. EFRAG acknowledges that a similar concept exists in IFRS Standards for providing disclosures, however, not for measurement purposes. EFRAG questions whether a cost-benefit consideration is a sufficient conceptual basis for the exemption as a single NCS can force an entity to apply a particular measurement method. The proposed approach may

lead to structuring opportunities and inappropriate accounting outcomes. EFRAG considers that additional guidance is necessary to make the exemption workable in practice.

EFRAG supports the related-party exception to the acquisition method for BCUCC affecting the non-controlling shareholders of a privately-held receiving entity. However, EFRAG considers that the related-party exception should be optional rather than required. EFRAG suggests the IASB to provide further guidance on the practical application of the exemption and the exception when there are different levels of receiving companies with NCS.

Acquisition method for publicly traded receiving company

38 EFRAG's response to this question has to be read in conjunction with its cautious support for the IASB's decision tree when selecting the measurement method (see Question 2).

39 EFRAG observes that establishing an appropriate dividing line as to when to apply the acquisition method or a book-value method to BCUCC is conceptually very important when recommending a measurement approach for BCUCC transactions.

40 The DP includes a decision tree to help companies select whether to apply the acquisition method or a book-value method to a BCUCC, where:

(a) Step 1 of the decision tree establishes whether the receiving company has non-controlling shareholders; and

(b) Step 2 makes further reference to whether the receiving company's equity instruments are publicly traded.

41 EFRAG acknowledges that a reference to publicly-traded shares is already used in IFRS Standards to determine what information should be disclosed. However, the use of publicly-traded shares has not been applied for selecting a measurement method.

42 Furthermore, EFRAG notes that the selection of a measurement method as described in the DP will depend on the definition of a public market. The description of a public market used in the DP is consistent with the one used in IFRS Standards – 'a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets'. However, EFRAG recommends that the IASB further consider whether the description of a public market is robust enough for creating the dividing line between when to apply the acquisition method and when to apply a book-value method, The description of a public market currently refers to both regulated and non-regulated (over-the-counter) markets and there is a risk of divergent interpretation and application in practice. For instance, an over-the-counter (OTC) market is a market where participants trade bilaterally and therefore it may be questionable whether instruments listed on it are 'publicly traded'. In this respect, EFRAG suggests the IASB to clarify the meaning of the term 'traded' as used in the DP.

43 Furthermore, EFRAG notes that the DP's assumption that trading in a public market provide protection to NCS may not apply to all non-regulated markets or to all public markets globally.

44 EFRAG also considers that the decision tree on when to apply the acquisition method or the book-value method should be better explained and supported with further examples. For instance, illustrating the accounting in case of a listed entity effecting a carve-out with the intention to have a NewCo listed on a public market.

45 Furthermore, EFRAG recommends the IASB to consider the interests of other stakeholders, like lenders and other creditors, when determining the measurement method. The information needs of lenders and other creditors could be the same as the information needs of shareholders of a listed entity.

Optional exemption from the acquisition method

46 EFRAG supports the optional exemption from the acquisition method for privately-held entities with existing non-controlling shareholders because it will result in less costs for those entities compared to applying the acquisition method to BCUCC.

47 EFRAG observes that the condition that non-controlling shareholders did not object the receiving company providing book value information for the transfer is similar to provisions already existing in IFRS Standards. This condition, which relates to providing disclosures, has been tested and has proven to be workable in practice. However, EFRAG questions whether cost-benefit consideration is a sufficient conceptual basis for the exemption, considering that it will determine a measurement method for BCUCC based on a decision taken by the non-controlling shareholders.

48 EFRAG observes that the optional exemption may not be practicable when a single NCS can force an entity to apply the acquisition method. In addition, the proposed approach may lead to structuring opportunities.

