XRB EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

Board Meeting Agenda

Thursday 17 December 2020, by videoconference

Est Time	Item	Topic	Objective		Page
A: NON-PUBLIC SESSION					
B: PUBLIC SESSION					
For-profit Item for Approval					
10.00 am	**3**	**Business Combinations—Disclosures, Goodwill and Impairment** ***(Item continues after morning tea)***	(GS)		
30 mins	3.1	Cover memo	Note	Paper	
then 60 minutes after morning tea	3.2.1	Draft comment letter – marked up	Consider	Paper	
	3.2.2	Draft comment letter – clean	Approve	Paper	
	3.3	Submissions			
	3.3.1	Submission from the OAG (sent directly to the IASB with a copy to the NZASB)	Note	Supp paper	
	3.4	IASB DP/2020/1	Note	Supp paper	
	3.5	Snapshot IASB DP/2020/1	Note	Supp paper	
10.30am		*Morning tea*			
10.45 am	**3**	**Business Combinations—Disclosures, Goodwill and Impairment *(continued)***	(GS)		
60 mins	3.1–3.5	See above	See above	See above	
PBE Items for Approval					
–	**4**	**Public Sector Specific Financial Instruments**	(JP)		
	4.1	Cover Memo	Note	Moved to February 2021	
	4.2	Draft ITC	Approve		
	4.3	Draft ED	Approve		
Editorial corrections to NZ IFRS					
12.15 pm	**5**	**Editorial Corrections to NZ IFRS**	(VSF)		
10 mins	5.1	Cover memo	Approve	Paper	
12.25 pm		*Lunch*			

Est Time	Item	Topic	Objective		Page
C: NON-PUBLIC SESSION					
D: PUBLIC SESSION					
For-profit Item for Consideration					
1.55 pm	**7**	**Business Combinations under Common Control**	(GS)		
45 mins	7.1	Presentation slides	Consider	Paper	
	7.2	IASB DP/2020/2 *Business Combinations under Common Control*	Consider	Paper	
	7.3	Snapshot IASB DP/2020/2	Consider	Paper	
Standard for Noting					
2.40 pm	**8**	**Standard Approved**	(VSF)		
1 min	8.1	Approval 130 *PBE Interest Rate Benchmark Reform—Phase 2*	Note	Paper	
2.42 pm		*Afternoon tea*			
E: NON-PUBLIC SESSION					
4.05 pm		*Finish*			

Next NZASB meeting: Thursday 11 February (1pm–5pm) and Friday 12 February (9am–1pm) 2021 in person, in Wellington

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	4 December 2020
To:	NZASB Members
From:	Gali Slyuzberg
Subject:	**Cover Memo – IASB DP *Business Combinations – Disclosure Goodwill and Impairment***

Recommendations[1]

1. We recommend that the Board CONSIDERS and APPROVES the draft comment letter on the IASB Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* (the DP) (see agenda item 3.2.2).

Background

2. The IASB issued the DP in March 2020. This DP was issued as part of the IASB's *Goodwill and Impairment* project – a research project initiated with a view to considering issues identified in the Post-implementation Review (PIR) of IFRS 3 *Business Combinations*.

3. In issuing the DP, the IASB's objective is to explore whether companies can, at a reasonable cost, provide investors with more useful information about the acquisitions those companies make. The DP discusses the IASB's preliminary views on the following.

   (a) disclosures about business acquisitions (including proposals to introduce new disclosures on management's objectives for an acquisition and how the acquisition performs against these objectives in subsequent years)

   (b) the subsequent accounting for goodwill (including whether the goodwill impairment test can be made significantly more effective, whether goodwill amortisation should be reintroduced, and whether the impairment test should be simplified); and

   (c) other related topics (whether entities should be required to present total equity excluding goodwill on the balance sheet, and whether the IASB should retain the current requirements on the recognition of intangible assets separately from goodwill).

Submissions received

4. The Board decided to comment on the DP. Comments on the DP were due to the Board by 2 November 2020. The Board received a copy of the OAG's submission to the IASB (see

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

agenda item 3.3.1), as well as preliminary comments from another organisation (see agenda item 2.3.1).

Outreach conducted

5. Furthermore, as part of our outreach activities on this project, we have discussed the DP with the TRG, XRAP and the NZAuASB. We also ran a webinar on the DP (presented by staff) and held a virtual Outreach Event presented by Sue Lloyd (IASB Vice Chair) and Tim Craig (IASB technical staff member – Goodwill and Impairment project lead). A summary of all feedback received during outreach was included in the agenda of the Board's November meeting.[2]

Draft comment letter

6. At the Board's November meeting, the Board discussed the first draft of the comment letter on the DP. In this first draft, we attempted to reflect the Board's views expressed to date and feedback received. For those areas of the DP where Board members previously expressed mixed views, we drafted possible response options for the Board to choose.

7. After the November meeting, we updated the draft comment letter to reflect the Board's discussion at that meeting. Given that there were still mixed views among Board members on certain DP topics – for example, whether goodwill amortisation should be reintroduced – we circulated the revised draft comment letter to Board members on 20 November, to confirm whether the Board agrees with the general direction of the answers and whether any major redrafting is needed ahead of the December meeting. The key changes in the comment letter that was circulated to the Board are summarised in the table below.

Table 1 Changes reflected in the revised draft comment letter circulated to the Board on 20 November

Topic/Section	Changes since November NZASB meeting
Cover letter (and throughout the comment letter)	Added emphasis on the recommendation to conduct a holistic review of the accounting for intangible assets (in addition to holistically reviewing IAS 36).
Disclosures on subsequent performance of acquisitions (DP Question 2)	The draft response now says that we do *not* support requiring these disclosures in the financial statement. We have emphasised the concerns about the cost of the disclosures, the risk that the subjective nature of the disclosure requirements could lead to misleading information being disclosed, and the fact that the proposed requirements would introduce extensive disclosures on acquisitions while no such disclosures are required for investment in 'organic growth', including through the internal generation of intangible assets.

[2] Please refer to item 5.2 of the NZASB November 2020 agenda.

Topic/Section	Changes since November NZASB meeting
Disclosures on synergies (DP Question 4)	The draft response now says that we do *not* support requiring these disclosures, mainly due to concerns about costs and verifiability for audit purposes.
Impairment-only vs amortisation of goodwill (DP Question 7)	We have tried to reach a compromise between the mixed views expressed at the November meeting. We have suggested the following. ○ Noting that the Board had mixed views and we have heard mixed views on this matter, and listing some of the arguments for and against each model (this is similar to what the AASB intends to say in their letter, as per the recent AASB Action Alert). ○ Retaining the impairment-only model at this stage, but reconsidering whether to re-introduce goodwill amortisation after conducting a holistic review of IAS 36 and of the accounting for intangible assets in general. ○ Recommending that these holistic reviews should be carried out with some urgency (as some Board members were concerned that a holistic review may not happen for a long time).
Moving to an indicator-based approach for goodwill impairment vs requiring an impairment test every year (DP Question 9)	Previously we have provided the Board with two options. At the November meeting, the Board tended to support retaining the annual impairment test for goodwill, unless amortisation is reintroduced. The draft response reflects this.
Whether to remove the restriction on cash flows from future asset enhancements and uncommitted restructures (DP Question 10)	There were mixed views on this in November, there seemed to be a tentative consensus not to remove the restriction, but to reconsider this after a holistic review. This is reflected in the draft response.

8. Some Board members provided feedback on the abovementioned revised draft comment letter. We further updated the comment letter to reflect this feedback. All changes made to the comment letter after 20 November are marked up in agenda Item 3.2.1.

9. The key changes made to the draft comment letter since 20 November involved edits to reduce the risk of diluting or contradicting our key messages to the IASB, as explained below.

   (a) The draft comment letter that was circulated to the Board on 20 November included some recommendations in the event that the IASB disagrees with the Board's views. For example, under Question 2 of the DP, the draft comment letter expressed disagreement with including the proposed disclosure requirements on the subsequent performance of acquisitions in the financial statements, but the letter also provided comments and

recommendations in relation to the proposed disclosures in the event that the IASB disagrees with the Board's views. In following this approach, we attempted to strike a balance between communicating the Board's disagreement with the IASB's preliminary view expressed in the DP on one hand, and providing comments that could be helpful to the IASB should it disagree with the Board's view.

(b) When we circulated the revised comment letter to Board members on 20 November, some Board members agreed with the abovementioned approach. However, we also received feedback that this approach risks diluting and potentially even contradicting the Board's key messages to the IASB.

(c) To address this feedback, we proposed the following changes to the draft comment letter.

   (i) Delete the responses to certain questions that deal with specific aspects of a proposal that the Board disagrees with (see Question 2, paragraph 20 and the deleted paragraphs after it in agenda Item 3.2.1).

   (ii) Shorten certain paragraphs that contain recommendations should the IASB disagree with the Board's view, and re-frame the discussion in these paragraphs to ensure that they do not indicate agreement with the proposals, but rather highlight issues that would be important to resolve if the IASB proceeds with these disclosures (for example, see paragraphs 18 and 19 in agenda Item 3.2.1).

10. Other changes made to the draft comment letter in response to Board members' comments on the 20 November version of the letter include the following.

   (a) Paragraph 7: Expanded the discussion on the subjectivity of the proposed disclosures on the subsequent performance of an acquisition, to refer to the high level of judgement involved in determining whether certain revenues and costs are attributable to 'the acquisition' or to other parts of the business.

   (b) Paragraph 17: Added discussion on whether the proposed disclosures on the objectives and subsequent performance of acquisitions may be better placed in management commentary.

   (c) Paragraph 62: Added discussion about the misconception that goodwill can only be impaired if the related cash generating unit (CGU) is making losses. Under an indicator-based approach to goodwill impairment, this misconception could exacerbate the risk of goodwill impairment losses being missed and not recognised in a timely manner.

11. We have also completed the drafting of the cover letter (the cover letter was previously incomplete, pending the finalisation of the responses to the DP questions).

12. Furthermore, we would like to confirm whether the Board wishes to retain the following paragraphs in the letter. There were mixed views among those Board members who commented on the 20 November version of the letter as to whether these paragraphs should be deleted or retained.

   (a) Paragraph 38 – which recommends emphasising the 'reasonable and supportable' requirement in IAS 36, to address the tension that currently exists between this

requirement and the requirement to base assumptions on budgets and forecasts approved by management.

(b) Paragraphs 46 (a) and (b) – which acknowledge the argument that the core elements of goodwill have an indefinite life, and that valuers assume this to be the case when determining the price of a business.

13. A 'clean' version of the comment letter is included in agenda Item 3.2.2.

Questions for the Board

Q1. Does the Board agree with the changes to the comment letter that are marked up in agenda Item 3.2.1?

Q2. Does the Board agree to retain paragraphs 38 and 46(a) and (b) in the comment letter?

Q3. Does the Board have any other comments on the draft comment letter in agenda Item 3.2.2?

Q4. Does the Board approve the draft comment letter in agenda Item 3.2.2?

Next steps

14. If the Board identifies additional changes to the draft comment letter at this meeting and agrees to approve the comment letter subject to such changes, we propose that staff work with the Acting Chair to finalise the comment letter.

15. We will then send the approved comment letter to the IASB before the due date of 31 December 2020.

Attachments

Agenda item 3.2.1:	Draft comment letter – marked up
Agenda item 3.2.2:	Draft comment letter – clean
Agenda item 3.3.1:	Submission from the OAG (sent directly to the IASB with a copy to the NZASB – in supplementary papers)
Agenda item 3.4:	IASB DP/2020/1 *Business Combinations—Disclosures, Goodwill and Impairment* (in supplementary papers)
Agenda item 3.5:	IASB Snapshot *Business Combinations—Disclosures, Goodwill and Impairment* (in supplementary papers)

NZ ACCOUNTING STANDARDS BOARD

Note for the Board: On 20 November, we circulated a revised draft cover letter to the Board, reflecting the Board's discussion at the November meeting. This draft includes additional changes resulting from Board members' feedback on the 20 November draft. Only those changes made after 20 November are marked up.

Mr Hans Hoogervorst
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Submitted to: www.ifrs.org or By email: commentletters@ifrs.org

Dear Hans

DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment*

Thank you for the opportunity to comment on the Discussion Paper DP/2020/1 *Business Combinations – Disclosure, Goodwill and Impairment* (the DP). We acknowledge the importance and relevance of the topics discussed in the DP, and appreciate the timeliness of the IASB's consultation on these topics. The DP has been exposed for comment in New Zealand and some New Zealand constituents may comment directly to you.

Our comments should be read in the following context.

- Section 6 of the DP refers to the 2019 research report by the Australian Accounting Standards Board (AASB), entitled AASB Research Report 9 *Perspectives on IAS 36: A Case for Standard Setting Activity* (AASB Research Report). The AASB Research Report notes that the ongoing application issues relating to IAS 36 *Impairment of Assets* demonstrate a consistent divergence in preparers', users', auditors' and regulators' understanding of the impairment requirements. Consequently, the AASB Research Report recommends a holistic review of IAS 36.
- Section 6 of the DP notes that such a holistic review is beyond the scope of this project. However, stakeholders who consider that such a holistic review is required are encouraged to provide this feedback by responding to the IASB's forthcoming 2020 agenda consultation.

- While we have focused our responses to the specific matters discussed in the DP, we would strongly support a holistic review of IAS 36 and intend to make a recommendation to that effect when we comment on the IASB's forthcoming agenda consultation.
- We also intend to recommend a holistic review of the accounting for goodwill and other intangible assets, including internally generated intangible items that are not recognised under current requirements in IFRS Standards.

The main points that we have raised in this letter are summarised below.

Commented [GS1]: The text below is new, and is based on the Board's most recent review of the detailed responses

- Proposed disclosures on the subsequent performance of acquisitions and expected synergies: We do not agree that these disclosures should be included in the financial statements for the following reasons.
    - We are concerned that the subjective nature of the disclosures on the subsequent performance of acquisitions may lead to misleading information being disclosed in the financial statements. Furthermore, disclosures about synergies may be based on information that lacks accuracy and completeness.
    - We think that the cost of preparing the disclosures and having them audited would significantly increase costs for preparers of financial statements, and we are not convinced that these costs are outweighed by the possible benefits of the disclosures.
    - There is a risk that due to concerns about commercial sensitivity or about possible failure to achieve targets, the proposed disclosures would be provided in such a generic way so as not to be useful to investors.
    - The disclosures may also be challenging to audit.
    - While the DP proposes relatively extensive disclosures in relation to business acquisitions, we note that no such disclosures are proposed in relation to organic growth, which may be equally as significant to the entity and of as much interest to investors as growth through business acquisitions. Arguably, it would be beneficial for investors to understand how successfully management is running the business as a whole and creating value for investors – be it through acquisitions or organic growth. This is linked to our comment above recommending that the IASB perform a holistic review of the accounting requirements for intangible assets, including those that are not recognised under the current requirements.
- Subsequent accounting for goodwill
    - We think that without conducing a holistic review of IAS 36, it is not feasible to make the impairment test significantly more effective at a reasonable cost.
    - To improve the goodwill impairment test, we recommend that the IASB develop additional guidance on the allocation of goodwill to CGUs. We are aware that this is a challenging aspect of IAS 36 for preparers, and that there are concerns that goodwill is

sometimes tested for impairment as part of an excessively large CGUs. Guidance on the allocation of goodwill to CGUs can be considered as part of a holistic review of IAS 36.

- We have mixed views as to whether goodwill amortisation or the impairment-only model is generally more appropriate. However, at this stage, we recommend retaining the impairment-only model, and reconsidering this topic after carrying out a holistic review of IAS 36 and of the accounting requirements for intangible assets in general (including those that are currently not recognised on the balance sheet). We would like to emphasise the urgency of this review.

- We do not agree with moving to an indicator-based approach for goodwill impairment, unless amortisation is reintroduced. We think that an indicator-based approach would not be sufficiently robust to allow for the timely recognition of goodwill impairment losses and would exacerbate the concern that goodwill impairment losses are recognised 'too late'. Without having to perform a quantitative impairment test, it would be relatively easy to claim that the impairment indicators as currently described in IAS 36 do not apply, and therefore that goodwill is not impaired.

- We agree with the proposal to allow the use of post-tax inputs in the value-in-use (VIU) calculation, and note that this is consistent with current practice. However, we recommend not to remove the restriction on cash flows from future asset enhancements and uncommitted restructures at this stage, but to reconsider this after a holistic review of IAS 36 – which could include considering what guidance would be needed to mitigate the risk of subjectivity and management over-optimism if the restriction is to be removed.

- Other topics:

  - Presentation of total equity excluding goodwill: We strongly disagree with this proposal, as such presentation would indicate that goodwill is not an asset. Furthermore, if investors are interested in the amount of equity excluding goodwill themselves, it would be easy for them to obtain this amount themselves from readily available information in the financial statements.

  - Intangible assets: We agree that the IASB should retain the requirement to recognise identifiable intangible assets acquired in a business combination separately from goodwill. Subsuming such intangible assets within goodwill could result in entities providing investors with less information on what was acquired as part of the business combinations. As noted above, we recommend that the IASB conduct a holistic review on the accounting requirements for intangible assets (including those that are currently not recognised).

Our recommendations and responses to the specific questions for respondents are provided in the Appendix to this letter.

We would like to take this opportunity to thank IASB Vice Chair Sue Lloyd and IASB staff member Tim Craig for their assistance with an outreach event that we held on the DP with New Zealand constituents.

If you have any queries or require clarification of any matters in this letter, please contact Gali Slyuzberg (gali.slyuzberg@xrb.govt.nz) or me.

Yours sincerely

Michael Bradbury
Acting Chair – New Zealand Accounting Standards Board

Appendix:

Question 1

Paragraph 1.7 summarises the objective of the Board's research project. Paragraph IN9 summarises the Board's preliminary views. Paragraphs IN50–IN53 explain that these preliminary views are a package and those paragraphs identify some of the links between the individual preliminary views.

The Board has concluded that this package of preliminary views would, if implemented, meet the objective of the project. Companies would be required to provide investors with more useful information about the businesses those companies acquire. The aim is to help investors to assess performance and more effectively hold management to account for its decisions to acquire those businesses. The Board is of the view that the benefits of providing that information would exceed the costs of providing it.

(a) Do you agree with the Board's conclusion? Why or why not? If not, what package of decisions would you propose and how would that package meet the project's objective?

(b) Do any of your answers depend on answers to other questions? For example, does your answer on relief from a mandatory quantitative impairment test for goodwill depend on whether the Board reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?

Response to Question 1:

1. We acknowledge that acquisitions of businesses are often major transactions that have a significant impact on the acquiring entity, and that it is important for investors to receive enough information about these transactions and their impact on the entity's financial performance and position. However, while we agree with some of the preliminary views expressed in the DP, we think that the package of preliminary views as discussed in the DP may not help investors assess the performance of acquisitions and hold management to account for their acquisition decisions. Specifically, as explained in our response to Question 2, we are concerned that the subjective nature of the proposed disclosures on the subsequent performance of acquisitions could result in misleading disclosures – which would go against the intended purpose of the disclosures. Another risk is that disclosures provided under the proposed requirement would be overly generic and therefore not useful to investors, or would not be provided at all – either because of commercial sensitivity or to avoid criticism of management. Furthermore, while the DP aims to provide better information on acquisition at a reasonable cost to preparers, we are concerned that the cost of preparing the disclosures proposed in the DP and having these disclosures audited may not be reasonable.

2. If the IASB decides to proceed with proposing the disclosures included in the DP, we think it would be very important to do the following before requiring these disclosures.

    (a) Consider introducing safeguards to avoid misleading disclosures or overly generic disclosures, and;

    (b) consider and analyse the costs of the suggested disclosures to ensure that the cost is justified by the expected benefits – field tests could be useful in this regard.

3. While the DP emphasises the importance of looking at the preliminary views in the DP as a package, we think it is also important to consider how these preliminary views fit within the larger package of IAS 36 as a whole and the accounting for intangible assets in general – including internally generated intangible items. We understand that these wider considerations are outside the scope of this project, but we think it is important to take these considerations into account before deciding whether to make significant changes to the disclosure requirements for acquisitions or to the accounting for goodwill (e.g. reintroducing amortisation).

4. As to whether our answers to the questions in the DP are interlinked, we note that a common theme in most of our answers is that we would recommend not to make significant changes to the accounting and disclosure requirements in relation to acquisitions without conducting a holistic review of IAS 36 and the accounting requirements for goodwill and other intangibles. We also note the following interlinked answers:

   (a) If the IASB introduces the proposed disclosures on the subsequent performance of acquisition, we would support retaining the existing requirements to disclose the 'pro forma' performance information currently required by IFRS 3 *Business Combinations* only for those acquisitions that are not monitored by the chief operating decision maker (CODM) – as the disclosures on the subsequent performance of acquisitions would not be provided for such acquisitions.

   (b) We would not support an indicator-based approach for goodwill impairment testing if the impairment-only model is retained, but would support such an approach if goodwill is amortised.

Question 2

Paragraphs 2.4–2.44 discuss the Board's preliminary view that it should add new disclosure requirements about the subsequent performance of an acquisition.

(a) Do you think those disclosure requirements would resolve the issue identified in paragraph 2.4—investors' need for better information on the subsequent performance of an acquisition? Why or why not?

(b) Do you agree with the disclosure proposals set out in (i)–(vi) below? Why or why not?

(i) A company should be required to disclose information about the strategic rationale and management's (the chief operating decision maker's (CODM's)) objectives for an acquisition as at the acquisition date (see paragraphs 2.8–2.12). Paragraph 7 of IFRS 8 *Operating Segments* discusses the term 'chief operating decision maker'.

(ii) A company should be required to disclose information about whether it is meeting those objectives. That information should be based on how management (CODM) monitors and measures whether the acquisition is meeting its objectives (see paragraphs 2.13–2.40), rather than on metrics prescribed by the Board.

(iii) If management (CODM) does not monitor an acquisition, the company should be required to disclose that fact and explain why it does not do so. The Board should not require a company to disclose any metrics in such cases (see paragraphs 2.19–2.20).

(iv) A company should be required to disclose the information in (ii) for as long as its management (CODM) continues to monitor the acquisition to see whether it is meeting its objectives (see paragraphs 2.41–2.44).

(v) If management (CODM) stops monitoring whether those objectives are being met before the end of the second full year after the year of acquisition, the company should be required to disclose that fact and the reasons why it has done so (see paragraphs 2.41–2.44).

(vi) If management (CODM) changes the metrics it uses to monitor whether the objectives of the acquisition are being met, the company should be required to disclose the new metrics and the reasons for the change (see paragraph 2.21).

(c) Do you agree that the information provided should be based on the information and the acquisitions a company's CODM reviews (see paragraphs 2.33–2.40)? Why or why not? Are you concerned that companies may not provide material information about acquisitions to investors if their disclosures are based on what the CODM reviews? Are you concerned that the volume of disclosures would be onerous if companies' disclosures are not based on the acquisitions the CODM reviews?