49 EFRAG considers that additional guidance is necessary to make the exemption workable in practice and suggests the IASB to:

(a) avoid situations where NCS, representing a negligible portion of interests in the receiving company's equity, can impose the use of the acquisition method;

(b) provide guidance on the practical application of the exemption when there are different levels of receiving companies with NCS;

(c) consider excluding the related parties from the NCS when considering the exemption process. Respectively, Step 4 of the decision tree can be amended with the following wording: '*Has the receiving company chosen to use a book-value method, and have its non-controlling shareholders except related parties not objected?*'.

Related-party exception to the acquisition method

50 EFRAG supports the related-party exception to the acquisition method for BCUCC affecting the non-controlling shareholders of a privately-held receiving entity based on a cost-benefit consideration and information being generally available to related parties without them having to rely on general purpose financial statements.

51 However, EFRAG observes that in certain situations in which all the non-controlling shareholders are also related parties to the receiving company, it is possible that these non-controlling shareholders do not have the information they need about the transaction, for example, investors with significant influence over the reporting entity.

52 Therefore, EFRAG considers that the related-party exception should be 'permitted' rather than 'required' as the information needs of different related parties can be different given the broad composition of related parties as defined in IAS 24 *Related Party Disclosures*. Furthermore, EFRAG suggests the IASB to provide further guidance on the practical application of the exception when there are different levels of receiving companies with NCS, as the term 'receiving company' in the DP refers not only to the immediate receiving company but also to its parent companies that did not control the transferred company before the combination.

Extending the exemption and exception to publicly traded companies

Question 4

Paragraphs 2.48–2.54 of the DP 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 IASB'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?

EFRAG's response

EFRAG's response to this question has to be read in conjunction with its cautious support for the IASB's decision tree when selecting the measurement method. EFRAG agrees with the IASB that the optional exemption from the acquisition method should not be extended to publicly traded companies. Such companies usually have many non-controlling shareholders that rely on the general-purpose financial statements of the receiving company. The non-controlling shareholders of a publicly traded company also change share ownership frequently which could result in potential shareholders being provided with information which was requested by the previous shareholders of the receiving company.

Likewise, EFRAG agrees with the IASB that the related-party exception to the acquisition method should not be extended to publicly traded receiving companies. EFRAG is of the view that situations in which all non-controlling shareholders are related parties to the receiving company are not common in Europe and extending the exception will have very limited application, if at all.

53 EFRAG's response to this question has to be read in conjunction with its cautious support for the IASB's decision tree when selecting the measurement method (see Question 2).

54 EFRAG agrees with the IASB's proposal not to extend the optional exemption from the acquisition method to publicly traded receiving companies with non-controlling shareholders because:

(a) publicly traded receiving companies usually have a large number of non-controlling shareholder that rely on general purpose financial statements of the receiving company. Therefore, extending the optional exemption to publicly traded companies would result in potential non-controlling shareholders being provided with information based on the decision taken by consulting the previous non-controlling shareholders of the receiving company;

(b) it might be more difficult to operationalise the optional exemption from the acquisition method compared to privately-held receiving companies. Publicly traded receiving companies usually have a larger number of external non-controlling shareholders which could change regularly and it would be difficult to trace and obtain consent from non-controlling shareholders regarding what measurement method to be used; and

(c) extending the optional exemption to publicly traded companies with non-controlling shareholders will allow different measurement methods to be used for similar BCUCC. Consequently, some non-controlling shareholders will be provided with fair value information and some non-controlling shareholders will have book value for the same type of BCUCC transaction. This will reduce comparability within and across entities.

55 Similarly, EFRAG agrees with the IASB's proposal not to extend the related-party exception to the acquisition method to publicly traded receiving companies. EFRAG notes that situations when all non-controlling shareholders are related parties to a publicly traded receiving company are not common in Europe and extending the exception will have very limited application, if applied at all.

Section 3: Applying the acquisition method

Question 5

Paragraphs 3.11–3.20 discuss how to apply the acquisition method to business combinations under common control.

(a) In the IASB'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 IASB'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 IASB 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?