(d) Could concerns about commercial sensitivity (see paragraphs 2.27–2.28) inhibit companies from disclosing information about management's (CODM's) objectives for an acquisition and about the metrics used to monitor whether those objectives are being met? Why or why not? Could commercial sensitivity be a valid reason for companies not to disclose some of that information when investors need it? Why or why not?

(e) Paragraphs 2.29–2.32 explain the Board's view that the information setting out management's (CODM's) objectives for the acquisition and the metrics used to monitor progress in meeting those objectives is not forward-looking information. Instead, the Board considers the information would reflect management's (CODM's) targets at the time of the acquisition. Are there any constraints in your jurisdiction that could affect a company's ability to disclose this information? What are those constraints and what effect could they have?

Response to Question 2

Question 2(a)–(b): General comments on the proposed disclosures on the subsequent performance of acquisitions

5. We do not support requiring disclosures listed in Question 2(b) in the financial statements. We acknowledge that in principle, if the proposed disclosures are prepared in an unbiased and sufficiently detailed way, these disclosures could help investors better understand the rationale for an acquisition, what benefits management intended to achieve by acquiring the business for the price that it paid – and in subsequent years, how successful the acquisition has been. The proposed disclosures could also focus management's attention on these matters. However, we are not sure to what extent these disclosures would affect investors' decision making, and we are not convinced that the possible benefits of the disclosures are justified by the risks and costs explained below.

Subjective nature of disclosure requirements may lead to misleading disclosures

6. We are concerned that the subjective nature of the disclosures and level of judgement required in providing them could lead to misleading disclosures about acquisitions. The DP proposes that the disclosures on the subsequent performance of acquisitions should be based on those metrics that are used by management (specifically, the CODM) to monitor the acquisition's performance. Under this 'management approach', no requirements or guidance is proposed as to what metrics would be appropriate. There is a range of metrics that management could use to measure the subsequent performance of an acquisition. An acquisition may be successful based on one set of metrics but unsuccessful based on another set. For example, an acquisition may reach a revenue or sales volumes target, but fail with respect to profitability targets. Deciding which metrics should be used by the CODM to measure the success of an acquisition, and therefore which metrics should be disclosed, requires a high degree of judgement. Management would be able to select performance metrics or change these metrics in a way that portrays an unsuccessful acquisition as successful. This could happen inadvertently due to genuine perspective bias on management's part – or it could happen due to a desire to hide poor acquisition decisions.

7. Furthermore, a high level of judgement would be required in determining the performance of the acquisition for a given metric. For example, if the CODM monitors the performance of the acquisition based on operating profit, it would be necessary to decide whether this operating profit should be measured for the acquired business on a standalone basis, or together with

the acquiree's existing business (or a division of that business) with which the acquired business is integrated. It would also be necessary to decide how to allocate revenue and costs to the acquired business (or the acquired business and those parts of the existing business with which it is integrated). In some cases it would be challenging to determine whether a revenue or expense transaction is attributable to the acquisition and therefore should form part of the metric that measures the success of the acquisition – or whether that transaction is attributable to the existing business. Different decisions could lead to very different disclosures about the acquisition's performance. The subjective nature of these decisions and the high level of judgement involved means that the selected metrics and disclosures based on them may not provide a representationally faithful view of whether the acquisition is successful or not in meeting management's objectives for the acquisition.

Commented [GS2]: Added based on comments from a Board member

8. If disclosures about the subsequent performance of acquisitions is misleading, this would negate the abovementioned possible benefits of these disclosures.

Risk of entities providing overly generic or minimal disclosures

9. Furthermore, there is a risk that entities would change their internal reporting to the CODM in such a way that the CODM reviews overly generic information about acquisitions – which would justify the disclosure of such overly generic information in the financial statements, and this would not be helpful to investors. Overly generic disclosures could be driven by management concerns about commercial sensitivity and/or the risk of being criticised for not achieving the expected objectives.

10. Commercial sensitivity was a common concern that constituents expressed during our outreach activities – particularly in the context of New Zealand's relatively small economy.

11. Concerns about commercial sensitivity could arise particularly for privately held companies. While listed companies arguably already share some information of a strategic nature with investors and provide some information about acquisitions beyond the current accounting requirements, for example, when it is appropriate to do so under the continuous disclosure requirements of the stock exchange, privately held companies would perhaps be less accustomed to sharing such information with the users of their financial statements.

12. We think commercial sensitivity would be a factor that entities would take into account when determining the nature of information and level of detail that they are prepared to provide under the proposed disclosure requirements. There is a risk that due to concerns about commercial sensitivity, some preparers might provide disclosures that are so general so as not to be useful to investors. Furthermore, some preparers who do not wish to provide the disclosures for reasons other than commercial sensitivity (for example, due to concerns that the objectives for the acquisition might not be achieved) may refer to commercial sensitivity as a justification for lack of disclosure or for overly general disclosures.

Commented [GS3]: This is existing text from Question 2(d) – I have transferred it here as I am proposing to delete the response to Question 2(d) (see below), but I think this part of the response is worth keeping as it supports our argument against the disclosures.

Cost of the disclosures: preparation, audit and regulation

13. We appreciate that the IASB has taken steps to ensure that costs to preparers would be reasonable – by proposing that disclosures be based on information used by management internally and by requiring disclosures only for those acquisitions that are managed by the

CODM. However, we think that the cost of the proposed disclosures (including audit costs) could be very high, and may exceed the benefits of the disclosures (particularly given the above concerns about the risk of misleading or overly generic disclosures).

Commented [GS4]: Added as recommended by a Board member

14. We think that the proposed disclosures could give rise to the following costs:

    (a) Preparation costs: We have heard concerns that the costs of providing the proposed disclosures may be high. Preparation costs could arise, for example, from having to 'sanitise' internally used metrics and targets so that they can be disclosed without giving away commercially sensitive information while providing sufficient detail for investors.

    (b) Assurance costs: The proposed disclosures are relatively extensive and would increase the scope of the audit. Furthermore, we have heard concerns that the proposed disclosures may be difficult to audit. This could lead to more expensive audits for entities that acquire other businesses.

    (c) Regulatory costs: It is likely that the proposed disclosures would be a focus area for regulators (particularly due to the degree of subjectivity and level of judgement required – please see above). Compliance with regulators' queries and reviews in relation to the proposed disclosures could indirectly lead to increased preparation costs and audit costs.

    (d) Proprietary costs: These are the costs that result from providing information that an entity's competitors can use to gain competitive advantage over the entity (and the costs incurred in trying to avoid providing this information).

Commented [GS5]: Added as per comments from a Board member

Asymmetry between reporting on business acquisitions vs reporting on organic growth

15. The proposals in the DP would introduce relatively extensive disclosure requirements about the subsequent performance of business acquisitions. However, no such disclosures would be required for the organic growth of an entity – which could involve just as much capital outlay and have just as significant an impact on the entity's performance and position as growth through acquisitions, and could be of as much interest to investors.

16. There is already a difference in the extent of accounting requirements for growth through acquisitions as compared to organic growth. For example, goodwill and certain intangible assets can be recognised only in a business combination, but not when they are generated internally. However, introducing significant disclosure requirements in relation to acquisition would increase this 'imbalance' in information provided in the financial statements about the two different types of investment in the entity's growth. Arguably, it would be beneficial for investors to understand how successfully management is running the business as a whole and creating value for investors – be it through acquisitions or organic growth. This is linked to our comment in the cover letter about recommending that the IASB perform a holistic review of the accounting requirements for intangible assets, including those that are not recognised under the current requirements.

17. The IASB's Practice Statement *Management Commentary* notes that two of the key elements

of management commentary are "management's objectives and its strategy for meeting these objectives" and "critical performance measures and indicators that management uses to evaluate the entity's performance against stated objectives". The nature of the disclosures proposed in the DP on the subsequent performance of acquisition appear to be similar in nature to the abovementioned elements of management commentary. Therefore, it is possible that these disclosures may fit better in management commentary rather than in the financial statements. If the disclosures proposed in the DP on the objectives and subsequent performance of and acquisition are included in an entity's management commentary – together with information about the strategy and performance of the existing business (which we understand is already disclosed in management commentary by some entities) – then by reading the management commentary an investor would receive a holistic picture of the entity's performance and value creation.

Proposed considerations should ~~If~~ the IASB ~~decides~~ be inclined to proceed with the proposed disclosures:

18. If the IASB ~~decides~~ is inclined to proceed with proposing the disclosures included in the DP, we think it would be very important for the IASB to consider the following before requiring these disclosures.

    (a) Considering whether and to what extent it is possible to introduce ~~Introducing~~ safeguards to avoid the risk of misleading disclosures. For example, the IASB could consider providing principles-based guidance on the type of disclosures on objectives and metrics that would be expected or appropriate, or a certain minimum level of disclosures. While this may mean that some entities would need to collect certain information that they did not previously collect as part of their internal monitoring processes, it could help remove some of the subjectivity and bias around the proposed disclosures and ensure that investors are receiving a certain minimum level of useful information about acquisitions.

    (b) Carefully analysing the costs of providing the proposed disclosures. A careful consideration of the costs of the disclosures in practice – for example, by running field tests – could help the IASB confirm whether the benefits of the disclosures ~~would~~ could outweigh the costs to preparers, and what changes to the proposed disclosures would be necessary for the benefits to exceed the costs.

    (c) Carrying out a holistic review of the accounting and disclosure requirements for intangible assets, including those that are currently not recognised, before deciding whether to introduce the disclosures proposed in the DP.

    (d) Working with the International Auditing and Assurance Standards Board (IAASB) with a view to ensuring that any proposed disclosures are verifiable for audit purposes, and to clarify what auditors' responsibilities would be in relation to the proposed disclosures.

19. If, after considering the above, the IASB decides to propose requiring the disclosures in the DP, we think that there are certain matters that would need to be clarified for constituents in relation to the disclosures, as we think that these matters are currently not clear in the DP. For

Commented [GS6]: Added based on comments from a Board member
(I also note the suggestion that management commentary might be a more suitable place for the proposed disclosures has been mentioned often by participants at various international outreach events on the DP)

Commented [GS7]: Some Board members supported retaining the comments on what we think the IASB should consider if they decide to proceed with the disclosure -- with the caveat that we do not agree with the suggested disclosures in the first place.

However, we have also received feedback that comments in the nature of "If the IASB proceeds with the proposed disclosures, then…" can dilute and even contradict our message of disagreement with the proposed disclosures. This risk is particularly strong if we say "If the IASB proceeds with the proposed disclosures, then we *agree* with [a proposal].

For these reasons, we propose to:

- Reframe what is now para 18, so that it now says 'if the IASB is inclined to include the disclosures, we think it should consider the following before proposing to introduce the disclosures (for example, conducting a holistic review of intangibles)'
- Replace deleted paragraphs 19 and 20 with a shorter version of these paragraphs (new paragraph 19 and point (d) to paragraph 18) – and frame the list in paragraph 19 as matters that will need to be addressed if it is ultimately decided to propose the disclosures, and;
- Delete our answers to Question 2(c)–2(d).

Hopefully this strikes an appropriate balance between:

- Delivering a clear message that we disagree with the proposed disclosures, without diluting this message or potentially contradicting it, and;
- Being helpful to the IASB in terms of identifying issues that we think would be important to address if the IASB is inclined to proceed with proposing the disclosures included in the DP.

Do Board members agree with the proposed approach?
Or, would Board members prefer to retain some/all of the deleted disclosures?
Alternatively, would Board members prefer to delete paragraphs 15 and 16 in addition to the paragraphs already deleted?

example, it would be important to clarify:

(a) whether comparative information must be restated when there is a change in the metrics used to assess the performance of the acquisition (given that changes in metrics can result in lack of year-on-year comparability);

(b) whether it is permitted to provide the proposed disclosures in aggregate for a number of similar acquisitions, particularly if the CODM monitors these acquisitions in aggregate (for highly acquisitive entities, this could somewhat reduce the cost and volume of the disclosures);

(c) that if the acquired business is integrated into the acquirer's existing business soon after the acquisition, information on performance metrics can be provided for the integrated business, if that is how the CODM monitors the success of the acquisition (this is noted in the DP, but the inability to provide the proposed disclosures due to integration was a common concern that we heard, so it would be important to make this point very clear);

(d) if the CODM monitors the performance of the acquisition against targets established shortly after the acquisition, rather than the estimated targets that existed at the acquisition date, whether the updated targets can be used as the basis for the disclosing 'the metrics that management (CODM) will use to monitor whether the objectives of the acquisition are being met' in the year of the acquisition.

20. As we do not support requiring the proposed disclosures on the subsequent performance of acquisitions in the financial statements, we have not answered Question 2(c)–(f) of the DP.

19. We also recommend that the IASB consider the following matters in relation to disclosures on the subsequent performance of acquisitions, if the IASB decides to propose these disclosures.

(a) Paragraph 2.45(b) of the DP notes the following proposed disclosures:

(b) add a requirement for companies to disclose:

(i) in the year in which an acquisition occurs, the metrics that management (CODM) will use to monitor whether the objectives of the acquisition are being met;

(ii) the extent to which management's (CODM's) objectives for the acquisition are being met using those metrics, for as long as management (CODM) monitors the acquisition against its objectives;

[...]

(v) if management (CODM) changes the metrics it uses to monitor whether management's (CODM's) objectives for the acquisition are being met, the new metrics and the reasons for the change

Some entities monitor the performance of their acquisitions against a budget prepared shortly after the acquisition, rather than against the estimated targets for the acquisition that existed as at the acquisition date. It would be useful to clarify which set of metrics should be used to satisfy the proposed requirements in (i) and (ii) above: those that existed as at the acquisition date (in which case the updated metrics would

~~constitute a change in the metrics as per paragraph 2.45(v) of the DP), or the updated metrics established shortly after the acquisition?~~

~~(b) According to the DP, an entity would need to disclose the fact that it stopped monitoring an acquisition and the reason for this, but only if monitoring stopped within two years from the year of acquisition. If an entity has been providing information about the performance of an acquisition in previous years and then stops providing this information because it stopped monitoring the acquisition, we think that this fact should be explained regardless of how many years have passed since the acquisition..~~

~~(c) It may be useful to consider whether to allow aggregation of disclosures about acquisitions of a similar nature – particularly if the CODM monitors these acquisitions in aggregate. For highly acquisitive entities, the ability to aggregate disclosures about similar acquisitions could make these disclosure requirements less onerous, and would avoid potentially voluminous disclosures that investors may find difficult to engage with. We note that for most of the existing disclosure requirements on acquisitions, paragraph B65 of IFRS 3 permits aggregation of information for acquisitions that are not material individually.~~

~~(d) A relatively common concern that we have heard during outreach is that it is difficult to track the performance of an individual acquisition because it is often integrated into the existing business quickly. The DP explains that if the acquired business is integrated with the acquirer's business, information about the subsequent performance of the acquisition may be based on the combined business. However, we think it would be important to clearly explain in any forthcoming Exposure Draft and in the final standard that the disclosures on the subsequent performance of acquisitions can be provided for the integrated business if that is how management plans to measure – and measures – the performance of the acquisition.~~

~~(e) The DP proposes that the disclosures on the subsequent performance of acquisitions should be provided for as long as the acquisition is monitored by the CODM. However, we think it is possible that some CODMs would continue monitoring the performance of an acquisition when information about this performance has ceased to be relevant to users – which means that some entities would continue to provide the proposed disclosures when they are no longer relevant. It may be worth considering whether to allow entities to stop providing the disclosures when they are unlikely to be relevant to users, and whether to provide guidance on this matter.~~

~~(f) The DP notes that if there is a change in the metrics used by the CODM to measure the performance of an acquisition, disclosures would be based on the revised metrics and the change would need to be explained. Changes in metrics could result in lack of year-on-year comparability, which could be challenging for investors. If the IASB decides to propose the disclosures included in the DP, we would recommend adding requirements on how comparative information should be treated when the metrics used by the CODM change, as it is currently not clear from the DP. We note that under IFRS 8 *Operating Segments*, if the composition of an entity's reportable segments changes, comparative segment information must be restated – unless the cost restatement is excessive, in which case the segment information for the current period must be~~

disclosed on both the new basis and the old basis in the year of the change. The IASB may wish to consider analogous requirements for changes in metrics used for monitoring the subsequent performance of acquisitions.

20. As noted above, we have heard concerns that the proposed disclosures may be difficult to audit. Therefore, we recommend that the IASB consider working with the International Auditing and Assurance Standards Board (IAASB) with a view to clarify what auditors' responsibilities would be in relation to the proposed disclosures.

While we do not support requiring the proposed disclosures on the subsequent performance of acquisitions in the financial statements, we have including our answers for Questions 2(c)–(f) below, in case the IASB decided to proceed with requiring these disclosures.

Question 2(c): Whether the information provided should be based on information and acquisitions that the entity's CODM reviews

21. We do not support the proposed disclosure requirements on the subsequent performance of acquisitions. However, if the IASB proceed with the proposed disclosures, we agree that requiring the proposed disclosures for those acquisitions that are reviewed by the CODM, and using the metrics the CODM uses, strikes a reasonable balance between providing investors with information that is important to them, avoiding disclosure overload, and making it feasible for preparers to provide information to investors.

22. We also agree that this approach is superior to requiring disclosures for 'major' or 'fundamental' acquisitions. Those approaches would have effectively introduced a new level of materiality, whereas the IASB's proposed approach builds on existing concepts that are already used under IFRS 8 Segment Reporting.

23. We also think that auditing disclosures on acquisitions that are monitored by the CODM could be easier than auditing disclosures on all material acquisitions, as it would be easier to ascertain whether an acquisition is monitored by the CODM as compared to whether an acquisition is material.

24. Having said this, we are aware that under this 'CODM approach', there is a risk that investors will not receive material information on acquisitions that are not monitored by the CODM but are nevertheless material. However, if an acquisition is not monitored by the CODM, we note that the IASB proposes to require entities to explain why that is the case. We think this proposed requirement could somewhat guard against entities omitting material information on acquisitions.

Question 2(d): Whether concerns about commercial sensitivity could inhibit entities from providing the proposed disclosures

25. Commercial sensitivity was a common concern that constituents expressed during our outreach activities – particularly in the context of New Zealand's relatively small economy.

26. Concerns about commercial sensitivity could arise particularly for privately held companies. While listed companies arguably already share some information of a strategic nature with investors and provide some information about acquisitions beyond the current accounting

~~requirements, for example, when it is appropriate to do so under the continuous disclosure requirements of the stock exchange, privately held companies would perhaps be less accustomed to sharing such information with the users of their financial statements.~~

~~27. We think commercial sensitivity would be a factor that entities would take into account when determining the nature of information and level of detail that they are prepared to provide under the proposed disclosure requirements. There is a risk that due to concerns about commercial sensitivity, some preparers might provide disclosures that are so general so as not to be useful to investors. Furthermore, some preparers who do not wish to provide the disclosures for reasons other than commercial sensitivity (for example, due to concerns that the objectives for the acquisition might not be achieved) may refer to commercial sensitivity as a justification for lack of disclosure or for overly general disclosures. To mitigate this risk, we think it would be important to clarify the level of detail that would be acceptable when providing the disclosures proposed in the DP. This could include examples of disclosures about the strategic rationale for the acquisition and metrics for measuring subsequent performance – like the example provided in paragraph 2.11 of the DP.~~

~~*Question 2(e): Whether disclosures on the objectives for the acquisition and related metrics constitute forward-looking information, and possible constraints on the ability to provide these disclosures*~~

~~28. The DP notes that information about management's strategic rationale, objectives and related targets for an acquisition reflects management's targets *at the time of the acquisition*; therefore, information about the objectives for the acquisition and relevant metrics is not forward-looking information.~~

~~29. While targets are not necessarily predictions of future outcomes, we think that targets by their nature represent expectations of future performance. Therefore, in the year of acquisition, we think there would be a forward-looking element to the disclosure of management's objectives and targets for the acquisition.~~

~~30. We have heard during outreach that some entities may be reluctant to disclose the objectives for the acquisition, as the expected performance may not be achieved.~~

~~31. We note that disclosures about expectations for the future are already required in IFRS Standards. For example, IAS 36 requires information about growth rates used to determine forecast cash flows, and IFRS 7 *Financial Instruments: Disclosures* requires information on expected credit losses for certain financial assets. However, not achieving the objectives of an acquisition may possiblyract greater criticism of management as compared to not achieving the expected growth rate disclosed under IAS 36 or actual credit losses on a financial instrument being different to those disclosed under IFRS 7.~~

~~We think that the risks of not achieving objectives and targets is not necessarily a reason to not provide investors with the information they need to be able to assess the performance of acquisitions. However, we do not support requiring the proposed disclosures for other reasons (see above).~~

Question 3

Paragraphs 2.53–2.60 explain the Board's preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand:

- the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and
- the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition.

Do you agree with the Board's preliminary view? Why or why not?

Response to Question 3:

~~32.~~21. We support the IASB's proposal to update the disclosure objectives in IFRS 3 to specifically refer to providing information on benefits expected from an acquisition. We note that IFRS 3 already requires entities to disclose the reason for the business combination, and the proposed specific disclosure objective could help enhance this disclosure.

~~33.~~22. Regarding the proposed specific disclosure objective to provide information on the extent to which acquisitions are meeting management's objectives: As noted in our response to Question 2 above, we do not support requiring the proposed disclosures on the subsequent performance of acquisitions in the financial statements. ~~However, if the IASB proceeds with the proposed disclosures, then we support the IASB's proposal to update the disclosure objectives in IFRS 3 consistently with these disclosure requirements.~~

Commented [GS8]: Deleted in response to a Board member's comment that this sentence contradicts our arguments for disagreeing with the proposed disclosures.

Question 4

Paragraphs 2.62–2.68 and paragraphs 2.69–2.71 explain the Board's preliminary view that it should develop proposals:

- to require a company to disclose:
  - a description of the synergies expected from combining the operations of the acquired business with the company's business;
  - when the synergies are expected to be realised;
  - the estimated amount or range of amounts of the synergies; and
  - the expected cost or range of costs to achieve those synergies; and
- to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.

Do you agree with the Board's preliminary view? Why or why not?

Response to Question 4:

Proposed disclosures about synergies

~~34.~~23. We do not agree with the IASB's proposal to require the specific disclosures on expected synergies from acquisitions as proposed in the DP.

~~35.~~24. We acknowledge that in principle, the proposed specific disclosures on synergies could help provide investors with more useful information about the expected benefits of the acquisition and the rationale for the transaction price (and therefore the value of goodwill on acquisition). However, we are not convinced that the benefits of providing these disclosures would exceed the cost of providing them, for the following reasons.