EFRAG's response

EFRAG welcomes the IASB's discussions on the notion of distributions from and contributions to equity but acknowledges that these are difficult to be measured and unlikely to occur in practice. If a distribution from equity occurs, EFRAG agrees that the IASB should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity but rather recognise any difference between the fair value of consideration paid and the fair value of identifiable acquired assets and liabilities entirely as goodwill.

EFRAG's consultation and outreach resulted in mixed views regarding when the consideration paid is lower than the identifiable assets and liabilities acquired in the business combination. Some preferred recognition in equity while others preferred consistency with IFRS 3, i.e., recognition in profit or loss. EFRAG sees merit in using each of these two alternatives. Therefore, EFRAG suggests the IASB to further explore these approaches in order to provide relevant information to users of financial statements.

Moreover, EFRAG suggests that the IASB provides further guidance on identifying the acquirer, both when entities apply the acquisition method and when they apply a book-value method, particularly when the transaction involves a NewCo.

Distributions from equity

56 EFRAG welcomes the IASB's discussions on the notion of distributions from equity. However, EFRAG considers that these distributions would be unlikely in practice when an entity applies the acquisition method as non-controlling shareholders are affected. In such circumstances, EFRAG considers that the consideration paid is expected to be priced at arm's length. Thus, EFRAG considers that entities should apply the acquisition method in full when applying the acquisition method to BCUCCs.

57 In the unlikely event that a distribution from equity occurs, EFRAG agrees with the IASB's tentative decision not to develop a requirement for the receiving company to identify, measure and recognise a distribution from equity. EFRAG considers that any difference between the fair value of consideration paid and the fair value of identifiable acquired assets and liabilities should be recognised entirely as goodwill (i.e., no support for recognising a distribution resulting from the excess between the fair value of the consideration paid and the fair value of the acquired business). EFRAG supports the difference being recognised as goodwill for the following reasons:

(a) recognition of a distribution from equity would only increase complexity of reporting the transaction and result in higher costs for preparers compared to the excess being recognised as goodwill. The calculation of the distribution would be too complex and judgemental thus questioning the relevance and reliability of the results;

(b) this treatment is consistent with IFRS 3 whereby goodwill is initially recognised and then subsequently tested for impairment. Therefore, any excess consideration paid over the identifiable acquired assets and liabilities would be subsequently addressed via the goodwill impairment testing; and

(c) dividing the excess between a distribution from equity and goodwill would result in significant judgement, e.g., an overpayment is unlikely to be evident or known at the acquisition date and that the overpayment would be difficult, if not impossible, to quantify.

Contributions to equity

58 EFRAG welcomes the IASB's discussions on the notion of contributions to equity. However, EFRAG considers that these contributions are unlikely to occur in practice because the controlling party is unlikely to allow a transfer of wealth to non-controlling shareholders. EFRAG also acknowledges it would be difficult to measure a full amount of this contribution to equity.

59 EFRAG has considered two alternatives when applying the acquisition method to BCUCCs:

(a) Alternative 1 relates to the IASB's proposals in the DP; while

(b) Alternative 2 relates to consistency with the requirements in IFRS 3.

60 Based on EFRAG's consultation and outreach, EFRAG received mixed views on the alternatives. The following are reasons in favour of each alternative.

61 Reasons considered for a portion of the contribution to be recognised as part of equity (Alternative 1) are as follows:

(a) This should not be recognised as a gain in the statement of profit or loss because, the difference between the consideration paid and the fair value of identifiable acquired assets and liabilities does not represent an actual gain in a transaction where the ultimate controlling party does not change;

(b) Recognition within equity instead of in the statement of profit or loss would minimise any management structuring opportunities; and

(c) This portion is consistent with paragraph 106 of IAS 1 *Presentation of Financial Statements*. That is, these BCUCC are transactions with owners acting in their capacity as owners and based on IAS 1 requirements should be reported in the receiving entity's statement of changes in equity.

62 Reasons considered for recognition in profit or loss, i.e., consistency with IFRS 3 (Alternative 2) are as follows:

(a) The receiving company may expect future losses from the acquired company because the business is loss-making or because of internal restructuring. Therefore, in such circumstances, an entity would incorrectly recognise the gain from a bargain purchase directly in equity;

(b) Is consistent with the IASB's view in the DP that if such a transfer occurs which results in a substantive change in the ownership interests in the economic resources of the transferred company, that transaction is similar to business combinations covered by IFRS 3 (paragraph 2.20 of the DP); and

(c) Consistent with the assumption that BCUCC affecting non-controlling shareholders are similar to business combinations covered by IFRS 3.

63 Based on the reasons provided above, EFRAG sees merit in using each of the two alternatives. Therefore, EFRAG suggests the IASB to further explore both alternatives in order to provide relevant information to users of financial statements.

Any other special requirements

64 EFRAG notes that the DP is focused on the receiving entity and appears to assume that the receiving entity is always the acquirer under the requirements in IFRS 3. However, EFRAG observes that identifying the acquirer, particularly in cases that involve a NewCo, might be challenging. Therefore, EFRAG considers that it would be useful to have guidance on identifying the receiving entity (the acquirer) in BCUCC when the acquisition method is applied. Likewise, identifying the receiving entity (the acquirer) is relevant for a BCUCC to which a book-value method is applied, in particular, when providing pre-combination information about the combining entities in the transaction.

65 Furthermore, EFRAG considers that further developing relevant definitions for both distributions from equity and contributions to equity would be useful in order to clearly understand the concepts being considered under the acquisition method.

Section 4: Applying a book-value method

Measuring the assets and liabilities received

Question 6

Paragraphs 4.10–4.19 discuss the IASB'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 IASB's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

EFRAG's response

EFRAG considers that both the use of the carrying amounts in the consolidated financial statements of the transferred company's controlling party and use of the carrying amounts in the financial statements of the transferred company can provide decision-useful information for users.

EFRAG also considers that using one or the other approach would depend on facts and circumstances of the receiving company including cost/benefit considerations. For this reason, EFRAG proposes an accounting policy option to allow the use of the carrying amounts in the consolidated financial statements of the transferred company's controlling party. EFRAG further suggests that the accounting policy choice should be applied on a transaction-by-transaction basis and be supported by additional disclosures explaining that choice.

66 There are two possible approaches that EFRAG is aware of to measure the assets and liabilities received by the receiving company:

(a) Carrying amounts included in the financial statements of the transferred company (as suggested by the DP); or

(b) Carrying amounts included in the consolidated financial statements of the transferred company's controlling party (or ultimate controlling parties), including the possibility to use the intermediate book values of potential sub-holding within the group to capture the latest IFRS amounts within the group.

67 The advantages of using the transferred company's book values (the IASB's preferred option), when compared to that of the controlling party, are that this approach:

(a) provides uninterrupted historical information about the transferred company, that is useful in analysing trends;

(b) treats the assets and liabilities of the combining companies on the same basis. That is, continued measurement at book values previously reported by the transferred company;

(c) reflects the view that the ownership within a group has simply been moved from one part of the group to another (no significant incremental value of the group); and

(d) is consistent with the Conceptual Framework which focuses on information about transactions and events from the perspective of the company that prepares the financial statements. In this case, it could be argued that the controlling party is not a party to the transaction.

68 Disadvantages of using the transferred company's book values, when compared to that of the controlling party, are that:

(a) this approach does not provide a more recent valuation of the assets and liabilities acquired;

(b) this approach does not take into consideration the perspective of the controlling party as the transaction does not change the controlling party's control over the assets and liabilities received;

(c) the transferred company may not have prepared its financial statements in accordance with IFRS Standards or may not have prepared any financial statements at all. Therefore, the book values of the transferred company may have to be adjusted to align with the receiving company's accounting policies applying IFRS 10; and

(d) using the book values of the controlling party would enable consistent accounting policies within the group.