(a) ~~Reliability~~ Accuracy and completeness: We think there could be issues around the ~~reliability~~ accuracy and completeness of the underlying information that will be used to prepare the proposed disclosures on synergies. We are aware that some acquirers have well-documented and detailed synergy calculations, whereas others do not. It is possible that the proposed specific disclosure requirements on synergies could encourage entities to consider and document expected synergies more carefully, which would be beneficial. However, some entities may continue to undertake acquisitions without detailed analysis and documentation of synergies – in which case the proposed disclosures would be prepared based on incomplete and potentially unreliable information. Furthermore, it could be argued that despite an acquirer's efforts around the performance of due diligence, business acquisitions are always based on incomplete information. Therefore, there would be a certain degree of risk around the completeness and ~~reliability~~ accuracy of the information underlying the proposed disclosures on synergies, even for entities that have robust processes around the analysis of synergies.

Commented [GS9]: A Board member recommended not using the term 'reliability', because it was removed from the Conceptual Framework.
I have gone with 'accuracy' (a general term).
Another option could be to use 'faithful representation' (a qualitative characteristic), but I am not sure whether this is the best term to describe the issue.

(b) ~~Auditability~~ Verifiability and cost of audit: We also have some concerns about the auditability of the proposed disclosures on synergies. As noted above, depending on the robustness of an entity's analysis and documentation of synergies, the disclosures may be prepared based on incomplete and potentially unreliable information, which would make the disclosures challenging to audit. We are also aware of concerns that auditors may be expected to opine on the reasonableness of management's expectations around synergies – which would effectively require the auditor to perform a due diligence exercise in relation to the acquisition. The process of determining the acquisition price, including the determination of expected synergies, is often complex. If auditors have to review this process to determine whether the disclosures on synergies are faithfully representative, this would significantly increase the scope and therefore the cost of the audit. The abovementioned concerns about auditability are also likely to increase audit costs.

(c) Concerns about commercial sensitivity: We are aware of concerns around the commercial sensitivity of these disclosures, and such concerns could affect the level of detail that entities are prepared to provide regarding expected synergies.

~~36.~~25. If the IASB proceed with proposing the disclosures on synergies as described in the DP, we ~~recommend considering the following~~think it would be important to clarify certain matters to constituents, including the acceptable level of disclosures on synergies (this may help mitigate concerns about commercial sensitivity to a certain extent), that synergies may not necessarily equal to or be readily reconcilable to the transaction price itself, and what disclosures are required when no synergies are expected from an acquisition (for example, because the purchased business is unrelated to the existing business, or in case of a 'protective' acquisition). Furthermore, it would be important to clarify, through discussions with the IAASB, the auditor's role regarding assurance over the disclosures over synergies.

~~(a) To mitigate concerns about commercial sensitivity, we would recommend clarifying the acceptable level of disclosures – possibly by providing examples.~~

~~(b) We also note that while disclosures about expected synergies would help explain the rationale for the acquisition and its transaction price, they would not necessarily equal to – or be easily reconcilable to – the transaction price itself. It is important to make this clear, to avoid an expectation to the contrary from users and auditors.~~

~~(c) Furthermore, we would like to emphasise the importance of qualitative disclosures on the expected synergies and other expected benefits of the acquisition – in addition to quantitative disclosures. Qualitative disclosures could complement and add context to the quantitative disclosures on the range of expected synergies, etc.~~

~~(d) As noted above, we heard concerns in relation to the audit of disclosures on expected synergies – including concerns that auditors may be expected to opine on whether the expectations around synergies are reasonable. If the proposed disclosures are introduced, we think it would be important to clarify, through discussions with the IAASB, the auditor's role regarding assurance over the disclosures over synergies.~~

Commented [GS10]: A Board member recommended to stick to Conceptual Framework terminology where possible, therefore replaced 'auditability' with the qualitative characteristic 'verifiability'.

Commented [GS11]: As explained under Question 2 above, while some Board members were happy to keep this paragraph we also received feedback that comments in the nature of 'If the IASB proceeds with the disclosures, then…' run the risk of diluting or contradicting our arguments against the proposed disclosures.

Therefore, we have proposed to shorten this paragraph and frame it in the context of matters that would need to be clarified if the disclosures are introduced.

The other option would be to delete this paragraph completely.

(e) ~~We also think that the IASB should clarify what disclosures would be required (if any) if no synergies are expected from an acquisition. For example, this could happen when an entity purchases a business that is unrelated to its current operations, as part of a diversification strategy. It could also happen in case of 'protective' acquisitions.~~

Proposal to specifically require disclosure of the acquiree's liabilities from financing activities and defined benefit pension liabilities

~~37.~~26. We note that paragraph B64 of IFRS 3 requires disclosure of the amounts as at acquisition date for major classes of assets and liabilities assumed in a business combination. Therefore, under the current requirements, whether the acquiree's liabilities from financing activities and/or defined benefit pension plan are disclosed or not depends on whether they are considered to be major classes of transaction.

~~38.~~27. Furthermore, paragraph 31 of IAS 1 *Presentation of Financial Statements* notes that if a certain disclosure is required by an IFRS Standard but it is not material, then the disclosure need not be provided – whereas additional disclosures that are not specifically required by IFRS Standards should be considered to enable users to understand a transaction. Therefore, if information about the acquiree's liabilities from financing activities and/or defined benefit pension plan liabilities are material and an investor would need this information to understand the impact of the acquisition on the financial statements, then separate disclosure of these liabilities would need to be considered under paragraph 31 of IAS 1 – even if the IASB does not specifically require the disclosure of these liabilities. Conversely, if these liabilities are not material, then application of paragraph 31 of IAS 1 would mean that these liabilities would not be disclosed, even if the IASB specifically requires the proposed disclosures.

~~39.~~28. For these reasons, we do not think it is necessary to introduce the proposed specific requirement to disclose the acquiree's liabilities from financing activities and defined benefit pension liabilities.

~~40.~~29. We also note that the proposed requirement to disclose the acquiree's liabilities from financing activities and defined benefit pension liability is a rather specific requirement, as compared to the more principles-based requirements usually found in IFRS Standards.

Question 5

IFRS 3 *Business Combinations* requires companies to provide, in the year of acquisition, pro forma information that shows the revenue and profit or loss of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period.

Paragraphs 2.82–2.87 explain the Board's preliminary view that it should retain the requirement for companies to prepare this pro forma information.

(a) Do you agree with the Board's preliminary view? Why or why not?

(b) Should the Board develop guidance for companies on how to prepare the pro forma information? Why or why not? If not, should the Board require companies to disclose how they prepared the pro forma information? Why or why not?

IFRS 3 also requires companies to disclose the revenue and profit or loss of the acquired business after the acquisition date, for each acquisition that occurred during the reporting period.

Paragraphs 2.78–2.81 explain the Board's preliminary view that it should develop proposals:

- to replace the term 'profit or loss' with the term 'operating profit before acquisition-related transaction and integration costs' for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or loss would be defined as in the Exposure Draft *General Presentation and Disclosures*.
- to add a requirement that companies should disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.

(c) Do you agree with the Board's preliminary view? Why or why not?

Response to Question 5:

~~41.~~30. In the context of our disagreement with including the proposed disclosures on the subsequent performance of acquisitions in the financial statements (see Question 2 above), we agree with the IASB's proposal to retain the existing requirement to disclose 'pro forma' information on the revenue and profit of the combined business as if the acquisition occurred at the start of the year. We also agree that the IASB should develop guidance on how to calculate the abovementioned pro-forma information, as we are aware that it is often difficult for preparers to provide this information. However, we would prefer not to require the proposed additional disclosures on operating cash flows.

~~42.~~31. If the IASB introduces the proposed disclosures on subsequent performance of acquisitions, then we recommend retaining the existing disclosures on the acquiree's pro-forma and actual contribution to the group only for those acquisitions that are not monitored by the CODM, as the proposed disclosures on subsequent performance would not be provided for such acquisitions. For acquisitions that are monitored by the CODM, the new disclosures on subsequent performance of acquisitions would mean that the existing disclosures on the acquiree's pro-forma and actual contribution to the group are unlikely to be needed by investors.

~~43.~~32. Regarding the proposal to use term ‘operating profit before acquisition-related transaction and integration costs’ instead of ‘profit or loss’: We note that the determination of integration costs can be highly subjective. Therefore, if the IASB retains the existing pro-forma requirements and proposes the new disclosures on cash flows as per its preliminary view, using the term ‘operating profit before acquisition-related transaction and integration costs’ will add a layer of subjectivity to these disclosures.

Question 6

As discussed in paragraphs 3.2–3.52, the Board investigated whether it is feasible to make the impairment test for cash-generating units containing goodwill significantly more effective at recognising impairment losses on goodwill on a timely basis than the impairment test set out in IAS 36 Impairment of Assets. The Board's preliminary view is that this is not feasible.

(a) Do you agree that it is not feasible to design an impairment test that is significantly more effective at the timely recognition of impairment losses on goodwill at a reasonable cost? Why or why not?

(b) If you do not agree, how should the Board change the impairment test? How would those changes make the test significantly more effective? What cost would be required to implement those changes?

(c) Paragraph 3.20 discusses two reasons for the concerns that impairment losses on goodwill are not recognised on a timely basis: estimates that are too optimistic; and shielding. In your view, are these the main reasons for those concerns? Are there other main reasons for those concerns?

(d) Should the Board consider any other aspects of IAS 36 in this project as a result of concerns raised in the Post-implementation Review (PIR) of IFRS 3?

Response to Question 6:

Questions 6(a) and (b): Whether it is possible to design a significantly more effective impairment test

~~44.~~33. We think that without conducing a holistic review of IAS 36 and of the accounting requirements for intangible assets, it is not feasible to design an impairment test that is significantly more effective at recognising impairment losses on goodwill on a timely basis and at a reasonable cost.

~~45.~~34. As the DP notes, goodwill does not generate cash flows independently and cannot be measured directly. Therefore, goodwill must be tested for impairment together with other assets as part of a cash generating unit (CGU) or group of CGUs. Furthermore, unless and until the prohibition on recognising internally generated goodwill and certain other internally generated intangible items is removed, CGUs to which goodwill is allocated will often include unrecognised headroom from these items. Therefore, we agree that goodwill will inevitably be shielded by unrecognised headroom within the CGU, be it headroom generated before or after the acquisition.

~~46.~~35. We also agree that the IASB should not implement the alternative impairment method described as the 'headroom approach' in Section 3 of the DP – as this method would not eliminate the shielding of goodwill, there would be issues around allocating the impairment amount between acquired goodwill and unrecognised 'headroom' items, and the DP notes that it will be costly for preparers to implement this model.

Question 6(c): Reasons for concern that goodwill impairment losses are recognised too late

~~47.~~36. We agree with the IASB that overly optimistic estimates in performing the impairment test and the shielding of goodwill within CGUs are the main reasons for the concern that goodwill impairment is not recognised on a timely basis. Our specific comments on these two concerns are included below.

Management over-optimism

~~48.~~37. There are already some requirements in IAS 36 that attempt to mitigate the risk of management over-optimism, and we agree that in general, any additional safeguards to mitigate against this risk should come from the work of auditors and regulators.

~~49.~~38. However, it may be worth considering whether there are opportunities to enhance the existing safeguards in IAS 36. For example, we would recommend considering whether more emphasis should be given to the requirement to base cash flow projections on 'reasonable and supportable information'. At the moment, IAS 36 requires cash flows in the VIU calculation to be based on "reasonable and supportable assumptions" (paragraph 33(a)), and also to be based on budgets or forecasts approved by management (paragraph 33(b)). However, these are presented as two separate requirements. Therefore, there could potentially be tension between these two requirements, and an entity could potentially put more emphasis on basing the cash flows on forecasts approved by management – and these forecasts could be over-optimistic. This risk could be somewhat mitigated if the standard puts more emphasis on the requirement around 'reasonable and supportable assumptions'.

Commented [GS12]: There were mixed views among Board members on whether to retain or delete this point.
What would the Board prefer?

Shielding

~~50.~~39. As noted above, we agree that shielding cannot be fully eliminated – because goodwill must be tested for impairment with a group of other assets, including certain intangible items that cannot be recognised on the balance sheet, and these can shield goodwill from impairment.

~~51.~~40. However, we note that the issue of shielding as described in the DP is compounded by issues around the identification of CGUs/groups of CGUs for the purpose of the impairment test and the allocation of goodwill to these CGUs. That is, allocating goodwill to excessively large CGUs can exacerbate the impact of shielding.

~~52.~~41. A CGU is defined in IAS 36 as the "smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets". However, we are aware that some entities default to identifying CGUs at the operating segment level, which is the maximum possible size under IAS 36 (paragraph 80(b)), and justify this by saying that this is the lowest level at which management monitors goodwill (paragraph 80(a) of IAS 36). Sometimes this means that the entire reporting entity is seen as a single CGU, and goodwill (sometimes from several acquisition) is tested for impairment together with all the assets and liabilities and unrecognised headroom of the whole reporting entity. While this might be appropriate in some cases, in other cases a more granular identification of CGUs would lead to a more meaningful goodwill impairment test, and would decrease the impact of shielding.

~~53.~~42. To the extent that this issue arises from incorrect application of IAS 36, we think this issue is perhaps better addressed by auditors and regulators than through standard setting. However, the AASB Research Report notes that due to lack of clarity around the requirements in IAS 36 to allocate goodwill to CGUs, respondents said that these requirements are difficult to interpret and implement, require a high degree of subjectivity and result in diversity in application.

~~54.~~43. Therefore, we recommend considering whether additional guidance on allocating goodwill to CGUs or groups of CGUs could be provided.

Question 6(d): Should the IASB consider any other aspects of IAS 36

~~55.~~44. As noted above, we recommend that the IASB consider developing additional guidance on the identification of CGUs and the allocation of goodwill to CGUs. The difficulties and subjectivity involved in allocating goodwill to CGUs for impairment testing purposes was one of the concerns raised by stakeholders during the IASB's PIR of IFRS 3. Therefore, in theory, this matter could be considered as part of this project. Alternatively, it could be considered as part of a holistic review of IAS 36 at a later stage.

Question 7

Paragraphs 3.86–3.94 summarise the reasons for the Board's preliminary view that it should not reintroduce amortisation of goodwill and instead should retain the impairment-only model for the subsequent accounting for goodwill.

(a) Do you agree that the Board should not reintroduce amortisation of goodwill? Why or why not? (If the Board were to reintroduce amortisation, companies would still need to test whether goodwill is impaired.)

(b) Has your view on amortisation of goodwill changed since 2004? What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already had?

(c) Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not?

(d) Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not?

(e) If amortisation were to be reintroduced, do you think companies would adjust or create new management performance measures to add back the amortisation expense? (Management performance measures are defined in the Exposure Draft *General Presentation and Disclosures*.) Why or why not? Under the impairment-only model, are companies adding back impairment losses in their management performance measures? Why or why not?

(f) If you favour reintroducing amortisation of goodwill, how should the useful life of goodwill and its amortisation pattern be determined? In your view how would this contribute to making the information more useful to investors?

Response to Question 7:

Question 7(a): Do you agree that the IASB should not reintroduce amortisation of goodwill? Why or why not?

~~56.~~45. We have heard mixed views from constituents regarding the subsequent accounting for goodwill, and like the IASB, we are aware that both the impairment-only model and the amortisation model have advantages and disadvantages. Our views on this topic were also mixed.

~~57.~~46. We are aware of the following arguments in favour of retaining the impairment-only model.

(a) There is an argument that core elements of goodwill as described in BC313–BC 318 of IFRS 3, i.e. synergies and the 'going concern' element, generate economic benefits over an indefinite time period. On this basis, the impairment-only model is appropriate for goodwill and the amortisation model is not (like other intangible assets with an indefinite life).

(b) According to a recent article[1] by the International Valuation Standards Council (IVSC), business valuation models used to price businesses generally assume that the core elements of goodwill (being the going concern element and a synergies element) are non-wasting. For example, the IVSC note that synergies are included in the terminal value calculation in the pricing model for acquisition. Therefore, the amortisation method (which reflects the consumption of a 'wasting' asset over a finite period) would not be consistent with the principles used to determine the purchase price of the acquired business, which in turn is used for determining the goodwill amount on acquisition.

Commented [GS13]: There were mixed views among Board members as to whether to retain or delete these points. These points were noted by a TRG member.
However, some Board members disagree with this view.
What would the Board prefer?

(c) Even if it is argued that the value of goodwill is consumed over a finite period, it could be difficult to reliably estimate the useful life of goodwill. The amortisation model is likely to result in an arbitrary amortisation expense amount being charged over an arbitrary time frame. Such arbitrary information is unlikely to provide useful information to users of financial statements, including investors. On the other hand, the impairment-only model provides useful information to investors – about the fact that impairment has occurred (if that is the case), and about the underlying assumptions used in determining whether goodwill is or is not impaired.

(d) While amortisation would reduce the goodwill balance every year, it would also increase headroom within the CGU every year, which could reduce the likelihood of an *impairment loss* being recognised when an acquisition is not performing as well as expected. The impairment test would still be performed under the amortisation method, but because of the regular decreases in the goodwill balance, it would be less likely that the carrying amount of CGUs to which goodwill is allocated would not be recoverable. Therefore, the amortisation method could lead to impairment losses being mislabelled as 'business as usual' amortisation.

(e) For most assets, while amortisation is mandatory it is also possible to capitalise certain costs incurred in relation to the asset. However, such capitalisation is not possible for goodwill. Therefore, under the amortisation method, there is a risk of a 'double-hit' to the P&L in the same year: once from expenditure incurred to enhance goodwill, and again from amortisation.

(f) While internally generated goodwill could possibly replace impaired or consumed amounts of acquired goodwill, in practice it is very difficult to distinguish between acquired goodwill and goodwill generated internally after the acquisition (see discussion further below). The extent to which internally generated goodwill replaces acquired goodwill could be limited, assuming that acquired goodwill generates benefits over an indefinite time period.

(g) The reintroduction of amortisation would be a major change in accounting requirements. While the amortisation method has some practical advantages over the impairment-only model, it also has some disadvantages as compared to impairment-

[1] *IVSC Perspective Paper: Business Valuation – Is Goodwill a Wasting Asset?* (September 2019)

only, and it is not clear that a change in model would lead to an overall improvement in the accounting for goodwill and the information that is provided to investors.

(h) This project has a relatively narrow scope in relation to impairment and accounting for goodwill, as it is based on a post-implementation review of IFRS 3 (which focuses on business combinations, rather than impairment or intangible assets). If the IASB was to reintroduce amortisation, this would require a wider scope project which would potentially consider other indefinite-lived assets, as well as possible amortisation methods and amortisation periods – which would require a lot of additional research. Therefore, we believe that the reintroduction of amortisation should be proposed only as part of a more comprehensive project on this subject – rather than as part of this project.

~~58.~~47. On the other hand, we are also aware of the following arguments in favour of the reintroduction of amortisation.

(a) There is an argument that the economic benefits embodied within goodwill do not last indefinitely; rather, they are consumed by the entity over a finite time period and are replaced by internally generated goodwill (which is different to acquired goodwill). This consumption would be best reflected by amortisation.

(b) Under the impairment-only model, goodwill remains on the balance sheet long after it has stopped being a relevant or meaningful. An entity can be restructured several times and change significantly after an acquisition that gives rise to goodwill. Without regular amortisation, goodwill stays on the balance sheet throughout these changes and restructures (as long as the recoverable amounts of relevant CGUs exceed their carrying amounts) – even when the entity bears very little resemblance to either the acquired business or the original business as it existed at the time of the acquisition.

(c) By its nature, the goodwill impairment test is complex and requires a high degree of estimation, which is subject to error and management over-optimism. As a result of this – as well as due to the effect of shielding, which cannot be eliminated – there is a high risk that goodwill balances are overstated. Amortisation would be a simpler and more effective way to ensure that the goodwill balance is not overstated.

(d) We heard concerns that goodwill impairment test is costly, particularly for medium-sized companies, who do not have the same level or resources and internal expertise as larger companies. For such companies in particular, amortisation would be a more cost-effective way of accounting for goodwill – including ensuring that goodwill is not overstated. Even though impairment testing would still be required under an amortisation model, the IASB's proposed move to an indicators-based approach for testing for impairment of goodwill, amortisation would mean that goodwill will need to be tested for impairment less often that it is currently, which will reduce costs for preparers.

(e) The Basis for Conclusions of IFRS 3 explain that the core components of goodwill are the 'going concern' element of the acquired business and the synergies expected from the acquisition. While it could possibly be argued that these components of goodwill have an indefinite life, in practice the goodwill balance sometimes contains other intangible items that have finite useful lives and for which amortisation would be appropriate.

(f) Determining the useful life of goodwill could be challenging and would require judgement, but it is not impossible. Before New Zealand adopted IFRS Standards, the standard on accounting for acquisitions (FRS 36 *Accounting for Acquisitions Resulting in Combinations of Entities or Operations*) included guidance on determining the estimated useful life of goodwill. In addition, the IASB could put a cap on the amortisation period, to reduce complexity and avoid overly optimistic estimation of useful life. Such caps could be based on academic research, the IFRS for SMEs standard, or another current or previous standard outside of IFRS that allows amortisation and has a cap on useful life.

~~59.~~48. Ultimately, we think that the IASB should retain the impairment-only model *at this time*, but reconsider whether to reintroduce amortisation after carrying out a holistic review of IAS 36 (including considering guidance on the determination of CGUs and the allocation of goodwill to CGUs), and of the accounting for intangible assets in general – including those intangible items that are not recognised under the current requirements. Having said this, we think it would be important to carry out these reviews with some urgency.

~~60.~~49. To help the IASB decide on whether to retain the impairment-only model or to reintroduce goodwill amortisation (after carrying out the abovementioned holistic reviews), we think it may be useful for the IASB to conduct further research on the following.

(a) Whether goodwill is generally a wasting asset with a finite life or a non-wasting asset with an infinite life – including investors' perception on this matter;

(b) Whether the hybrid approach discussed in the DP (i.e. applying the impairment-only model for the first few years after an acquisition and then applying amortisation) would result in useful information for investors, and;

~~(c) Whether allowing non-public companies to amortise goodwill, while requiring the impairment-only model for publicly listed companies, would achieve an appropriate balance between the costs and benefits of both model. (We note that the forthcoming IASB DP on Business Combinations under Common Control is expected to distinguish between companies whose shares are publicly traded and privately-held companies).~~

Commented [GS14]: A couple of Board members questioned the appropriateness of such a 'differential' regime, therefore proposing to delete.

Question 7(b): Has your view on amortisation of goodwill changed since 2004? What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already had?

~~61.~~50. At an outreach event, we asked New Zealand constituents whether their views on the subsequent accounting for goodwill have changed since 2004, when the impairment-only model was first introduced. About 40% of the attendees said that their views have changed, while about 60% have not changed their views. For the majority of those attendees whose

views have changed since 2004, the change was in favour of amortisation – but about 7% of attendees changed their preference to impairment-only.