69 EFRAG considers that both approaches can provide decision-useful information for users. Also, EFRAG's outreach showed that there was no distinct approach preferred. EFRAG considers that using one or the other approach would depend on facts and circumstances of the receiving company. For example, on the one hand, some receiving companies would find it more costly (and more complex) to use the transferred company's carrying amounts because the amounts would be more readily available at the controlling party level. This is especially if the transferred company prepares financial statements under local GAAP. While on the other hand, uninterrupted historical information is preferred and would be less costly.

70 Therefore, based on the above reasons, EFRAG proposes an accounting policy choice between the two approaches listed in paragraph 66 above. EFRAG further suggests that the accounting policy choice should be applied on a transaction-by-transaction basis and be supported by additional disclosures explaining that choice.

71 EFRAG considers, in general, that accounting policy choices affect comparability to a certain extent. However, in this case, EFRAG considers that the cost/benefit trade-off is more important than a lack of comparability, for reasons which include that in Europe, many companies apply local GAAP in their separate financial statements.

Measuring the consideration paid

Question 7

Paragraphs 4.20–4.43 discuss the IASB's preliminary views that:

(a) the IASB 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 IASB's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

EFRAG's response

EFRAG agrees with the IASB proposal not to prescribe how the receiving company should measure the consideration paid in its own shares.

In addition, EFRAG agrees with the measurement proposed in the DP for consideration paid in assets and consideration paid by incurring or assuming liabilities. However, EFRAG observes that the consideration paid in assets is not consistent with the requirements of IFRIC 17 *Distributions of Non-cash Assets to Owners* on how to measure non-cash assets distributed as dividends. Therefore, EFRAG suggests that the IASB considers allowing the use of fair value measurement for consideration paid in assets as the information may be relevant for creditors and other lenders.

Consideration paid in own shares

72 EFRAG agrees with the IASB proposal not to prescribe how the receiving company should measure the consideration paid in its own shares. EFRAG agrees with the IASB that the reporting of components within a reporting company's equity and the

measurement of issued shares for the purpose of that reporting are often affected by national requirements and regulations, and are generally not prescribed in IFRS Standards.

Consideration paid in assets

73 EFRAG agrees with the IASB's preliminary view that consideration paid in the form of assets would be measured at the receiving entity's book values of those assets at the combination date. This is consistent with the measurement approach which focuses on book value rather than fair value. In addition, it is likely to be less costly and burdensome to use book value rather than fair value.

74 EFRAG notes that the approach taken by the IASB to measure the consideration paid in the form of assets at their book values at the date of the combination may appear to be inconsistent with a scenario where the entity first sells the asset at fair value and uses the cash proceeds received as consideration in a BCUCC. However, EFRAG considers that these are two different situations because the transaction in the form of assets is not a disposal of assets while if the entity first sells the assets, there would be a disposal of these assets.

75 Furthermore, EFRAG acknowledges that measuring the consideration paid in assets at fair value could be costly and involve significant measurement uncertainty. However, EFRAG suggests that the IASB considers allowing the use of fair value measurement, particularly in light of IFRIC 17 *Distributions of Non-cash Assets to Owners*, where an entity has to measure a liability to distribute non-cash assets as a dividend at the fair value of the net assets to be distributed (even if IFRIC 17 does not currently apply to common control transactions).

Consideration paid by incurring or assuming liabilities

76 EFRAG agrees with the IASB's proposals to measure the carrying amounts of those liabilities determined at the combination date in accordance with applicable IFRS Standards as this would provide the most useful information about those liabilities in such BCUCC transactions. Furthermore, it would ensure consistency as IFRS Standards would continue to be applied to subsequent measurement of those liabilities.

Other comments

77 EFRAG considers that the consideration paid in BCUCC can take additional forms such as exchange of interests in businesses in a group restructuring. The receiving entity may exchange an existing business in order to obtain the transferred company. In this case, EFRAG questions how the consideration would be measured.

Reporting the difference between the consideration paid and book value of assets and liabilities received

Question 8

Paragraphs 4.44–4.50 discuss the IASB'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 IASB should not prescribe in which component, or components, of equity the receiving company should present that difference.

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

EFRAG's response

EFRAG agrees to recognise within equity any difference between the consideration paid and the book value of the assets and liabilities received.

EFRAG also agrees with not specifying in which component(s) of equity the difference between consideration paid and assets and liabilities received should be presented.

78 Not all of the difference arising from applying the book-value method necessarily constitutes a contribution to or a distribution from the receiving company's equity nor an income or expense. The difference may include one or more of the following:

(a) the difference between the consideration paid and what would have been paid in an arm's length transaction, i.e., constituting a contribution to or a distribution from the receiving company's equity;

(b) any unrecognised goodwill (pre-existing goodwill in the transferred company and any synergies). However, EFRAG considers that, since the consideration paid may not be priced at arm's length, recognising any goodwill might result in measuring goodwill at an arbitrary amount that does not provide useful information; and

(c) other factors, such as measurement differences arising from measuring assets and liabilities received at their book values rather than their fair values and the effects of how the consideration paid is measured under a book-value method.

79 However, EFRAG does not support disaggregating these components as it is likely to be complex and costly. EFRAG considers it more appropriate to recognise any difference (between the consideration paid and the book value of the assets and liabilities received) within equity:

(a) based on cost-benefit considerations, since the book-value method should only be applied to particular BCUCC;

(b) BCUCC involves related parties, these transactions may include a contribution to or distribution from the receiving company's equity;

(c) this is consistent with the Conceptual Framework, paragraph F4.4(b) that states that "*income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants*"; and

(d) this is also consistent with IAS 1 which states that transactions with owners acting in their capacity as owners should be reported in the receiving entity's statement of changes in equity.

80 EFRAG also agrees with not specifying in which component or components of equity the difference between consideration paid and assets and liabilities received should be presented. This is because allocation to components of equity is not generally prescribed under IFRS Standards and such specification is commonly addressed by local legislation.

81 However, EFRAG considers that the impact on equity might be significant in cases where the consideration paid is at fair value. This impact will also depend on how far in the past the transferred entity was acquired by the controlling party. The longer the time since the acquisition, the more significant will be the negative impact on the receiving entity's equity.

Reporting transaction costs

Question 9

Paragraphs 4.51–4.56 discuss the IASB'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 IASB's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

EFRAG's response

EFRAG agrees with the IASB's preliminary view that transaction costs should be recognised as an expense when incurred except that the costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS Standards.

82 Transaction costs may include advisory, legal, accounting and other professional fees for BCUCC transactions.

83 The IASB's proposal is consistent with the requirement for transaction costs under IFRS 3. The IASB's rationale in developing IFRS 3 was that costs are not part of the exchange between the buyer and the seller for the business. Rather, they are separate transactions in which the buyer pays for the services received. EFRAG agrees with this reasoning.

84 Therefore, EFRAG agrees to recognise transaction costs incurred in BCUCC as an expense in the period in which they are incurred and to recognise costs related to the issue of debt or equity instruments in accordance with IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments*.

Providing pre-combination information

Question 10

Paragraphs 4.57–4.65 discuss the IASB'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 IASB's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

EFRAG's response

The EFRAG [TEG] members, as well as European stakeholders, expressed mixed views with respect to the pre-combination information to be provided under the book-value method.

A majority of members agree with the IASB proposals that 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 based on a cost-benefit consideration and the feedback received during the consultation process on this project.

A minority of members disagree with the IASB's view that the retrospective approach would be more costly to apply than a prospective approach. Based on the EFRAG consultation and outreach, it was indicated that the benefits provided by the presentation of retrospective information would outweigh the costs and some jurisdictions require to restate comparatives due to local requirements. Therefore, those members suggest an accounting policy choice and support for retrospective application until the beginning of the reporting period if the receiving entity chooses this option. This is in order to avoid the use of hindsight.

85 Feedback from EFRAG stakeholders indicates that mixed views exist on whether the pre-combination information should be applied prospectively (from the combination date) or retrospectively.