~~62.~~51. We are not aware of significant new conceptual arguments in favour of amortisation that the IASB is not already aware of. However, the practical issues that have been arising from applying the IAS 36 since the impairment-only model for goodwill was introduced could possibly constitute a reason for reintroducing amortisation. Such practical issues include the length of time that goodwill has stayed on entities' financial statements, challenges around identifying CGUs and allocating goodwill to CGUs, the cost of performing the impairment test every year, the risk of management over-optimism in performing the impairment test, etc. Having said this, we would recommend a review of IAS 36 as a whole, as well as the accounting requirements for intangible assets in general, before considering the reintroduction of goodwill amortisation.

Question 7(c): Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not?

~~63.~~52. In terms of shielding, unlike the impairment-only model, amortisation targets goodwill directly, and therefore decreases the shielding effect and the risk of overstated goodwill. However, while amortisation could potentially reduce the carrying value of goodwill in a timelier manner, it would not necessarily make the recognition of impairment losses more timely. This is because the amortisation method could lead to impairment losses (as distinct from regular reduction in value through consumption) being mislabelled as regular amortisation.

~~64.~~53. In terms of over-optimistic estimates, the amortisation method would require management to estimate the useful life of goodwill and the expected pattern of consumption. These estimates could equally be subject to management over-optimism. On the other hand, it is possible that, under the amortisation method, the IASB would require a specific amortisation period or would introduce a cap on the permitted amortisation period. This would significantly decrease the impact of management over-optimism under the amortisation method. However, this would also increase the arbitrariness of the goodwill's useful life and amortisation amount, which would decrease the usefulness of this information.

Question 7(d): Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not?

~~65.~~54. We think that in practice, it is difficult to distinguish between acquired goodwill and goodwill generated internally after the acquisition. Specifically, it is difficult to determine whether certain activities maintain the value of the acquired goodwill or create internally generated goodwill. Furthermore, it can be difficult to determine whether future expected benefits from new customers, a new product line or a new brand are related to the acquired goodwill (i.e. part of the synergies from the acquisition, or part of the 'going concern' element of the acquired entity which allows finding new customers, developing new products, etc.) – or whether it is new, internally generated goodwill that is unrelated to any previous acquisition.

~~66.~~55. However, if it is accepted that acquired goodwill has a finite useful life, then it is likely that it is

replaced by internally generated goodwill.

Question 7(e): If amortisation were to be reintroduced, do you think companies would adjust or create new management performance measures to add back the amortisation expense? Under the impairment-only model, are companies adding back impairment losses in their management performance measures? Why or why not?

~~67.~~56. We think that companies are likely to adjust management performance measures to add back the amortisation expense.

Question 7(f): If you favour reintroducing amortisation of goodwill, how should the useful life of goodwill and its amortisation pattern be determined? In your view how would this contribute to making the information more useful to investors?

~~68.~~57. As noted above, we do not recommend the reintroduction of amortisation of goodwill at this time.

~~69.~~58. However, if the IASB reintroduce amortisation, we would recommend that the IASB introduce a rebuttable cap on the amortisation period~~[Board to select one of the following, if any: cap on amortisation/rebuttable fixed amortisation period/a mandatory fixed amortisation period]~~. We believe that this ~~[~~cap~~/period]~~ should be based on research, such as academic research on the lifespan of acquisitions' additive value. Introducing such a ~~[~~cap~~/period]~~ would mitigate the risk of over-optimistic estimations of the amortisation period and would simplify the amortisation requirements for preparers.

Commented [GS15]: Of those Board members who expressed a view on this, a rebuttable cap/rebuttable fixed period was most popular

Question 8

Paragraphs 3.107–3.114 explain the Board's preliminary view that it should develop a proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill. The Board would be likely to require companies to present this amount as a free-standing item, not as a subtotal within the structure of the balance sheet (see the Appendix to this Discussion Paper).

(a) Should the Board develop such a proposal? Why or why not?

(b) Do you have any comments on how a company should present such an amount?

Response to Question 8:

~~70.~~59. We strongly disagree with the IASB's proposal to require entities to disclose the amount of equity excluding goodwill on the balance sheet.

~~71.~~60. We appreciate that that the IASB's intention in making this proposal was to provide more transparency around goodwill, and help investors identify companies in which goodwill forms a large part of the equity balance. However, we disagree with the IASB's proposal for the following reasons.

(a) We acknowledge that goodwill has certain characteristics that make it different to most other assets (as discussed in the DP) – but it is nevertheless an asset for the purpose of IFRS Standards. Presenting the amount of equity excluding goodwill could imply that goodwill is not an asset and should not be recognised on the balance sheet.

(b) If the amount of equity excluding goodwill is useful information for investors, it would be easy for investors to calculate that amount themselves, without that amount being presented on the balance sheet. Separate disclosure of goodwill (either on the balance sheet or in the notes) is already required in IFRS Standards. Moreover, the IASB ED *General Presentation and Disclosures* proposed that goodwill be presented as a separate line item on the balance sheet.

(c) Having two equity balances may be confusing for some users of financial statements – and they may question which amount represents the 'true' equity position of the entity. Furthermore, if there are users who do not know how to calculate the amount of equity excluding goodwill themselves, for such users the presentation of two equity balances could be even more confusing.

Question 9

Paragraphs 4.32–4.34 summarise the Board's preliminary view that it should develop proposals to remove the requirement to perform a quantitative impairment test every year. A quantitative impairment test would not be required unless there is an indication of impairment. The same proposal would also be developed for intangible assets with indefinite useful lives and intangible assets not yet available for use.

(a) Should the Board develop such proposals? Why or why not?

(b) Would such proposals reduce costs significantly (see paragraphs 4.14–4.21)? If so, please provide examples of the nature and extent of any cost reduction. If the proposals would not reduce costs significantly, please explain why not.

(c) In your view, would the proposals make the impairment test significantly less robust (see paragraphs 4.22–4.23)? Why or why not?

Response to Question 9:

~~72.~~61. If the IASB retains the impairment-only model for goodwill, then we do not agree with the IASB's proposal to move to an indicator-based approach to goodwill impairment testing. We recommend retaining the current requirement to test goodwill for impairment every year.

~~73.~~62. Moving to an indicator-based approach could lead to some loss of robustness in the goodwill impairment process, because an indicator of impairment could be inadvertently missed or ignored due to management over-optimism, or due to incorrect assumptions as to when goodwill impairment can occur (as explained further below). ~~which would~~ This would result in not recognising impairment loss on time. This would exacerbate the concern over late recognition of impairment losses. By contrast, if goodwill must be tested for impairment every year, there is less risk that an impairment loss will be missed. For example, if the entity's competitor launches a new product, under an indicator-based approach it would be relatively easy to argue that this does not constitute "significant changes with an adverse effect on the entity […] in the technological, market, economic or legal environment in which the entity operates" (IAS 36, paragraph 12), and does not indicate that goodwill is impaired. However, if the annual impairment test requirement was retained, management would need to quantify the impact of the competitor's new product launch on the future cash flows or fair value of the relevant CGU, which could result to the recognition of an impairment loss that may have otherwise been missed. Furthermore, some assume that a CGU must be making a loss for an impairment of goodwill to occur. This could lead to an assumption that as long as the operations relating to the CGU are profitable, there are no indicators of goodwill impairment. Again, this could lead to goodwill impairment not being recognised, as goodwill can be impaired even if the related business is profitable (albeit not profitable enough to support the carrying amount of the assets within the CGU). There is good discipline in performing the goodwill impairment test every year.

Commented [GS16]: Edits to this paragraph are based on comments from a Board member (about the fact that some people assume that goodwill impairment can only happen if the CGU makes losses)

~~74.~~63. Performing the impairment test every year means that the impairment model gets refined over time, and the entity's experience and expertise in relation to performing the impairment

test is maintained. This benefit would not be available to entities that perform the impairment test only when there are indicators of impairment.

~~75.~~64. Cost saving from not performing the impairment test every year may be negated by the cost of assessing whether there are indicators of impairment – and the potential additional costs of preparing a goodwill impairment model when one has not been prepared for a long time and regaining expertise in performing the impairment test, etc.

~~76.~~65. Having said this, moving to an indicator-based approach could be appropriate if the IASB reintroduce goodwill amortisation. If goodwill is amortised, then there is less risk that missing an impairment indicator would result in an overstated goodwill balance.

~~77.~~66. If the IASB implements an indicators-based approach for goodwill impairment testing, we think it would be important to enhance the requirements and guidance in IAS 36 around the indicators of impairment. This could include developing new indicators specifically in relation to goodwill, developing specific guidance on applying existing indicators to goodwill, or developing a list of indicators that must be present to presume that goodwill is not impaired. Such enhancement would provide greater clarity to preparers in applying the indicator-based approach to goodwill, and would reduce the risk of management over-optimism when applying this approach.

Question 10

The Board's preliminary view is that it should develop proposals:

- to remove the restriction in IAS 36 that prohibits companies from including some cash flows in estimating value in use—cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance (see paragraphs 4.35–4.42); and
- to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use (see paragraphs 4.46–4.52).

The Board expects that these changes would reduce the cost and complexity of impairment tests and provide more useful and understandable information.

(a) Should the Board develop such proposals? Why or why not?

(b) Should the Board propose requiring discipline, in addition to the discipline already required by IAS 36, in estimating the cash flows that are the subject of this question? Why or why not? If so, please describe how this should be done and state whether this should apply to all cash flows included in estimates of value in use, and why.

Response to Question 10:

Question 10 (a): Allowing the use of post-tax inputs

~~78.~~67. We agree that the IASB should allow the use of post-tax inputs in the VIU calculation. We note that this how VIU tends to be calculated in practice, with the pre-tax discount rate being calculated for disclosure purposes.

~~79.~~68. However, if the IASB implements this proposal, we recommend that the IASB consider whether any additional guidance would be needed on the treatment of deferred tax, temporary tax differences and similar items that are the reason behind the current requirement to use pre-tax inputs.

Question 10(b): Removing the restriction on the inclusion of cash flows from future asset enhancements and uncommitted restructures

~~80.~~69. In our view, the proposal to allow the use of post-tax inputs in the VIU calculation reflects current practice and has clear advantages. By contrast, the proposal to remove the restriction on the inclusion of cash flows from future asset enhancements and uncommitted restructures in the VIU calculation would represent a significant change to the VIU model, and would be associated with a greater risk of non-recognition of impairment losses, due to the increased subjectivity involved in estimated cash flows from future enhancements to assets.

Commented [GS17]: Added as recommended by a Board member

~~81.~~70. At this time, we disagree with removing the restriction on the inclusion of cash flows from future asset enhancements and uncommitted restructures in the VIU calculation. However, we recommend that the IASB reconsider this matter after conducing a holistic review of IAS 36.

~~82.~~71. We think that removing this restriction would exacerbate the risk of impairment losses being

Commented [GS18]: Edits to this paragraph and the next are a consequence of deleting paragraph 85 (see below).

recognised too late. It is often difficult to reliably estimate cash flows from future asset enhancements and uncommitted restructures – but it would be relatively easy to argue that the 'reasonable and supportable' criterion is met. Removing the restriction around these cash flows would make the VIU calculation more susceptible to subjectivity and over-optimistic estimates. This could be mitigated by developing guidance to explain more clearly when it is appropriate to include the abovementioned cash flows in the VIU calculation – which could be done as part of a holistic review of IAS 36. It would be important to include such guidance in IAS 36 if, after conducting a holistic review of that standard, the IASB decides to remove the abovementioned restrictions.

~~83.~~72. Furthermore, removing the abovementioned restriction would make the VIU calculation very similar to an income-based calculation of fair value less costs of disposal (FVLCD) – except that FVLCD allows the inclusion of only those cash flows that a market participant would consider, whereas VIU does not have this restriction. If, after conducting a holistic review of IAS 36 and considering the additional guidance mentioned in the previous paragraph, the IASB decides to remove the abovementioned restrictions from the VIU method, we think that the IASB would need to consider ~~This raises the question as to~~ whether both methods for calculating the recoverable amount of a CGU should be retained, or whether a single method should be mandated.

~~84. Before reconsidering whether to remove the restrictions on cash flows from future asset enhancements and uncommitted restructures in the VIU calculation, we think it would be important to consider whether the VIU model should be a measurement of the value of the CGU based on the existing assets within the CGU in their current state – or based on the expected future state of these assets. If it is the former, then retaining the restriction on cash flows from future asset enhancements and restructures would be more appropriate.~~

Commented [GS19]: The Board member whose comment I was trying to capture here noted that they are not sure about this paragraph, therefore proposing to delete

~~85. If the IASB proceeds with the removal of the restrictions of cash flows from future asset enhancements and future restructures, then to avoid the risk of management over-optimism, we recommend that the IASB consider putting more emphasis on the 'reasonable and supportable' requirement. As noted in our response to Question 6(c) above, at the moment, IAS 36 requires cash flows in the VIU calculation to be based on "reasonable and supportable assumptions" (paragraph 33(a)), and also to be based on budgets or forecasts approved by management (paragraph 33(b)). However, these are presented as two separate requirements. Therefore, there could potentially be tension between these two requirements, and an entity could potentially put more emphasis on basing the cash flows on forecasts approved by management – and these forecasts could be over-optimistic. This risk could be somewhat mitigated if the standard puts more emphasis on the requirement around "reasonable and supportable assumptions". We would also recommend that the IASB consider including additional guidance on when it is appropriate to include cash flows from future asset enhancements and restructuring.~~

Commented [GS20]: Consistently with the proposed approach in Question 2, proposing to delete this paragraph to avoid diluting our message that we do not recommend removing the restrictions at this stage.
Also, the messages in this paragraph are already mentioned elsewhere in the letter (i.e. in the response to Question 6 and in para 72 above respectively).
I have also edited para 72 to further emphasise the importance of guidance on when it is appropriate to include cash flows from future enhancements _if_ a holistic review of IAS 36 results in the removal of the restrictions on these cash flows..

Question 11

Paragraph 4.56 summarises the Board's preliminary view that it should not further simplify the impairment test.

(a) Should the Board develop any of the simplifications summarised in paragraph 4.55? If so, which simplifications and why? If not, why not?

[Simplifications not pursed by the IASB as per paragraph 4.55 listed for the NZASB's information:]

- adding more guidance on the difference between entity-specific inputs used in value in use and market-participant inputs used in fair value less costs of disposal.
- mandating only one method for estimating the recoverable amount of an asset (either value in use or fair value less costs of disposal), or requiring a company to select the method that reflects the way the company expects to recover an asset.
- allowing companies to test goodwill at the entity level or at the level of reportable segments rather than requiring companies to allocate goodwill to groups of cash-generating units that represent the lowest level at which the goodwill is monitored for internal management purposes. Many stakeholders have said that allocating goodwill to cash-generating units is one of the main challenges of the impairment test.
- adding guidance on identifying cash-generating units and on allocating goodwill to cash-generating units.

(b) Can you suggest other ways of reducing the cost and complexity of performing the impairment test for goodwill, without making the information provided less useful to investors?

Response to Question 11:

~~86.~~73. As noted above, we recommend that the IASB consider developing additional guidance on the identification of CGUs and the allocation of goodwill to CGUs.

Question 12
Paragraphs 5.4–5.27 explain the Board's preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill. (a) Do you agree that the Board should not develop such a proposal? Why or why not? (b) If you do not agree, which of the approaches discussed in paragraph 5.18 should the Board pursue, and why? Would such a change mean that investors would no longer receive useful information? Why or why not? How would this reduce complexity and reduce costs? Which costs would be reduced? (c) Would your view change if amortisation of goodwill were to be reintroduced? Why or why not?

Response to Question 12:

~~87.~~74. We agree with the IASB that it should not change the current requirement to recognise identifiable intangible assets acquired in a business combination separately from goodwill. Our reasons for agreeing are as follows.

(a) The current requirement to recognise identifiable intangible assets separately from goodwill in a business combination provides users of financial statements with a better understand of what has been acquired as part of the business combination.

(b) Subsuming identifiable intangible assets within the goodwill balance could result in assets of dissimilar nature being combined together, which could be misleading for users of financial statements.

(c) If the impairment-only model for goodwill is retained, including intangible assets within the goodwill balance would mean that some intangible assets that have a finite useful life and should be amortised are instead subject to the impairment-only model. Even if goodwill amortisation is reintroduced, including intangible assets in the goodwill balance would mean that assets with potentially different useful lives are being amortised together.

~~88.~~75. As noted elsewhere in this letter, we recommend that the IASB undertake a holistic review of the accounting for intangible assets.

Question 13

IFRS 3 is converged in many respects with US generally accepted accounting principles (US GAAP). For example, in accordance with both IFRS 3 and US GAAP for public companies, companies do not amortise goodwill. Paragraphs 6.2–6.13 summarise an Invitation to Comment issued by the US Financial Accounting Standards Board (FASB).

Do your answers to any of the questions in this Discussion Paper depend on whether the outcome is consistent with US GAAP as it exists today, or as it may be after the FASB's current work? If so, which answers would change and why?

Response to Question 13:

~~89.~~76. We do not have any comments on this question. For most entities in New Zealand, alignment between IFRS Standards and US GAAP is not a major concern.

Question 14

Do you have any other comments on the Board's preliminary views presented in this Discussion Paper? Should the Board consider any other topics in response to the PIR of IFRS 3?

Response to Question 14:

~~90.~~77. We do not have any additional comments other than those already noted in this appendix and in the cover letter.

XRB EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

[date]

Mr Hans Hoogervorst
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Submitted to: www.ifrs.org or By email: commentletters@ifrs.org

Dear Hans

DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment*

Thank you for the opportunity to comment on the Discussion Paper DP/2020/1 *Business Combinations – Disclosure, Goodwill and Impairment* (the DP). We acknowledge the importance and relevance of the topics discussed in the DP, and appreciate the timeliness of the IASB's consultation on these topics. The DP has been exposed for comment in New Zealand and some New Zealand constituents may comment directly to you.

Our comments should be read in the following context.

- Section 6 of the DP refers to the 2019 research report by the Australian Accounting Standards Board (AASB), entitled AASB Research Report 9 *Perspectives on IAS 36: A Case for Standard Setting Activity* (AASB Research Report). The AASB Research Report notes that the ongoing application issues relating to IAS 36 *Impairment of Assets* demonstrate a consistent divergence in preparers', users', auditors' and regulators' understanding of the impairment requirements. Consequently, the AASB Research Report recommends a holistic review of IAS 36.
- Section 6 of the DP notes that such a holistic review is beyond the scope of this project. However, stakeholders who consider that such a holistic review is required are encouraged to provide this feedback by responding to the IASB's forthcoming 2020 agenda consultation.

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- While we have focused our responses to the specific matters discussed in the DP, we would strongly support a holistic review of IAS 36 and intend to make a recommendation to that effect when we comment on the IASB's forthcoming agenda consultation.

- We also intend to recommend a holistic review of the accounting for goodwill and other intangible assets, including internally generated intangible items that are not recognised under current requirements in IFRS Standards.

The main points that we have raised in this letter are summarised below.

- Proposed disclosures on the subsequent performance of acquisitions and expected synergies: We do not agree that these disclosures should be included in the financial statements for the following reasons.

  - We are concerned that the subjective nature of the disclosures on the subsequent performance of acquisitions may lead to misleading information being disclosed in the financial statements. Furthermore, disclosures about synergies may be based on information that lacks accuracy and completeness.

  - We think that the cost of preparing the disclosures and having them audited would significantly increase costs for preparers of financial statements, and we are not convinced that these costs are outweighed by the possible benefits of the disclosures.

  - There is a risk that due to concerns about commercial sensitivity or about possible failure to achieve targets, the proposed disclosures would be provided in such a generic way so as not to be useful to investors.

  - The disclosures may also be challenging to audit.

  - While the DP proposes relatively extensive disclosures in relation to business acquisitions, we note that no such disclosures are proposed in relation to organic growth, which may be equally as significant to the entity and of as much interest to investors as growth through business acquisitions. Arguably, it would be beneficial for investors to understand how successfully management is running the business as a whole and creating value for investors – be it through acquisitions or organic growth. This is linked to our comment above recommending that the IASB perform a holistic review of the accounting requirements for intangible assets, including those that are not recognised under the current requirements.

- Subsequent accounting for goodwill

  - We think that without conducing a holistic review of IAS 36, it is not feasible to make the impairment test significantly more effective at a reasonable cost.

  - To improve the goodwill impairment test, we recommend that the IASB develop additional guidance on the allocation of goodwill to CGUs. We are aware that this is a challenging aspect of IAS 36 for preparers, and that there are concerns that goodwill is

sometimes tested for impairment as part of an excessively large CGUs. Guidance on the allocation of goodwill to CGUs can be considered as part of a holistic review of IAS 36.

- We have mixed views as to whether goodwill amortisation or the impairment-only model is generally more appropriate. However, at this stage, we recommend retaining the impairment-only model, and reconsidering this topic after carrying out a holistic review of IAS 36 and of the accounting requirements for intangible assets in general (including those that are currently not recognised on the balance sheet). We would like to emphasise the urgency of this review.

- We do not agree with moving to an indicator-based approach for goodwill impairment, unless amortisation is reintroduced. We think that an indicator-based approach would not be sufficiently robust to allow for the timely recognition of goodwill impairment losses and would exacerbate the concern that goodwill impairment losses are recognised 'too late'. Without having to perform a quantitative impairment test, it would be relatively easy to claim that the impairment indicators as currently described in IAS 36 do not apply, and therefore that goodwill is not impaired.

- We agree with the proposal to allow the use of post-tax inputs in the value-in-use (VIU) calculation, and note that this is consistent with current practice. However, we recommend not to remove the restriction on cash flows from future asset enhancements and uncommitted restructures at this stage, but to reconsider this after a holistic review of IAS 36 – which could include considering what guidance would be needed to mitigate the risk of subjectivity and management over-optimism if the restriction is to be removed.

- <u>Other topics:</u>
  - Presentation of total equity excluding goodwill: We strongly disagree with this proposal, as such presentation would indicate that goodwill is not an asset. Furthermore, if investors are interested in the amount of equity excluding goodwill themselves, it would be easy for them to obtain this amount themselves from readily available information in the financial statements.
  - Intangible assets: We agree that the IASB should retain the requirement to recognise identifiable intangible assets acquired in a business combination separately from goodwill. Subsuming such intangible assets within goodwill could result in entities providing investors with less information on what was acquired as part of the business combinations. As noted above, we recommend that the IASB conduct a holistic review on the accounting requirements for intangible assets (including those that are currently not recognised).

Our recommendations and responses to the specific questions for respondents are provided in the Appendix to this letter.

We would like to take this opportunity to thank IASB Vice Chair Sue Lloyd and IASB staff member Tim Craig for their assistance with an outreach event that we held on the DP with New Zealand constituents.

If you have any queries or require clarification of any matters in this letter, please contact Gali Slyuzberg (gali.slyuzberg@xrb.govt.nz) or me.

Yours sincerely

Michael Bradbury
Acting Chair – New Zealand Accounting Standards Board

Appendix:

Question 1

Paragraph 1.7 summarises the objective of the Board's research project. Paragraph IN9 summarises the Board's preliminary views. Paragraphs IN50–IN53 explain that these preliminary views are a package and those paragraphs identify some of the links between the individual preliminary views.

The Board has concluded that this package of preliminary views would, if implemented, meet the objective of the project. Companies would be required to provide investors with more useful information about the businesses those companies acquire. The aim is to help investors to assess performance and more effectively hold management to account for its decisions to acquire those businesses. The Board is of the view that the benefits of providing that information would exceed the costs of providing it.

(a) Do you agree with the Board's conclusion? Why or why not? If not, what package of decisions would you propose and how would that package meet the project's objective?

(b) Do any of your answers depend on answers to other questions? For example, does your answer on relief from a mandatory quantitative impairment test for goodwill depend on whether the Board reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?

Response to Question 1:

1. We acknowledge that acquisitions of businesses are often major transactions that have a significant impact on the acquiring entity, and that it is important for investors to receive enough information about these transactions and their impact on the entity's financial performance and position. However, while we agree with some of the preliminary views expressed in the DP, we think that the package of preliminary views as discussed in the DP may not help investors assess the performance of acquisitions and hold management to account for their acquisition decisions. Specifically, as explained in our response to Question 2, we are concerned that the subjective nature of the proposed disclosures on the subsequent performance of acquisitions could result in misleading disclosures – which would go against the intended purpose of the disclosures. Another risk is that disclosures provided under the proposed requirement would be overly generic and therefore not useful to investors, or would not be provided at all – either because of commercial sensitivity or to avoid criticism of management. Furthermore, while the DP aims to provide better information on acquisition at a reasonable cost to preparers, we are concerned that the cost of preparing the disclosures proposed in the DP and having these disclosures audited may not be reasonable.

2. If the IASB decides to proceed with proposing the disclosures included in the DP, we think it would be very important to do the following before requiring these disclosures.

    (a) Consider introducing safeguards to avoid misleading disclosures or overly generic disclosures, and;

    (b) consider and analyse the costs of the suggested disclosures to ensure that the cost is

justified by the expected benefits – field tests could be useful in this regard.

3. While the DP emphasises the importance of looking at the preliminary views in the DP as a package, we think it is also important to consider how these preliminary views fit within the larger package of IAS 36 as a whole and the accounting for intangible assets in general – including internally generated intangible items. We understand that these wider considerations are outside the scope of this project, but we think it is important to take these considerations into account before deciding whether to make significant changes to the disclosure requirements for acquisitions or to the accounting for goodwill (e.g. reintroducing amortisation).

4. As to whether our answers to the questions in the DP are interlinked, we note that a common theme in most of our answers is that we would recommend not to make significant changes to the accounting and disclosure requirements in relation to acquisitions without conducting a holistic review of IAS 36 and the accounting requirements for goodwill and other intangibles. We also note the following interlinked answers:

   (a) If the IASB introduces the proposed disclosures on the subsequent performance of acquisition, we would support retaining the existing requirements to disclose the 'pro forma' performance information currently required by IFRS 3 *Business Combinations* only for those acquisitions that are not monitored by the chief operating decision maker (CODM) – as the disclosures on the subsequent performance of acquisitions would not be provided for such acquisitions.

   (b) We would not support an indicator-based approach for goodwill impairment testing if the impairment-only model is retained, but would support such an approach if goodwill is amortised.

Question 2

Paragraphs 2.4–2.44 discuss the Board's preliminary view that it should add new disclosure requirements about the subsequent performance of an acquisition.

(a) Do you think those disclosure requirements would resolve the issue identified in paragraph 2.4—investors' need for better information on the subsequent performance of an acquisition? Why or why not?

(b) Do you agree with the disclosure proposals set out in (i)–(vi) below? Why or why not?

   (i) A company should be required to disclose information about the strategic rationale and management's (the chief operating decision maker's (CODM's)) objectives for an acquisition as at the acquisition date (see paragraphs 2.8–2.12). Paragraph 7 of IFRS 8 *Operating Segments* discusses the term 'chief operating decision maker'.

   (ii) A company should be required to disclose information about whether it is meeting those objectives. That information should be based on how management (CODM) monitors and measures whether the acquisition is meeting its objectives (see paragraphs 2.13–2.40), rather than on metrics prescribed by the Board.

   (iii) If management (CODM) does not monitor an acquisition, the company should be required to disclose that fact and explain why it does not do so. The Board should not require a company to disclose any metrics in such cases (see paragraphs 2.19–2.20).

   (iv) A company should be required to disclose the information in (ii) for as long as its management (CODM) continues to monitor the acquisition to see whether it is meeting its objectives (see paragraphs 2.41–2.44).

   (v) If management (CODM) stops monitoring whether those objectives are being met before the end of the second full year after the year of acquisition, the company should be required to disclose that fact and the reasons why it has done so (see paragraphs 2.41–2.44).

   (vi) If management (CODM) changes the metrics it uses to monitor whether the objectives of the acquisition are being met, the company should be required to disclose the new metrics and the reasons for the change (see paragraph 2.21).

(c) Do you agree that the information provided should be based on the information and the acquisitions a company's CODM reviews (see paragraphs 2.33–2.40)? Why or why not? Are you concerned that companies may not provide material information about acquisitions to investors if their disclosures are based on what the CODM reviews? Are you concerned that the volume of disclosures would be onerous if companies' disclosures are not based on the acquisitions the CODM reviews?

(d) Could concerns about commercial sensitivity (see paragraphs 2.27–2.28) inhibit companies from disclosing information about management's (CODM's) objectives for an acquisition and about the metrics used to monitor whether those objectives are being met? Why or why not? Could commercial sensitivity be a valid reason for companies not to disclose some of that information when investors need it? Why or why not?

(e) Paragraphs 2.29–2.32 explain the Board's view that the information setting out management's (CODM's) objectives for the acquisition and the metrics used to monitor progress in meeting those objectives is not forward-looking information. Instead, the Board considers the information would reflect management's (CODM's) targets at the time of the acquisition. Are there any constraints in your jurisdiction that could affect a company's ability to disclose this information? What are those constraints and what effect could they have?

Response to Question 2

Question 2(a)–(b): General comments on the proposed disclosures on the subsequent performance of acquisitions

5. We do not support requiring disclosures listed in Question 2(b) in the financial statements. We acknowledge that in principle, if the proposed disclosures are prepared in an unbiased and sufficiently detailed way, these disclosures could help investors better understand the rationale for an acquisition, what benefits management intended to achieve by acquiring the business for the price that it paid – and in subsequent years, how successful the acquisition has been. The proposed disclosures could also focus management's attention on these matters. However, we are not sure to what extent these disclosures would affect investors' decision making, and we are not convinced that the possible benefits of the disclosures are justified by the risks and costs explained below.

<u>Subjective nature of disclosure requirements may lead to misleading disclosures</u>

6. We are concerned that the subjective nature of the disclosures and level of judgement required in providing them could lead to misleading disclosures about acquisitions. The DP proposes that the disclosures on the subsequent performance of acquisitions should be based on those metrics that are used by management (specifically, the CODM) to monitor the acquisition's performance. Under this 'management approach', no requirements or guidance is proposed as to what metrics would be appropriate. There is a range of metrics that management could use to measure the subsequent performance of an acquisition. An acquisition may be successful based on one set of metrics but unsuccessful based on another set. For example, an acquisition may reach a revenue or sales volumes target, but fail with respect to profitability targets. Deciding which metrics should be used by the CODM to measure the success of an acquisition, and therefore which metrics should be disclosed, requires a high degree of judgement. Management would be able to select performance metrics or change these metrics in a way that portrays an unsuccessful acquisition as successful. This could happen inadvertently due to genuine perspective bias on management's part – or it could happen due to a desire to hide poor acquisition decisions.

7. Furthermore, a high level of judgement would be required in determining the performance of the acquisition for a given metric. For example, if the CODM monitors the performance of the acquisition based on operating profit, it would be necessary to decide whether this operating profit should be measured for the acquired business on a standalone basis, or together with the acquiree's existing business (or a division of that business) with which the acquired business is integrated. It would also be necessary to decide how to allocate revenue and costs to the acquired business (or the acquired business and those parts of the existing business

with which it is integrated). In some cases it would be challenging to determine whether a revenue or expense transaction is attributable to the acquisition and therefore should form part of the metric that measures the success of the acquisition – or whether that transaction is attributable to the existing business. Different decisions could lead to very different disclosures about the acquisition's performance. The subjective nature of these decisions and the high level of judgement involved means that the selected metrics and disclosures based on them may not provide a representationally faithful view of whether the acquisition is successful or not in meeting management's objectives for the acquisition.

8. If disclosures about the subsequent performance of acquisitions is misleading, this would negate the abovementioned possible benefits of these disclosures.

<u>Risk of entities providing overly generic or minimal disclosures</u>

9. Furthermore, there is a risk that entities would change their internal reporting to the CODM in such a way that the CODM reviews overly generic information about acquisitions – which would justify the disclosure of such overly generic information in the financial statements, and this would not be helpful to investors. Overly generic disclosures could be driven by management concerns about commercial sensitivity and/or the risk of being criticised for not achieving the expected objectives.

10. Commercial sensitivity was a common concern that constituents expressed during our outreach activities – particularly in the context of New Zealand's relatively small economy.

11. Concerns about commercial sensitivity could arise particularly for privately held companies. While listed companies arguably already share some information of a strategic nature with investors and provide some information about acquisitions beyond the current accounting requirements, for example, when it is appropriate to do so under the continuous disclosure requirements of the stock exchange, privately held companies would perhaps be less accustomed to sharing such information with the users of their financial statements.

12. We think commercial sensitivity would be a factor that entities would take into account when determining the nature of information and level of detail that they are prepared to provide under the proposed disclosure requirements. There is a risk that due to concerns about commercial sensitivity, some preparers might provide disclosures that are so general so as not to be useful to investors. Furthermore, some preparers who do not wish to provide the disclosures for reasons other than commercial sensitivity (for example, due to concerns that the objectives for the acquisition might not be achieved) may refer to commercial sensitivity as a justification for lack of disclosure or for overly general disclosures.

<u>Cost of the disclosures: preparation, audit and regulation</u>

13. We appreciate that the IASB has taken steps to ensure that costs to preparers would be reasonable – by proposing that disclosures be based on information used by management internally and by requiring disclosures only for those acquisitions that are managed by the CODM. However, we think that the cost of the proposed disclosures (including audit costs) could be very high, and may exceed the benefits of the disclosures (particularly given the above concerns about the risk of misleading or overly generic disclosures).

14. We think that the proposed disclosures could give rise to the following costs:

    (a) Preparation costs: We have heard concerns that the costs of providing the proposed disclosures may be high. Preparation costs could arise, for example, from having to 'sanitise' internally used metrics and targets so that they can be disclosed without giving away commercially sensitive information while providing sufficient detail for investors.

    (b) Assurance costs: The proposed disclosures are relatively extensive and would increase the scope of the audit. Furthermore, we have heard concerns that the proposed disclosures may be difficult to audit. This could lead to more expensive audits for entities that acquire other businesses.

    (c) Regulatory costs: It is likely that the proposed disclosures would be a focus area for regulators (particularly due to the degree of subjectivity and level of judgement required – please see above). Compliance with regulators' queries and reviews in relation to the proposed disclosures could indirectly lead to increased preparation costs and audit costs.

    (d) Proprietary costs: These are the costs that result from providing information that an entity's competitors can use to gain competitive advantage over the entity (and the costs incurred in trying to avoid providing this information).

<u>Asymmetry between reporting on business acquisitions vs reporting on organic growth</u>

15. The proposals in the DP would introduce relatively extensive disclosure requirements about the subsequent performance of business acquisitions. However, no such disclosures would be required for the organic growth of an entity – which could involve just as much capital outlay and have just as significant an impact on the entity's performance and position as growth through acquisitions, and could be of as much interest to investors.

16. There is already a difference in the extent of accounting requirements for growth through acquisitions as compared to organic growth. For example, goodwill and certain intangible assets can be recognised only in a business combination, but not when they are generated internally. However, introducing significant disclosure requirements in relation to acquisition would increase this 'imbalance' in information provided in the financial statements about the two different types of investment in the entity's growth. Arguably, it would be beneficial for investors to understand how successfully management is running the business as a whole and creating value for investors – be it through acquisitions or organic growth. This is linked to our comment in the cover letter about recommending that the IASB perform a holistic review of the accounting requirements for intangible assets, including those that are not recognised under the current requirements.

17. The IASB's Practice Statement *Management Commentary* notes that two of the key elements of management commentary are "management's objectives and its strategy for meeting these objectives" and "critical performance measures and indicators that management uses to evaluate the entity's performance against stated objectives". The nature of the disclosures proposed in the DP on the subsequent performance of acquisition appear to be similar in

nature to the abovementioned elements of management commentary. Therefore, it is possible that these disclosures may fit better in management commentary rather than in the financial statements. If the disclosures proposed in the DP on the objectives and subsequent performance of and acquisition are included in an entity's management commentary – together with information about the strategy and performance of the existing business (which we understand is already disclosed in management commentary by some entities) – then by reading the management commentary an investor would receive a holistic picture of the entity's performance and value creation.

<u>Proposed considerations should the IASB be inclined to proceed with the proposed disclosures:</u>

18. If the IASB is inclined to proceed with proposing the disclosures included in the DP, we think it would be very important for the IASB to consider the following before requiring these disclosures.

    (a) Considering whether and to what extent it is possible to introduce safeguards to avoid the risk of misleading disclosures. For example, the IASB could consider providing principles-based guidance on the type of disclosures on objectives and metrics that would be expected or appropriate, or a certain minimum level of disclosures. While this may mean that some entities would need to collect certain information that they did not previously collect as part of their internal monitoring processes, it could help remove some of the subjectivity and bias around the proposed disclosures and ensure that investors are receiving a certain minimum level of useful information about acquisitions.

    (b) Carefully analysing the costs of providing the proposed disclosures. A careful consideration of the costs of the disclosures in practice – for example, by running field tests – could help the IASB confirm whether the benefits of the disclosures could outweigh the costs to preparers, and what changes to the proposed disclosures would be necessary for the benefits to exceed the costs.

    (c) Carrying out a holistic review of the accounting and disclosure requirements for intangible assets, including those that are currently not recognised, before deciding whether to introduce the disclosures proposed in the DP.

    (d) Working with the International Auditing and Assurance Standards Board (IAASB) with a view to ensuring that any proposed disclosures are verifiable for audit purposes, and to clarify what auditors' responsibilities would be in relation to the proposed disclosures.

19. If, after considering the above, the IASB decides to propose requiring the disclosures in the DP, we think that there are certain matters that would need to be clarified for constituents in relation to the disclosures, as we think that these matters are currently not clear in the DP. For example, it would be important to clarify:

    (a) whether comparative information must be restated when there is a change in the metrics used to assess the performance of the acquisition (given that changes in metrics can result in lack of year-on-year comparability);

(b) whether it is permitted to provide the proposed disclosures in aggregate for a number of similar acquisitions, particularly if the CODM monitors these acquisitions in aggregate (for highly acquisitive entities, this could somewhat reduce the cost and volume of the disclosures);

(c) that if the acquired business is integrated into the acquirer's existing business soon after the acquisition, information on performance metrics can be provided for the integrated business, if that is how the CODM monitors the success of the acquisition (this is noted in the DP, but the inability to provide the proposed disclosures due to integration was a common concern that we heard, so it would be important to make this point very clear);

(d) if the CODM monitors the performance of the acquisition against targets established shortly after the acquisition, rather than the estimated targets that existed at the acquisition date, whether the updated targets can be used as the basis for the disclosing 'the metrics that management (CODM) will use to monitor whether the objectives of the acquisition are being met' in the year of the acquisition.

20. As we do not support requiring the proposed disclosures on the subsequent performance of acquisitions in the financial statements, we have not answered Question 2(c)–(f) of the DP.

Question 3

Paragraphs 2.53–2.60 explain the Board's preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand:

- the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and
- the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition.

Do you agree with the Board's preliminary view? Why or why not?

Response to Question 3:

21. We support the IASB's proposal to update the disclosure objectives in IFRS 3 to specifically refer to providing information on benefits expected from an acquisition. We note that IFRS 3 already requires entities to disclose the reason for the business combination, and the proposed specific disclosure objective could help enhance this disclosure.

22. Regarding the proposed specific disclosure objective to provide information on the extent to which acquisitions are meeting management's objectives: As noted in our response to Question 2 above, we do not support requiring the proposed disclosures on the subsequent performance of acquisitions in the financial statements.

Question 4

Paragraphs 2.62–2.68 and paragraphs 2.69–2.71 explain the Board's preliminary view that it should develop proposals:

- to require a company to disclose:
  - a description of the synergies expected from combining the operations of the acquired business with the company's business;
  - when the synergies are expected to be realised;
  - the estimated amount or range of amounts of the synergies; and
  - the expected cost or range of costs to achieve those synergies; and
- to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities.

Do you agree with the Board's preliminary view? Why or why not?

Response to Question 4:

Proposed disclosures about synergies

23. We do not agree with the IASB's proposal to require the specific disclosures on expected synergies from acquisitions as proposed in the DP.

24. We acknowledge that in principle, the proposed specific disclosures on synergies could help provide investors with more useful information about the expected benefits of the acquisition and the rationale for the transaction price (and therefore the value of goodwill on acquisition). However, we are not convinced that the benefits of providing these disclosures would exceed the cost of providing them, for the following reasons.

    (a) Accuracy and completeness: We think there could be issues around the accuracy and completeness of the underlying information that will be used to prepare the proposed disclosures on synergies. We are aware that some acquirers have well-documented and detailed synergy calculations, whereas others do not. It is possible that the proposed specific disclosure requirements on synergies could encourage entities to consider and document expected synergies more carefully, which would be beneficial. However, some entities may continue to undertake acquisitions without detailed analysis and documentation of synergies – in which case the proposed disclosures would be prepared based on incomplete and potentially unreliable information. Furthermore, it could be argued that despite an acquirer's efforts around the performance of due diligence, business acquisitions are always based on incomplete information. Therefore, there would be a certain degree of risk around the completeness and accuracy of the information underlying the proposed disclosures on synergies, even for entities that have robust processes around the analysis of synergies.

    (b) Verifiability and cost of audit: We also have some concerns about the auditability of the proposed disclosures on synergies. As noted above, depending on the robustness of an

entity's analysis and documentation of synergies, the disclosures may be prepared based on incomplete and potentially unreliable information, which would make the disclosures challenging to audit. We are also aware of concerns that auditors may be expected to opine on the reasonableness of management's expectations around synergies – which would effectively require the auditor to perform a due diligence exercise in relation to the acquisition. The process of determining the acquisition price, including the determination of expected synergies, is often complex. If auditors have to review this process to determine whether the disclosures on synergies are faithfully representative, this would significantly increase the scope and therefore the cost of the audit. The abovementioned concerns about auditability are also likely to increase audit costs.

(c) Concerns about commercial sensitivity: We are aware of concerns around the commercial sensitivity of these disclosures, and such concerns could affect the level of detail that entities are prepared to provide regarding expected synergies.

25. If the IASB proceed with proposing the disclosures on synergies as described in the DP, we think it would be important to clarify certain matters to constituents, including the acceptable level of disclosures on synergies (this may help mitigate concerns about commercial sensitivity to a certain extent), that synergies may not necessarily equal to or be readily reconcilable to the transaction price itself, and what disclosures are required when no synergies are expected from an acquisition (for example, because the purchased business is unrelated to the existing business, or in case of a 'protective' acquisition). Furthermore, it would be important to clarify, through discussions with the IAASB, the auditor's role regarding assurance over the disclosures over synergies.

Proposal to specifically require disclosure of the acquiree's liabilities from financing activities and defined benefit pension liabilities

26. We note that paragraph B64 of IFRS 3 requires disclosure of the amounts as at acquisition date for major classes of assets and liabilities assumed in a business combination. Therefore, under the current requirements, whether the acquiree's liabilities from financing activities and/or defined benefit pension plan are disclosed or not depends on whether they are considered to be major classes of transaction.

27. Furthermore, paragraph 31 of IAS 1 *Presentation of Financial Statements* notes that if a certain disclosure is required by an IFRS Standard but it is not material, then the disclosure need not be provided – whereas additional disclosures that are not specifically required by IFRS Standards should be considered to enable users to understand a transaction. Therefore, if information about the acquiree's liabilities from financing activities and/or defined benefit pension plan liabilities are material and an investor would need this information to understand the impact of the acquisition on the financial statements, then separate disclosure of these liabilities would need to be considered under paragraph 31 of IAS 1 – even if the IASB does not specifically require the disclosure of these liabilities. Conversely, if these liabilities are not material, then application of paragraph 31 of IAS 1 would mean that these liabilities would not be disclosed, even if the IASB specifically requires the proposed disclosures.

28. For these reasons, we do not think it is necessary to introduce the proposed specific requirement to disclose the acquiree's liabilities from financing activities and defined benefit pension liabilities.

29. We also note that the proposed requirement to disclose the acquiree's liabilities from financing activities and defined benefit pension liability is a rather specific requirement, as compared to the more principles-based requirements usually found in IFRS Standards.

Question 5

IFRS 3 *Business Combinations* requires companies to provide, in the year of acquisition, pro forma information that shows the revenue and profit or loss of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period.

Paragraphs 2.82–2.87 explain the Board's preliminary view that it should retain the requirement for companies to prepare this pro forma information.

(a) Do you agree with the Board's preliminary view? Why or why not?

(b) Should the Board develop guidance for companies on how to prepare the pro forma information? Why or why not? If not, should the Board require companies to disclose how they prepared the pro forma information? Why or why not?

IFRS 3 also requires companies to disclose the revenue and profit or loss of the acquired business after the acquisition date, for each acquisition that occurred during the reporting period.

Paragraphs 2.78–2.81 explain the Board's preliminary view that it should develop proposals:

- to replace the term 'profit or loss' with the term 'operating profit before acquisition-related transaction and integration costs' for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or loss would be defined as in the Exposure Draft *General Presentation and Disclosures*.
- to add a requirement that companies should disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.

(c) Do you agree with the Board's preliminary view? Why or why not?

Response to Question 5:

30. In the context of our disagreement with including the proposed disclosures on the subsequent performance of acquisitions in the financial statements (see Question 2 above), we agree with the IASB's proposal to retain the existing requirement to disclose 'pro forma' information on the revenue and profit of the combined business as if the acquisition occurred at the start of the year. We also agree that the IASB should develop guidance on how to calculate the abovementioned pro-forma information, as we are aware that it is often difficult for preparers to provide this information. However, we would prefer not to require the proposed additional disclosures on operating cash flows.