86 A majority of the EFRAG [TEG] members agree with the IASB proposals on pre-combination information for conceptual reasons, as they question the usefulness of information that refers to a period when the combination was not in existence. Furthermore, this presentation is consistent with the requirements in IFRS 3. These EFRAG [TEG] members also note that one of the key reasons for the IASB to propose a book-value method is based on a cost-benefit consideration, as a retrospective application may be more costly.

87 A minority of the EFRAG [TEG] members supported a retrospective application. To limit the use of hindsight when restating pre-combination information as if the combining companies had always been combined, these members propose restating pre-combination information until the beginning of the reporting period. These members, therefore, suggest having an accounting policy choice.

88 Based on the EFRAG consultation and outreach activities, there were mixed views on whether to provide prospective[1] or retrospective[2] information. The feedback has, in particular, shown that currently the local requirements/regulation of some jurisdictions require presentation of restated (pro-forma) comparatives, while others do not. Therefore, the cost-benefit profile may not be the same for all jurisdictions.

89 In addition, the IASB in its discussion paper notes that a retrospective approach would be more costly to apply than a prospective approach. However, based on EFRAG's outreach and consultation, it was indicated by some stakeholders that the benefits provided by the presentation of retrospective information would outweigh the costs. For example, in some situations, compared to prospective application, retrospective application could result in more relevant information, such as, for IPOs and also some have to provide retrospective information due to local

[1] That is, the receiving company's financial statements are prepared from the date of the combination without restating pre-combination information.

[2] That is, the receiving company's financial statements are prepared as if the combining companies had always been combined, with pre-combination information restated to include the transferred company's assets, liabilities, income and expenses.

requirements/regulation. In conclusion, the cost-benefit assessment would depend on the facts and circumstances of companies.

90 EFRAG finally notes that many of the respondents to its consultation were in favour of an accounting policy choice.

Section 5: Disclosure requirements

Disclosure when applying the acquisition method

Question 11

Paragraphs 5.5–5.12 of the DP discuss the IASB'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 IASB 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 IASB's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

EFRAG's response

EFRAG supports the proposed disclosure requirements for BCUCC accounted for under the acquisition method. In EFRAG's view, the proposed disclosures will provide relevant information to users of financial statements about the business combination under common control.

91 EFRAG supports the proposed disclosure requirements for BCUCC accounted for under the acquisition method. In situations where BCUCC have similar substance to a business combination within the scope of IFRS 3, users of financial statements will be provided with similar information about the transaction. EFRAG considers that this will result in relevant information about the BCUCC.

92 EFRAG supports the disclosures proposed by the IASB in the recent discussion paper *Business Combinations - Disclosures, Goodwill and Impairment* and supports having those disclosures applied also for BCUCC transactions.

Disclosure when applying a book-value method

Question 12

Paragraphs 5.13–5.28 of the DP discuss the IASB'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) of the DP;

(b) the IASB 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 IASB's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

EFRAG's response

EFRAG considers that the proposed disclosure requirements for BCUCC accounted for under the book-value method would provide relevant information about the transaction considering the specificities of BCUCC.

93 EFRAG supports the proposed disclosure requirements for BCUCC accounted for under the book-value method. The proposed disclosures would provide relevant information about the transaction considering the specificities of the BCUCC.

Appendix 2 – List of transactions requiring clarification whether they are captured by the scope of the BCUCC project

The following fact patterns require further clarification whether they fall within the scope of the IASB's DP on B**CUCC:**

(a) a transfer of an **ownership interest in an entity under common control which on its own does not constitute a transfer of a business from the transferor's perspective;**

(b) transactions where unrelated parties h**old an ownership interest in two joint ventures;**

(c) legal mergers fro**m the perspective of receiving company's separate financial statements;**

(d) group restructuring **which involves a transfer of a business to a parent - it is not clear whether the receiving company obtains control of the business because it already controlled it, through control of its subsidiary;**

(e) transactions in which shareholders before and after a restructuring **are exactly the same and there is no contractual arrangement arranging control. Currently, such transactions are not regarded as BCUCC under IFRS 3 and acquisition accounting is applied.**