31. If the IASB introduces the proposed disclosures on subsequent performance of acquisitions, then we recommend retaining the existing disclosures on the acquiree's pro-forma and actual contribution to the group only for those acquisitions that are not monitored by the CODM, as the proposed disclosures on subsequent performance would not be provided for such acquisitions. For acquisitions that are monitored by the CODM, the new disclosures on subsequent performance of acquisitions would mean that the existing disclosures on the acquiree's pro-forma and actual contribution to the group are unlikely to be needed by investors.

32. Regarding the proposal to use term 'operating profit before acquisition-related transaction and integration costs' instead of 'profit or loss': We note that the determination of integration costs can be highly subjective. Therefore, if the IASB retains the existing pro-forma requirements and proposes the new disclosures on cash flows as per its preliminary view, using the term 'operating profit before acquisition-related transaction and integration costs' will add a layer of subjectivity to these disclosures.

Question 6

As discussed in paragraphs 3.2–3.52, the Board investigated whether it is feasible to make the impairment test for cash-generating units containing goodwill significantly more effective at recognising impairment losses on goodwill on a timely basis than the impairment test set out in IAS 36 Impairment of Assets. The Board's preliminary view is that this is not feasible.

(a) Do you agree that it is not feasible to design an impairment test that is significantly more effective at the timely recognition of impairment losses on goodwill at a reasonable cost? Why or why not?

(b) If you do not agree, how should the Board change the impairment test? How would those changes make the test significantly more effective? What cost would be required to implement those changes?

(c) Paragraph 3.20 discusses two reasons for the concerns that impairment losses on goodwill are not recognised on a timely basis: estimates that are too optimistic; and shielding. In your view, are these the main reasons for those concerns? Are there other main reasons for those concerns?

(d) Should the Board consider any other aspects of IAS 36 in this project as a result of concerns raised in the Post-implementation Review (PIR) of IFRS 3?

Response to Question 6:

Questions 6(a) and (b): Whether it is possible to design a significantly more effective impairment test

33. We think that without conducing a holistic review of IAS 36 and of the accounting requirements for intangible assets, it is not feasible to design an impairment test that is significantly more effective at recognising impairment losses on goodwill on a timely basis and at a reasonable cost.

34. As the DP notes, goodwill does not generate cash flows independently and cannot be measured directly. Therefore, goodwill must be tested for impairment together with other assets as part of a cash generating unit (CGU) or group of CGUs. Furthermore, unless and until the prohibition on recognising internally generated goodwill and certain other internally generated intangible items is removed, CGUs to which goodwill is allocated will often include unrecognised headroom from these items. Therefore, we agree that goodwill will inevitably be shielded by unrecognised headroom within the CGU, be it headroom generated before or after the acquisition.

35. We also agree that the IASB should not implement the alternative impairment method described as the 'headroom approach' in Section 3 of the DP – as this method would not eliminate the shielding of goodwill, there would be issues around allocating the impairment amount between acquired goodwill and unrecognised 'headroom' items, and the DP notes that it will be costly for preparers to implement this model.

Question 6(c): Reasons for concern that goodwill impairment losses are recognised too late

36. We agree with the IASB that overly optimistic estimates in performing the impairment test

and the shielding of goodwill within CGUs are the main reasons for the concern that goodwill impairment is not recognised on a timely basis. Our specific comments on these two concerns are included below.

Management over-optimism

37. There are already some requirements in IAS 36 that attempt to mitigate the risk of management over-optimism, and we agree that in general, any additional safeguards to mitigate against this risk should come from the work of auditors and regulators.

38. However, it may be worth considering whether there are opportunities to enhance the existing safeguards in IAS 36. For example, we would recommend considering whether more emphasis should be given to the requirement to base cash flow projections on 'reasonable and supportable information'. At the moment, IAS 36 requires cash flows in the VIU calculation to be based on "reasonable and supportable assumptions" (paragraph 33(a)), and also to be based on budgets or forecasts approved by management (paragraph 33(b)). However, these are presented as two separate requirements. Therefore, there could potentially be tension between these two requirements, and an entity could potentially put more emphasis on basing the cash flows on forecasts approved by management – and these forecasts could be over-optimistic. This risk could be somewhat mitigated if the standard puts more emphasis on the requirement around 'reasonable and supportable assumptions'.

Shielding

39. As noted above, we agree that shielding cannot be fully eliminated – because goodwill must be tested for impairment with a group of other assets, including certain intangible items that cannot be recognised on the balance sheet, and these can shield goodwill from impairment.

40. However, we note that the issue of shielding as described in the DP is compounded by issues around the identification of CGUs/groups of CGUs for the purpose of the impairment test and the allocation of goodwill to these CGUs. That is, allocating goodwill to excessively large CGUs can exacerbate the impact of shielding.

41. A CGU is defined in IAS 36 as the "smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets". However, we are aware that some entities default to identifying CGUs at the operating segment level, which is the maximum possible size under IAS 36 (paragraph 80(b)), and justify this by saying that this is the lowest level at which management monitors goodwill (paragraph 80(a) of IAS 36). Sometimes this means that the entire reporting entity is seen as a single CGU, and goodwill (sometimes from several acquisition) is tested for impairment together with all the assets and liabilities and unrecognised headroom of the whole reporting entity. While this might be appropriate in some cases, in other cases a more granular identification of CGUs would lead to a more meaningful goodwill impairment test, and would decrease the impact of shielding.

42. To the extent that this issue arises from incorrect application of IAS 36, we think this issue is perhaps better addressed by auditors and regulators than through standard setting. However, the AASB Research Report notes that due to lack of clarity around the requirements in IAS 36

to allocate goodwill to CGUs, respondents said that these requirements are difficult to interpret and implement, require a high degree of subjectivity and result in diversity in application.

43. Therefore, we recommend considering whether additional guidance on allocating goodwill to CGUs or groups of CGUs could be provided.

Question 6(d): Should the IASB consider any other aspects of IAS 36

44. As noted above, we recommend that the IASB consider developing additional guidance on the identification of CGUs and the allocation of goodwill to CGUs. The difficulties and subjectivity involved in allocating goodwill to CGUs for impairment testing purposes was one of the concerns raised by stakeholders during the IASB's PIR of IFRS 3. Therefore, in theory, this matter could be considered as part of this project. Alternatively, it could be considered as part of a holistic review of IAS 36 at a later stage.

Question 7

Paragraphs 3.86–3.94 summarise the reasons for the Board's preliminary view that it should not reintroduce amortisation of goodwill and instead should retain the impairment-only model for the subsequent accounting for goodwill.

(a) Do you agree that the Board should not reintroduce amortisation of goodwill? Why or why not? (If the Board were to reintroduce amortisation, companies would still need to test whether goodwill is impaired.)

(b) Has your view on amortisation of goodwill changed since 2004? What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already had?

(c) Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not?

(d) Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not?

(e) If amortisation were to be reintroduced, do you think companies would adjust or create new management performance measures to add back the amortisation expense? (Management performance measures are defined in the Exposure Draft *General Presentation and Disclosures*.) Why or why not? Under the impairment-only model, are companies adding back impairment losses in their management performance measures? Why or why not?

(f) If you favour reintroducing amortisation of goodwill, how should the useful life of goodwill and its amortisation pattern be determined? In your view how would this contribute to making the information more useful to investors?

Response to Question 7:

Question 7(a): Do you agree that the IASB should not reintroduce amortisation of goodwill? Why or why not?

45. We have heard mixed views from constituents regarding the subsequent accounting for goodwill, and like the IASB, we are aware that both the impairment-only model and the amortisation model have advantages and disadvantages. Our views on this topic were also mixed.

46. We are aware of the following arguments in favour of retaining the impairment-only model.

    (a) There is an argument that core elements of goodwill as described in BC313–BC 318 of IFRS 3, i.e. synergies and the 'going concern' element, generate economic benefits over an indefinite time period. On this basis, the impairment-only model is appropriate for goodwill and the amortisation model is not (like other intangible assets with an indefinite life).

(b) According to a recent article[1] by the International Valuation Standards Council (IVSC), business valuation models used to price businesses generally assume that the core elements of goodwill (being the going concern element and a synergies element) are non-wasting. For example, the IVSC note that synergies are included in the terminal value calculation in the pricing model for acquisition. Therefore, the amortisation method (which reflects the consumption of a 'wasting' asset over a finite period) would not be consistent with the principles used to determine the purchase price of the acquired business, which in turn is used for determining the goodwill amount on acquisition.

(c) Even if it is argued that the value of goodwill is consumed over a finite period, it could be difficult to reliably estimate the useful life of goodwill. The amortisation model is likely to result in an arbitrary amortisation expense amount being charged over an arbitrary time frame. Such arbitrary information is unlikely to provide useful information to users of financial statements, including investors. On the other hand, the impairment-only model provides useful information to investors – about the fact that impairment has occurred (if that is the case), and about the underlying assumptions used in determining whether goodwill is or is not impaired.

(d) While amortisation would reduce the goodwill balance every year, it would also increase headroom within the CGU every year, which could reduce the likelihood of an *impairment loss* being recognised when an acquisition is not performing as well as expected. The impairment test would still be performed under the amortisation method, but because of the regular decreases in the goodwill balance, it would be less likely that the carrying amount of CGUs to which goodwill is allocated would not be recoverable. Therefore, the amortisation method could lead to impairment losses being mislabelled as 'business as usual' amortisation.

(e) For most assets, while amortisation is mandatory it is also possible to capitalise certain costs incurred in relation to the asset. However, such capitalisation is not possible for goodwill. Therefore, under the amortisation method, there is a risk of a 'double-hit' to the P&L in the same year: once from expenditure incurred to enhance goodwill, and again from amortisation.

(f) While internally generated goodwill could possibly replace impaired or consumed amounts of acquired goodwill, in practice it is very difficult to distinguish between acquired goodwill and goodwill generated internally after the acquisition (see discussion further below). The extent to which internally generated goodwill replaces acquired goodwill could be limited, assuming that acquired goodwill generates benefits over an indefinite time period.

(g) The reintroduction of amortisation would be a major change in accounting requirements. While the amortisation method has some practical advantages over the impairment-only model, it also has some disadvantages as compared to impairment-

[1] *IVSC Perspective Paper: Business Valuation – Is Goodwill a Wasting Asset?* (September 2019)

only, and it is not clear that a change in model would lead to an overall improvement in the accounting for goodwill and the information that is provided to investors.

(h) This project has a relatively narrow scope in relation to impairment and accounting for goodwill, as it is based on a post-implementation review of IFRS 3 (which focuses on business combinations, rather than impairment or intangible assets). If the IASB was to reintroduce amortisation, this would require a wider scope project which would potentially consider other indefinite-lived assets, as well as possible amortisation methods and amortisation periods – which would require a lot of additional research. Therefore, we believe that the reintroduction of amortisation should be proposed only as part of a more comprehensive project on this subject – rather than as part of this project.

47. On the other hand, we are also aware of the following arguments in favour of the reintroduction of amortisation.

(a) There is an argument that the economic benefits embodied within goodwill do not last indefinitely; rather, they are consumed by the entity over a finite time period and are replaced by internally generated goodwill (which is different to acquired goodwill). This consumption would be best reflected by amortisation.

(b) Under the impairment-only model, goodwill remains on the balance sheet long after it has stopped being a relevant or meaningful. An entity can be restructured several times and change significantly after an acquisition that gives rise to goodwill. Without regular amortisation, goodwill stays on the balance sheet throughout these changes and restructures (as long as the recoverable amounts of relevant CGUs exceed their carrying amounts) – even when the entity bears very little resemblance to either the acquired business or the original business as it existed at the time of the acquisition.

(c) By its nature, the goodwill impairment test is complex and requires a high degree of estimation, which is subject to error and management over-optimism. As a result of this – as well as due to the effect of shielding, which cannot be eliminated – there is a high risk that goodwill balances are overstated. Amortisation would be a simpler and more effective way to ensure that the goodwill balance is not overstated.

(d) We heard concerns that goodwill impairment test is costly, particularly for medium-sized companies, who do not have the same level or resources and internal expertise as larger companies. For such companies in particular, amortisation would be a more cost-effective way of accounting for goodwill – including ensuring that goodwill is not overstated. Even though impairment testing would still be required under an amortisation model, the IASB's proposed move to an indicators-based approach for testing for impairment of goodwill, amortisation would mean that goodwill will need to be tested for impairment less often that it is currently, which will reduce costs for preparers.

(e) The Basis for Conclusions of IFRS 3 explain that the core components of goodwill are the 'going concern' element of the acquired business and the synergies expected from the acquisition. While it could possibly be argued that these components of goodwill have an indefinite life, in practice the goodwill balance sometimes contains other intangible items that have finite useful lives and for which amortisation would be appropriate.

(f) Determining the useful life of goodwill could be challenging and would require judgement, but it is not impossible. Before New Zealand adopted IFRS Standards, the standard on accounting for acquisitions (FRS 36 *Accounting for Acquisitions Resulting in Combinations of Entities or Operations*) included guidance on determining the estimated useful life of goodwill. In addition, the IASB could put a cap on the amortisation period, to reduce complexity and avoid overly optimistic estimation of useful life. Such caps could be based on academic research, the IFRS for SMEs standard, or another current or previous standard outside of IFRS that allows amortisation and has a cap on useful life.

48. Ultimately, we think that the IASB should retain the impairment-only model *at this time*, but reconsider whether to reintroduce amortisation after carrying out a holistic review of IAS 36 (including considering guidance on the determination of CGUs and the allocation of goodwill to CGUs), and of the accounting for intangible assets in general – including those intangible items that are not recognised under the current requirements. Having said this, we think it would be important to carry out these reviews with some urgency.

49. To help the IASB decide on whether to retain the impairment-only model or to reintroduce goodwill amortisation (after carrying out the abovementioned holistic reviews), we think it may be useful for the IASB to conduct further research on the following.

(a) Whether goodwill is generally a wasting asset with a finite life or a non-wasting asset with an infinite life – including investors' perception on this matter;

(b) Whether the hybrid approach discussed in the DP (i.e. applying the impairment-only model for the first few years after an acquisition and then applying amortisation) would result in useful information for investors, and;

Question 7(b): Has your view on amortisation of goodwill changed since 2004? What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already had?

50. At an outreach event, we asked New Zealand constituents whether their views on the subsequent accounting for goodwill have changed since 2004, when the impairment-only model was first introduced. About 40% of the attendees said that their views have changed, while about 60% have not changed their views. For the majority of those attendees whose views have changed since 2004, the change was in favour of amortisation – but about 7% of attendees changed their preference to impairment-only.

51. We are not aware of significant new conceptual arguments in favour of amortisation that the IASB is not already aware of. However, the practical issues that have been arising from applying the IAS 36 since the impairment-only model for goodwill was introduced could

possibly constitute a reason for reintroducing amortisation. Such practical issues include the length of time that goodwill has stayed on entities' financial statements, challenges around identifying CGUs and allocating goodwill to CGUs, the cost of performing the impairment test every year, the risk of management over-optimism in performing the impairment test, etc. Having said this, we would recommend a review of IAS 36 as a whole, as well as the accounting requirements for intangible assets in general, before considering the reintroduction of goodwill amortisation.

Question 7(c): Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not?

52. In terms of shielding, unlike the impairment-only model, amortisation targets goodwill directly, and therefore decreases the shielding effect and the risk of overstated goodwill. However, while amortisation could potentially reduce the carrying value of goodwill in a timelier manner, it would not necessarily make the recognition of impairment losses more timely. This is because the amortisation method could lead to impairment losses (as distinct from regular reduction in value through consumption) being mislabelled as regular amortisation.

53. In terms of over-optimistic estimates, the amortisation method would require management to estimate the useful life of goodwill and the expected pattern of consumption. These estimates could equally be subject to management over-optimism. On the other hand, it is possible that, under the amortisation method, the IASB would require a specific amortisation period or would introduce a cap on the permitted amortisation period. This would significantly decrease the impact of management over-optimism under the amortisation method. However, this would also increase the arbitrariness of the goodwill's useful life and amortisation amount, which would decrease the usefulness of this information.

Question 7(d): Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not?

54. We think that in practice, it is difficult to distinguish between acquired goodwill and goodwill generated internally after the acquisition. Specifically, it is difficult to determine whether certain activities maintain the value of the acquired goodwill or create internally generated goodwill. Furthermore, it can be difficult to determine whether future expected benefits from new customers, a new product line or a new brand are related to the acquired goodwill (i.e. part of the synergies from the acquisition, or part of the 'going concern' element of the acquired entity which allows finding new customers, developing new products, etc.) – or whether it is new, internally generated goodwill that is unrelated to any previous acquisition.

55. However, if it is accepted that acquired goodwill has a finite useful life, then it is likely that it is replaced by internally generated goodwill.

Question 7(e): If amortisation were to be reintroduced, do you think companies would adjust or create new management performance measures to add back the amortisation expense? Under the impairment-only model, are companies adding back impairment losses in their management performance measures? Why or why not?

56. We think that companies are likely to adjust management performance measures to add back the amortisation expense.

Question 7(f): If you favour reintroducing amortisation of goodwill, how should the useful life of goodwill and its amortisation pattern be determined? In your view how would this contribute to making the information more useful to investors?

57. As noted above, we do not recommend the reintroduction of amortisation of goodwill at this time.

58. However, if the IASB reintroduce amortisation, we would recommend that the IASB introduce a rebuttable cap on the amortisation period. We believe that this cap should be based on research, such as academic research on the lifespan of acquisitions' additive value. Introducing such a cap would mitigate the risk of over-optimistic estimations of the amortisation period and would simplify the amortisation requirements for preparers.

Question 8

Paragraphs 3.107–3.114 explain the Board's preliminary view that it should develop a proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill. The Board would be likely to require companies to present this amount as a free-standing item, not as a subtotal within the structure of the balance sheet (see the Appendix to this Discussion Paper). (a) Should the Board develop such a proposal? Why or why not? (b) Do you have any comments on how a company should present such an amount?

Response to Question 8:

59. We strongly disagree with the IASB's proposal to require entities to disclose the amount of equity excluding goodwill on the balance sheet.

60. We appreciate that that the IASB's intention in making this proposal was to provide more transparency around goodwill, and help investors identify companies in which goodwill forms a large part of the equity balance. However, we disagree with the IASB's proposal for the following reasons.

    (a) We acknowledge that goodwill has certain characteristics that make it different to most other assets (as discussed in the DP) – but it is nevertheless an asset for the purpose of IFRS Standards. Presenting the amount of equity excluding goodwill could imply that goodwill is not an asset and should not be recognised on the balance sheet.

    (b) If the amount of equity excluding goodwill is useful information for investors, it would be easy for investors to calculate that amount themselves, without that amount being presented on the balance sheet. Separate disclosure of goodwill (either on the balance sheet or in the notes) is already required in IFRS Standards. Moreover, the IASB ED *General Presentation and Disclosures* proposed that goodwill be presented as a separate line item on the balance sheet.

    (c) Having two equity balances may be confusing for some users of financial statements – and they may question which amount represents the 'true' equity position of the entity. Furthermore, if there are users who do not know how to calculate the amount of equity excluding goodwill themselves, for such users the presentation of two equity balances could be even more confusing.

Question 9

Paragraphs 4.32–4.34 summarise the Board's preliminary view that it should develop proposals to remove the requirement to perform a quantitative impairment test every year. A quantitative impairment test would not be required unless there is an indication of impairment. The same proposal would also be developed for intangible assets with indefinite useful lives and intangible assets not yet available for use.

(a) Should the Board develop such proposals? Why or why not?

(b) Would such proposals reduce costs significantly (see paragraphs 4.14–4.21)? If so, please provide examples of the nature and extent of any cost reduction. If the proposals would not reduce costs significantly, please explain why not.

(c) In your view, would the proposals make the impairment test significantly less robust (see paragraphs 4.22–4.23)? Why or why not?

Response to Question 9:

61. If the IASB retains the impairment-only model for goodwill, then we do not agree with the IASB's proposal to move to an indicator-based approach to goodwill impairment testing. We recommend retaining the current requirement to test goodwill for impairment every year.

62. Moving to an indicator-based approach could lead to some loss of robustness in the goodwill impairment process, because an indicator of impairment could be inadvertently missed or ignored due to management over-optimism, or due to incorrect assumptions as to when goodwill impairment can occur (as explained further below). This would result in not recognising impairment loss on time. This would exacerbate the concern over late recognition of impairment losses. By contrast, if goodwill must be tested for impairment every year, there is less risk that an impairment loss will be missed. For example, if the entity's competitor launches a new product, under an indicator-based approach it would be relatively easy to argue that this does not constitute "significant changes with an adverse effect on the entity […] in the technological, market, economic or legal environment in which the entity operates" (IAS 36, paragraph 12), and does not indicate that goodwill is impaired. However, if the annual impairment test requirement was retained, management would need to quantify the impact of the competitor's new product launch on the future cash flows or fair value of the relevant CGU, which could result to the recognition of an impairment loss that may have otherwise been missed. Furthermore, some assume that a CGU must be making a loss for an impairment of goodwill to occur. This could lead to an assumption that as long as the operations relating to the CGU are profitable, there are no indicators of goodwill impairment. Again, this could lead to goodwill impairment not being recognised, as goodwill can be impaired even if the related business is profitable (albeit not profitable enough to support the carrying amount of the assets within the CGU). There is good discipline in performing the goodwill impairment test every year.

63. Performing the impairment test every year means that the impairment model gets refined over time, and the entity's experience and expertise in relation to performing the impairment

test is maintained. This benefit would not be available to entities that perform the impairment test only when there are indicators of impairment.

64. Cost saving from not performing the impairment test every year may be negated by the cost of assessing whether there are indicators of impairment – and the potential additional costs of preparing a goodwill impairment model when one has not been prepared for a long time and regaining expertise in performing the impairment test, etc.

65. Having said this, moving to an indicator-based approach could be appropriate if the IASB reintroduce goodwill amortisation. If goodwill is amortised, then there is less risk that missing an impairment indicator would result in an overstated goodwill balance.

66. If the IASB implements an indicators-based approach for goodwill impairment testing, we think it would be important to enhance the requirements and guidance in IAS 36 around the indicators of impairment. This could include developing new indicators specifically in relation to goodwill, developing specific guidance on applying existing indicators to goodwill, or developing a list of indicators that must be present to presume that goodwill is not impaired. Such enhancement would provide greater clarity to preparers in applying the indicator-based approach to goodwill, and would reduce the risk of management over-optimism when applying this approach.

Question 10

The Board's preliminary view is that it should develop proposals:

- to remove the restriction in IAS 36 that prohibits companies from including some cash flows in estimating value in use—cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance (see paragraphs 4.35–4.42); and
- to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use (see paragraphs 4.46–4.52).

The Board expects that these changes would reduce the cost and complexity of impairment tests and provide more useful and understandable information.

(a) Should the Board develop such proposals? Why or why not?

(b) Should the Board propose requiring discipline, in addition to the discipline already required by IAS 36, in estimating the cash flows that are the subject of this question? Why or why not? If so, please describe how this should be done and state whether this should apply to all cash flows included in estimates of value in use, and why.

Response to Question 10:

Question 10 (a): Allowing the use of post-tax inputs

67. We agree that the IASB should allow the use of post-tax inputs in the VIU calculation. We note that this how VIU tends to be calculated in practice, with the pre-tax discount rate being calculated for disclosure purposes.

68. However, if the IASB implements this proposal, we recommend that the IASB consider whether any additional guidance would be needed on the treatment of deferred tax, temporary tax differences and similar items that are the reason behind the current requirement to use pre-tax inputs.

Question 10(b): Removing the restriction on the inclusion of cash flows from future asset enhancements and uncommitted restructures

69. In our view, the proposal to allow the use of post-tax inputs in the VIU calculation reflects current practice and has clear advantages. By contrast, the proposal to remove the restriction on the inclusion of cash flows from future asset enhancements and uncommitted restructures in the VIU calculation would represent a significant change to the VIU model, and would be associated with a greater risk of non-recognition of impairment losses, due to the increased subjectivity involved in estimated cash flows from future enhancements to assets.

70. At this time, we disagree with removing the restriction on the inclusion of cash flows from future asset enhancements and uncommitted restructures in the VIU calculation. However, we recommend that the IASB reconsider this matter after conducing a holistic review of IAS 36.

71. We think that removing this restriction would exacerbate the risk of impairment losses being recognised too late. It is often difficult to reliably estimate cash flows from future asset

enhancements and uncommitted restructures – but it would be relatively easy to argue that the 'reasonable and supportable' criterion is met. Removing the restriction around these cash flows would make the VIU calculation more susceptible to subjectivity and over-optimistic estimates. This could be mitigated by developing guidance to explain more clearly when it is appropriate to include the abovementioned cash flows in the VIU calculation – which could be done as part of a holistic review of IAS 36. It would be important to include such guidance in IAS 36 if, after conducting a holistic review of that standard, the IASB decides to remove the abovementioned restrictions.

72. Furthermore, removing the abovementioned restriction would make the VIU calculation very similar to an income-based calculation of fair value less costs of disposal (FVLCD) – except that FVLCD allows the inclusion of only those cash flows that a market participant would consider, whereas VIU does not have this restriction. If, after conducting a holistic review of IAS 36 and considering the additional guidance mentioned in the previous paragraph, the IASB decides to remove the abovementioned restrictions from the VIU method, we think that the IASB would need to consider whether both methods for calculating the recoverable amount of a CGU should be retained, or whether a single method should be mandated.

Question 11

Paragraph 4.56 summarises the Board's preliminary view that it should not further simplify the impairment test.

(a) Should the Board develop any of the simplifications summarised in paragraph 4.55? If so, which simplifications and why? If not, why not?

[Simplifications not pursed by the IASB as per paragraph 4.55 listed for the NZASB's information:]

- adding more guidance on the difference between entity-specific inputs used in value in use and market-participant inputs used in fair value less costs of disposal.
- mandating only one method for estimating the recoverable amount of an asset (either value in use or fair value less costs of disposal), or requiring a company to select the method that reflects the way the company expects to recover an asset.
- allowing companies to test goodwill at the entity level or at the level of reportable segments rather than requiring companies to allocate goodwill to groups of cash-generating units that represent the lowest level at which the goodwill is monitored for internal management purposes. Many stakeholders have said that allocating goodwill to cash-generating units is one of the main challenges of the impairment test.
- adding guidance on identifying cash-generating units and on allocating goodwill to cash-generating units.

(b) Can you suggest other ways of reducing the cost and complexity of performing the impairment test for goodwill, without making the information provided less useful to investors?

Response to Question 11:

73. As noted above, we recommend that the IASB consider developing additional guidance on the identification of CGUs and the allocation of goodwill to CGUs.

Question 12

Paragraphs 5.4–5.27 explain the Board's preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill.

(a) Do you agree that the Board should not develop such a proposal? Why or why not?

(b) If you do not agree, which of the approaches discussed in paragraph 5.18 should the Board pursue, and why? Would such a change mean that investors would no longer receive useful information? Why or why not? How would this reduce complexity and reduce costs? Which costs would be reduced?

(c) Would your view change if amortisation of goodwill were to be reintroduced? Why or why not?

Response to Question 12:

74. We agree with the IASB that it should not change the current requirement to recognise identifiable intangible assets acquired in a business combination separately from goodwill. Our reasons for agreeing are as follows.

    (a) The current requirement to recognise identifiable intangible assets separately from goodwill in a business combination provides users of financial statements with a better understand of what has been acquired as part of the business combination.

    (b) Subsuming identifiable intangible assets within the goodwill balance could result in assets of dissimilar nature being combined together, which could be misleading for users of financial statements.

    (c) If the impairment-only model for goodwill is retained, including intangible assets within the goodwill balance would mean that some intangible assets that have a finite useful life and should be amortised are instead subject to the impairment-only model. Even if goodwill amortisation is reintroduced, including intangible assets in the goodwill balance would mean that assets with potentially different useful lives are being amortised together.

75. As noted elsewhere in this letter, we recommend that the IASB undertake a holistic review of the accounting for intangible assets.

Question 13
IFRS 3 is converged in many respects with US generally accepted accounting principles (US GAAP). For example, in accordance with both IFRS 3 and US GAAP for public companies, companies do not amortise goodwill. Paragraphs 6.2–6.13 summarise an Invitation to Comment issued by the US Financial Accounting Standards Board (FASB).
Do your answers to any of the questions in this Discussion Paper depend on whether the outcome is consistent with US GAAP as it exists today, or as it may be after the FASB's current work? If so, which answers would change and why?

Response to Question 13:

76. We do not have any comments on this question. For most entities in New Zealand, alignment between IFRS Standards and US GAAP is not a major concern.

Question 14
Do you have any other comments on the Board's preliminary views presented in this Discussion Paper? Should the Board consider any other topics in response to the PIR of IFRS 3?

Response to Question 14:

77. We do not have any additional comments other than those already noted in this appendix and in the cover letter.

NZ ACCOUNTING
STANDARDS
BOARD

Memorandum

Date:	4 December 2020
To:	NZASB Members
From:	Vanessa Sealy-Fisher
Subject:	**Editorial corrections to NZ IFRS**

Recommendation[1]

1. We recommend that the Board approves the editorial corrections to NZ IFRS outlined in the memo.

IASB editorial correction to IFRS 7

2. In October 2020 the IASB issued an editorial correction to IFRS 7 *Financial Instruments: Disclosures* which needs to be incorporated into NZ IFRS 7 *Financial Instruments: Disclosures*.

3. The editorial correction corrects a paragraph reference in a paragraph added to IFRS 7/NZ IFRS 7 when *Interest Rate Benchmark Reform* was issued.

4. The amendment to paragraph 44EE of NZ IFRS 7 is shown below. New text is underlined and deleted text is struck through. Paragraph 44FF is not amended; it is shown for context.

Effective date and transition

…

44EE *Interest Rate Benchmark Reform*, which amended NZ IFRS 9, NZ IAS 39 and NZ IFRS 7, issued in November 2019, added paragraphs 24H and 44FF~~44DF~~. An entity shall apply these amendments when it applies the amendments to NZ IFRS 9 or NZ IAS 39.

44FF In the reporting period in which an entity first applies *Interest Rate Benchmark Reform*, issued in November 2019, an entity is not required to present the quantitative information required by paragraph 28(f) of NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Editorial correction to NZ IAS 34

5. A constituent has noted that some paragraphs in NZ IAS 34 *Interim Financial Reporting* refer to Appendices A, B and C. These paragraphs should refer to Parts A, B and C of the Illustrative Examples accompanying IAS 34 *Interim Financial Reporting*. This inadvertent difference between NZ IAS 34 and IAS 34 existed before the XRB was established.[2]

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

[2] We think the amendments to IAS 34 were made in 2003 when the IASB made a substantial number of editorial changes to IFRS Standards, not all of which were exposed for comment. This is the period when NZ IFRS was being developed.

6. We propose to amend paragraphs 22, 40 and 42 of NZ IAS 34 as shown below so that the wording in these paragraphs is identical to the wording in paragraphs 22, 40 and 42 of IAS 34. New text is underlined and deleted text is struck through.

Periods for which interim financial statements are required to be presented

20 …

22 ~~Appendix~~ Part A of the illustrative examples accompanying this Standard illustrates the periods required to be presented by an entity that reports half-yearly and an entity that reports quarterly.

…

Applying the recognition and measurement principles

40 ~~Appendix~~ Part B of the illustrative examples accompanying this Standard provides examples of applying the general recognition and measurement principles set out in paragraphs 28–39.

Use of estimates

41 …

42 ~~Appendix Part~~ C of the illustrative examples accompanying this Standard provides examples of the use of estimates in interim periods.

7. Amendments are not needed to the same paragraphs in PBE IAS 34 *Interim Financial Reporting* because paragraphs 22, 40 and 42 are not used in PBE IAS 34.

8. We have checked for any other inadvertent differences between the two standards and have not identified any.

Next steps

9. Although editorial amendments are not subject to the approval process required for standards, we put a copy of editorial amendments on the recent approvals page on the website (see Appendix to this memo).

Appendix

Editorial corrections to NZ IFRS

Date posted: December 2020

Editorial corrections revise minor inaccuracies, including misspellings and numbering or grammatical mistakes.

New test is underlined and deleted text is struck through.

Standard	**Correction**
NZ IFRS 7 Paragraph 44EE. (Paragraph 44FF is not amended but is shown for context.)	**Effective date and transition** … 44EE *Interest Rate Benchmark Reform*, which amended NZ IFRS 9, NZ IAS 39 and NZ IFRS 7, issued in November 2019, added paragraphs 24H and 44FF~~44DF~~. An entity shall apply these amendments when it applies the amendments to NZ IFRS 9 or NZ IAS 39. 44FF In the reporting period in which an entity first applies *Interest Rate Benchmark Reform*, issued in November 2019, an entity is not required to present the quantitative information required by paragraph 28(f) of NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
NZ IAS 34 Paragraph 22	**Periods for which interim financial statements are required to be presented** 20 … 22 ~~Appendix~~ Part A of the illustrative examples accompanying this Standard illustrates the periods required to be presented by an entity that reports half-yearly and an entity that reports quarterly.
NZ IAS 34 Paragraph 40	**Applying the recognition and measurement principles** 40 ~~Appendix~~ Part B of the illustrative examples accompanying this Standard provides examples of applying the general recognition and measurement principles set out in paragraphs 28–39.
NZ IAS 34 Paragraph 42	**Use of estimates** 41 … 42 ~~Appendix Part~~ C of the illustrative examples accompanying this Standard provides examples of the use of estimates in interim periods.

Agenda Item 7.1

Business Combinations under Common Control

NZASB Education Session

Gali Slyuzberg – Project Manager, Accounting Standards

NZASB meeting

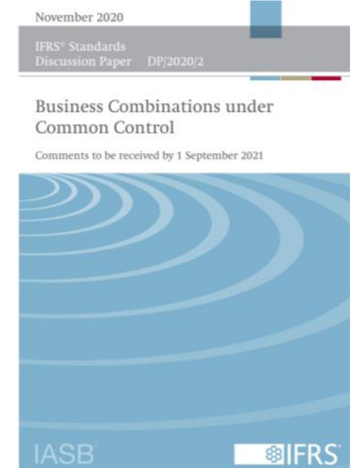
17 December 2020

EXTERNAL REPORTING BOARD

Te Kāwai Ārahi Pūrongo Mōwaho

Purpose and introduction

XRB



- On 30 November 2020, the IASB® published a Discussion Paper (DP) on *Business Combinations under Common Control* (BCUCC)
  - Comments are due to the IASB by **1 September 2021**

- The purpose of this agenda item is to:
  - present the Board with an education session on the DP, and;
  - seek the Board's agreement to comment on the DP

- The DP and a 'snapshot' summary of the DP are attached as Agenda Items 7.2 and 7.3. The Board is not expected to read the full DP ahead of this meeting.

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Presentation overview

XRB

- Why has the IASB published a DP on BCUCC?
- Scope and focus of the IASB's BCUCC project
- IASB's preliminary views on accounting for BCUCC
- BCUCC in New Zealand: Recent discussion with the TRG
- Should the NZASB comment on the IASB DP?

XRB

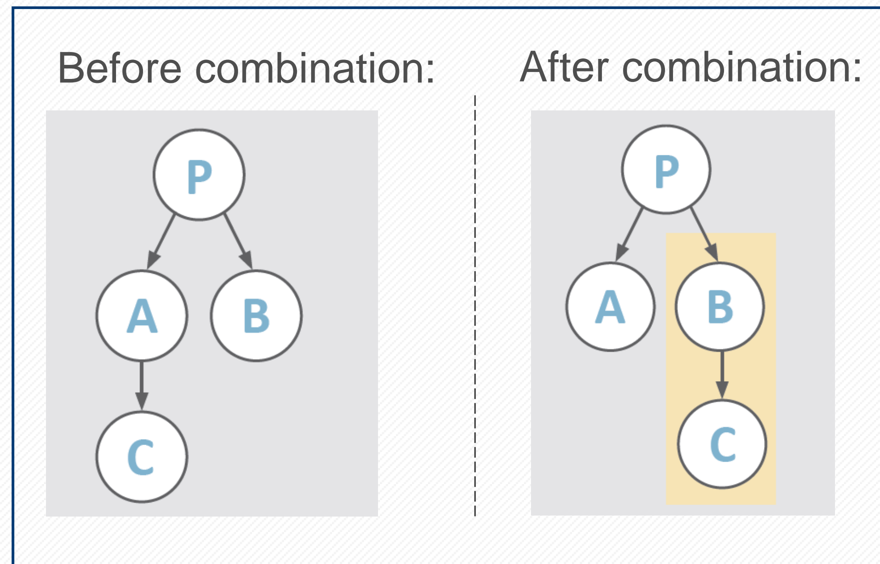
Why has the IASB published a Discussion Paper on BCUCC?

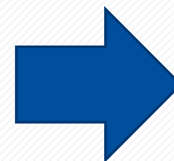
What is a Business Combinations Under Common Control (BCUCC)?

XRB

- In a BCUCC, the combining entities/businesses are ultimately controlled by the same party, both before and after the combination.

- Example of BCUCC:
  Entity B (‘receiving entity’) obtains control over Entity C (‘transferred entity’)



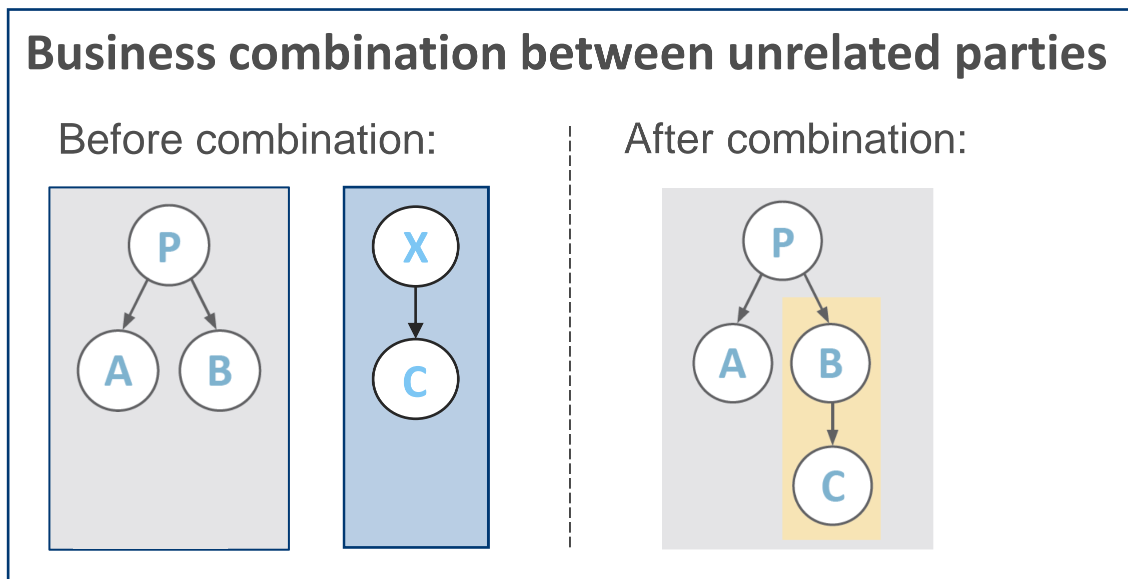


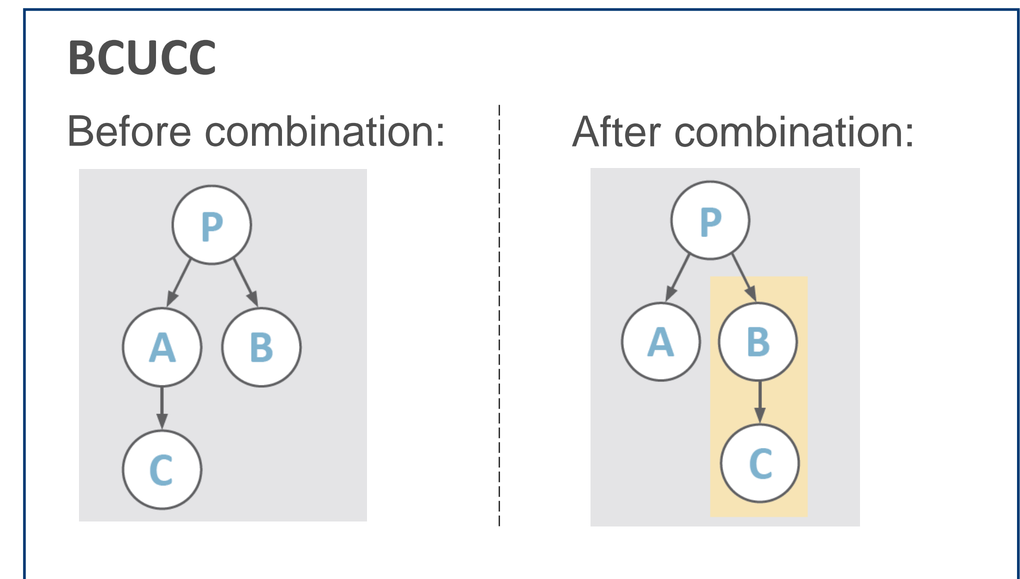
Entities B and C are ultimately owned by P – both before and after the combination

What is the issue?

XRB

- Currently, there are **no specific requirements** in IFRS® Standards on how the 'receiving entity' (Entity B) should account for a BCUCC
  - BCUCC are outside the scope of IFRS 3 *Business Combinations*





IFRS 3 applies – B accounts for C's assets and liabilities at fair value (acquisition method)

Outside the scope of IFRS 3 – no specific accounting requirements

BCUCC: What is the issue?

XRB

- Lack of specific requirements for BCUCC causes **diversity in practice**: Entities use various book value methods, or acquisition method per IFRS 3
- Therefore, for users of financial statements, it can be:
  - **Difficult to understand** the effect of BCUCC on the receiving entity's financial statements, and;
  - **Difficult to compare** entities that undertake similar transactions but apply different policies
- BCUCC transactions are **common around the world**
- Accounting for BCUCC has been identified as a **priority project** in IASB Agenda Consultation (in 2011/2012 and again in 2015/2016)

IASB project on BCUCC

XRB

- As part of its project on BCUCC, the IASB is considering whether it can **develop requirements** that would lead to **better information about BCUCC in the financial statements**
  - The aim is to improve the **comparability and transparency** of accounting for BCUCC

- **Discussion Paper** (DP) issued in **November 2020**
  - DP sets out the **IASB's preliminary views** on how the **receiving entity** should **account for transfers of businesses under common control**

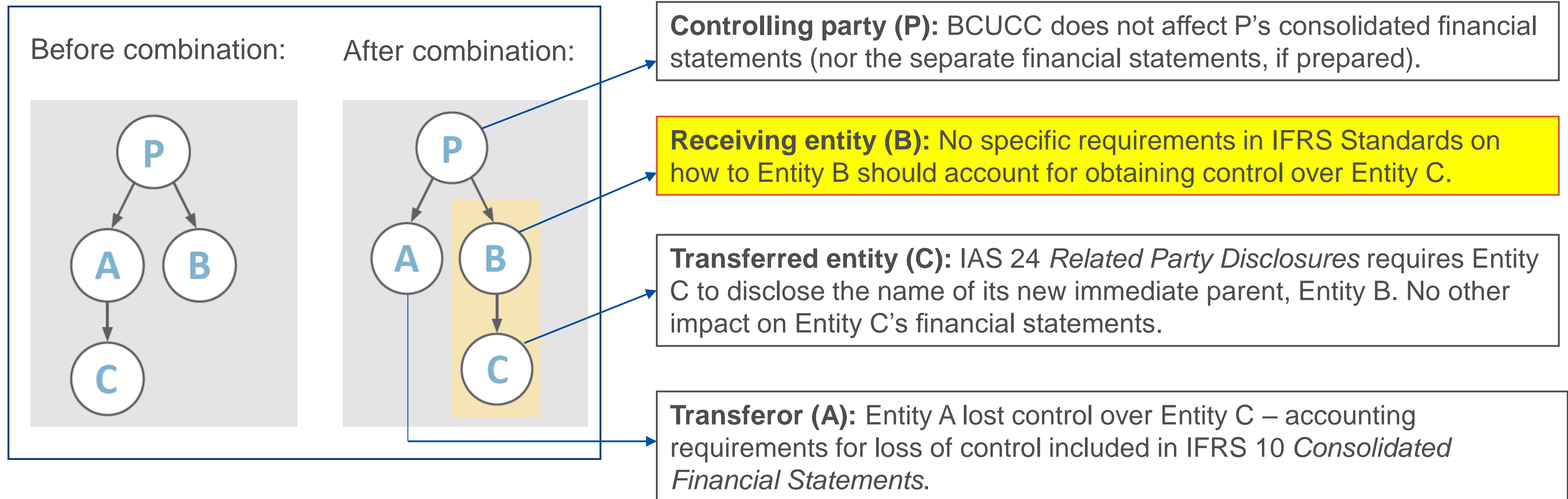
XRB

Scope and focus of the DP

Focus on the receiving entity

XRB

- The DP focuses on developing accounting requirements for the **receiving entity** – *not* for the ultimate controlling party, transferor or transferred entity



Controlling party (P): BCUCC does not affect P's consolidated financial statements (nor the separate financial statements, if prepared).

Receiving entity (B): No specific requirements in IFRS Standards on how to Entity B should account for obtaining control over Entity C.

Transferred entity (C): IAS 24 *Related Party Disclosures* requires Entity C to disclose the name of its new immediate parent, Entity B. No other impact on Entity C's financial statements.

Transferor (A): Entity A lost control over Entity C – accounting requirements for loss of control included in IFRS 10 *Consolidated Financial Statements*.

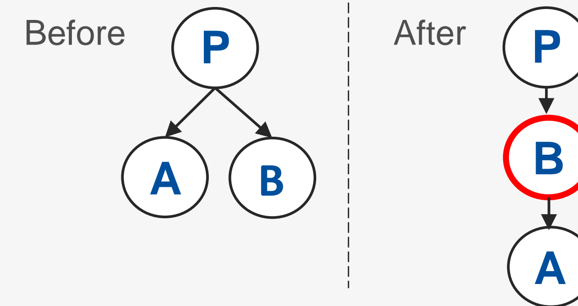
What transactions are in scope?

XRB

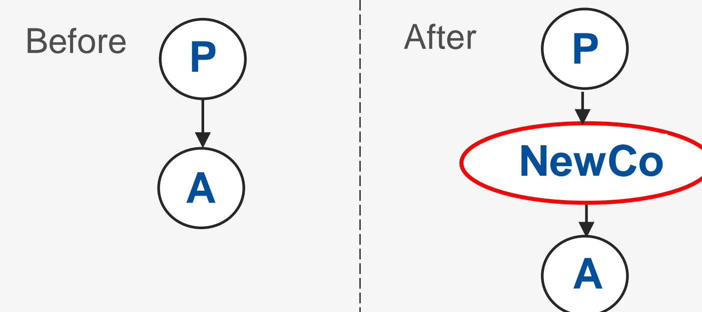
- The DP focuses on the **transactions under common control, where the receiving entity obtains control over one or more business**
- It does not matter if:
  - the receiving entity can be identified as the ‘acquirer’ under IFRS 3 or not (or if definition of ‘business combination’ is not met)
  - the transaction is in anticipation of an IPO or not
  - the transaction was preceded by an acquisition from an external party or will be followed by a sale to an external party

Examples of transactions in scope

Accounting by **Entity B** is **in scope**



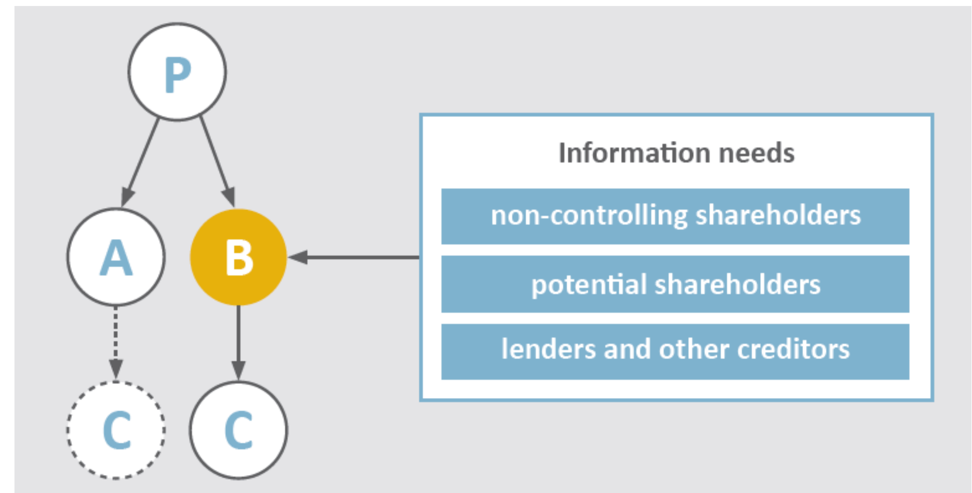
Accounting by **NewCo** is **in scope** – even if NewCo cannot be the ‘acquirer’ per IFRS 3 and even if the transaction is not a ‘business combination’ per IFRS 3



Which stakeholders' needs does the project focus on?

XRB

- The DP focuses on the information needs of the **primary users** of the **receiving entity's financial statements**:
  - **non-controlling shareholders**
  - **potential shareholders**
  - **lenders and other creditors**



- The DP does ***not*** focus on the information needs of the **controlling party** or its shareholders/creditors.
  - Unlike the primary users listed above, the controlling party does not need to rely on the receiving entity's financial statements to meet its information needs

IASB’s preliminary views on accounting for BCUCC

BCUCC: one size does not fit all

XRB

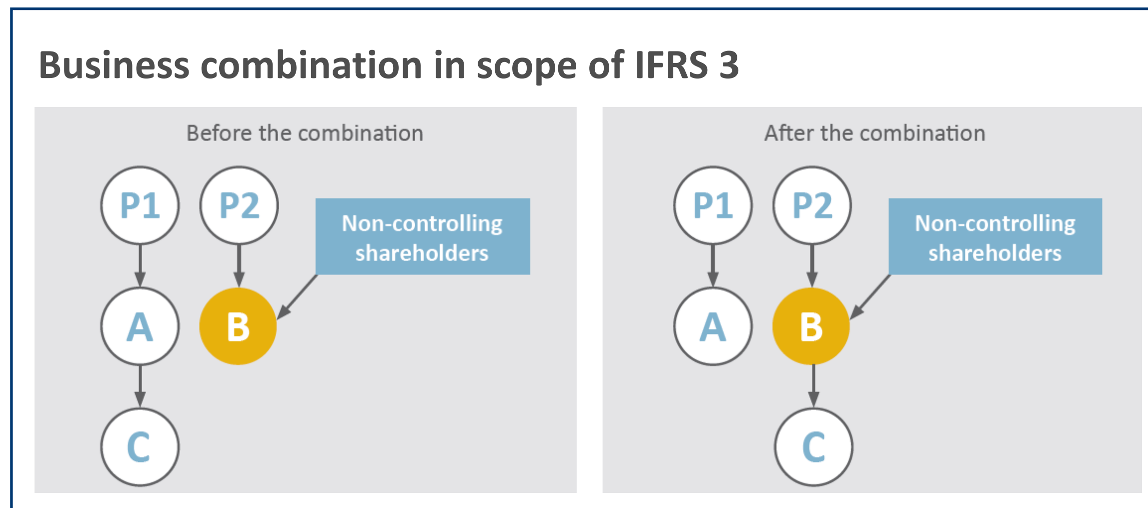
IASB's preliminary view:

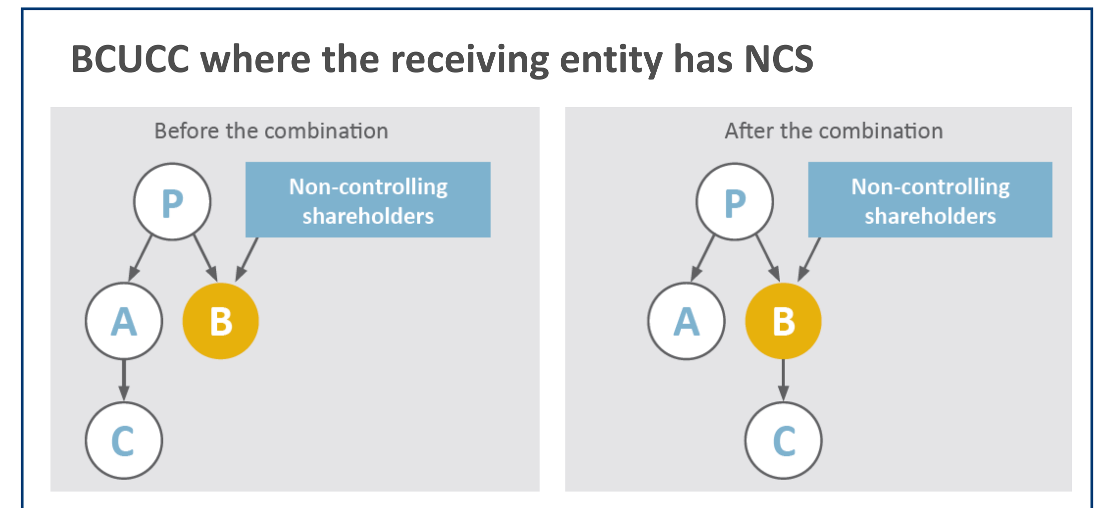
- In general, accounting for BCUCC would depend on whether the **receiving entity's non-controlling shareholders (NCS)** are affected by the transaction
  - If the **receiving entity's NCS are affected**, use the **acquisition method** (as per IFRS 3, but with some modifications)
  - For **all other BCUCC transactions**, use a **specified book value method**
- An **exception** and an **exemption** from the acquisition method would be available – to take into account **cost/benefit considerations**

Transactions where NCS are affected

XRB

- When the receiving entity has NCS, a BCUCC results in a **substantive change in the ownership interests in the transferred entity**
  - NCS obtain new ownership interest in the transferred entity, **just as they would have done if the combination was within the scope of IFRS 3**





- Therefore, the IASB proposes that these two transactions should be **accounted for similarly** – **similar nature** of transaction, **similar information needs** of primary users

Transactions where NCS are affected

XRB

IASB preliminary view:

- In BCUCC transactions where the receiving entity's NCS are affected, the **acquisition method as per IFRS 3** should be applied (i.e. the receiving entity should account for the **assets and liabilities of the transferred business** at **fair value**, except when IFRS 3 specifies otherwise)
- **But:** a **bargain purchase** (where consideration is lower than the fair value of the net assets acquired) would be accounted for as a **capital contribution (equity)** – rather than a gain in P&L

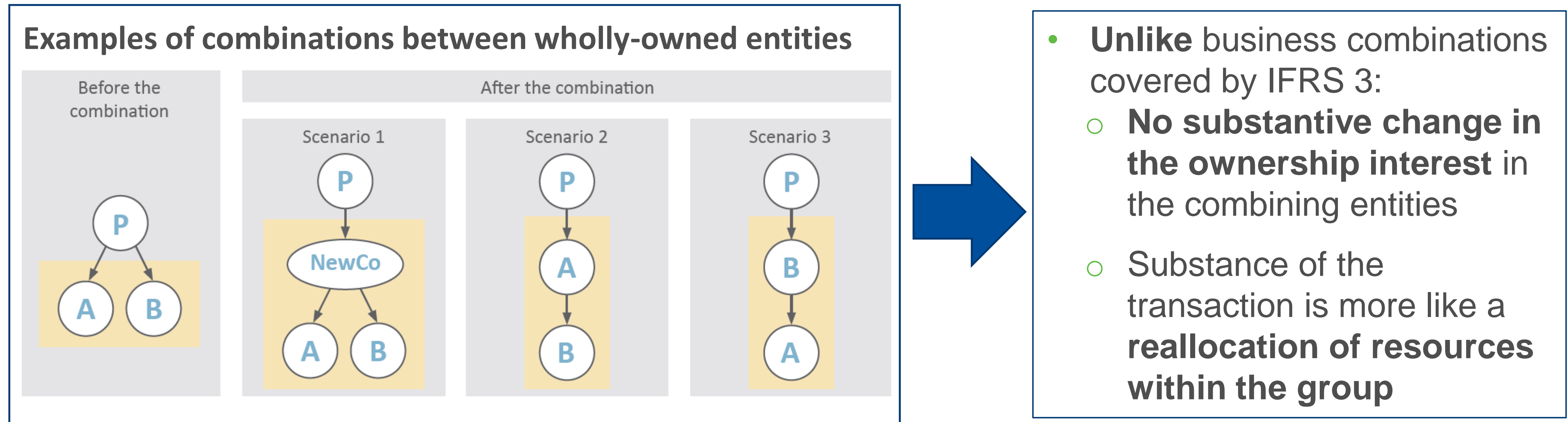
Transactions where NCS are affected: what about cost/benefit considerations?

IASB preliminary view

BCUCC transactions where the receiving entity's NCS are affected			
Scenario	The receiving entity's shares are **publicly traded**	The receiving entity's shares are **privately held**	
Cost/benefit considerations	The **cost of using the acquisition method** (obtaining fair values, etc.) is presumed to be **justified by the benefits**	The **cost of using the acquisition method may not be justified by the benefits**.	
Proposed accounting for BCUCC	**Require** the use of the **acquisition method**	Optional **exemption** from acquisition method: **Allow** the use of the **book value method if the NCS do not object**	**Exception** from acquisition method: **Require** the use of the **book value method if all NCS are related parties** of the receiving entity

All other BCUCC transactions

- A BCUCC where the receiving entity does not have NCS (e.g. a combinations between wholly-owned entities) is **different to business combinations covered by IFRS 3**



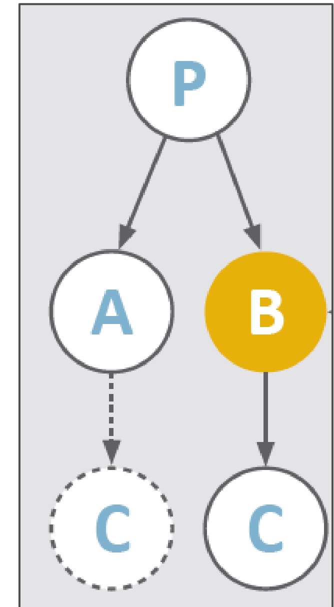
- If the above transactions were for the purpose of an IPO/sale of A and B, potential shareholders would be invited to invest in the **same group of resources in each scenario,** but if the applying the **acquisition method would result in different information** in each case (depends on who is the ‘acquirer’)

All other BCUCC transactions

XRB

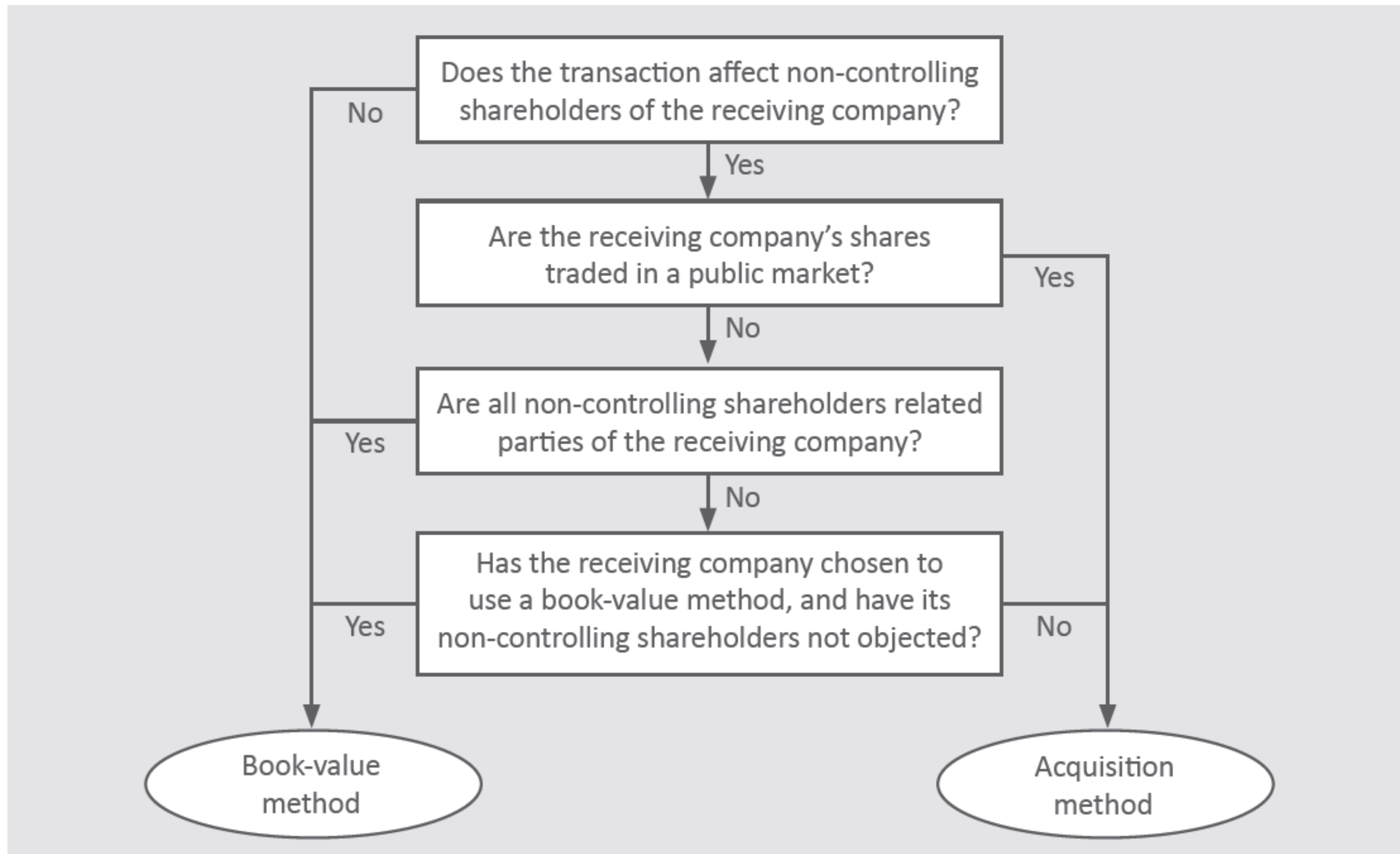
IASB preliminary view:

- In BCUCC transactions other than those where the receiving entity's NCS are affected, the receiving entity should use the following **book value method**:
  - The receiving entity (B) should measure the assets and liabilities of the transferred entity (C) at their **book values as per the transferred entity's financial statements** (i.e. per C's financial statements, *not* P's financial statements)
  - The assets, liabilities and results of the transferred entity (C) should be combined with those of the receiving entity (B) **from the date of the transaction** – the receiving entity (B) **does not restate comparatives**



Summary: proposed accounting methods for BCUCC transactions

XRB



BCUCC in New Zealand – recent discussion with the TRG

Discussion with TRG in September 2020

XRB

- The TRG noted that **BCUCC transactions are common in NZ** and there is **diversity in practice** - therefore specific requirements are welcome
- Members also raised the following points on the IASB's preliminary views:
  - Should the existence of NCS determine how to account for BCUCC? Sometimes the acquisition method may result in more useful information, even if there are no NCS
  - Book values as per the ultimate parent's financial statements may sometimes be more useful than book values per the transferred entity's financial statements
- The TRG thought that the **NZASB should comment** on the DP

XRB

Should the NZASB comment to the IASB on the DP?

Should the NZASB comment on the DP?

XRB

- For the purpose of the NZASB work plan, the BCUCC project is rated as medium priority.*

- Given the project's priority rating and the abovementioned discussion with the TRG, staff recommend that the Board comment to the IASB on the DP.

Question for the Board:

Q1. Does the Board agree to comment on the DP *Business Combinations under Common Control*?

* As per Agenda Item 4.1 of the NZASB August 2020 meeting (*Prioritisation of IASB and IPSAS Projects 2020/2021*)

Outreach plan

XRB

- If the Board agrees to comment on the DP, we recommend undertaking targeted outreach, given that this project has a ‘medium’ rating. For example, we plan to seek the TRG’s feedback on the DP.

Question for the Board:

If the Board agrees to comment on the DP:

Q2. Does the Board agree to take a targeted approach to seeking feedback from constituents?

Q3. Does the Board have any comments on who we should seek feedback from?

Q4. Does the Board have any comments to raise on the DP at this stage?

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EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

November 2020

IFRS® Standards
Discussion Paper DP/2020/2

Business Combinations under Common Control

Comments to be received by 1 September 2021

IASB®

Business Combinations under Common Control

Comments to be received by 1 September 2021

Discussion Paper *Business Combinations under Common Control* is published by the International Accounting Standards Board (Board) for comment only. Comments need to be received by **1 September 2021** and should be submitted in writing to the address below, by email to commentletters@ifrs.org or electronically using our 'Open for comment documents' page at:
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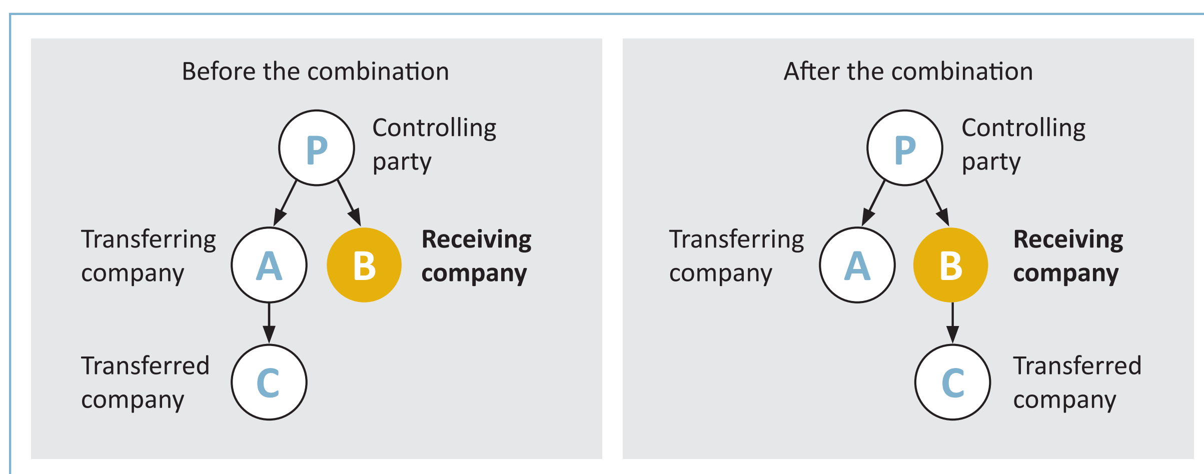
Introduction and invitation to comment

This Discussion Paper is designed to be accessible to a wide audience. It uses diagrams, colour and, where possible, simple non-technical language. Appendix A sets out the meanings of the terms defined in this Discussion Paper. Defined terms are in **bold type** the first time they appear in each section.

Why is the Board publishing this Discussion Paper?

IN1 The International Accounting Standards Board (Board) is undertaking a research project on **business combinations under common control**—combinations in which all of the combining companies or **businesses** are ultimately controlled by the same party, both before and after the combination. Diagram IN.1 provides a simple example of a business combination under common control.

Diagram IN.1—A business combination under common control



IN2 In the example in Diagram IN.1, control of Company C is transferred from Company A to Company B. All three companies are ultimately controlled by Company P, the **controlling party**, both before and after the transaction. IFRS Standards provide requirements on how companies P, A and C should report this transaction (see paragraph 1.19). However, no IFRS Standard specifically applies to how Company B (the **receiving company**) should report its combination with Company C (the **transferred company**)—such combinations are outside the scope of IFRS 3 *Business Combinations*. In the absence of a specifically applicable IFRS Standard, the receiving company is required to develop its own accounting policy for these transactions.[1]

IN3 The Board is carrying out a research project on business combinations under common control in response to stakeholder feedback that the lack of a specifically applicable IFRS Standard for such combinations has resulted in diversity in practice. Furthermore, companies often provide little information about such combinations. The objective of the project is to explore possible reporting requirements for a receiving company that would reduce that diversity in practice and provide users of the receiving company's financial statements with better information about these combinations.

1 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

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IN4 This Discussion Paper summarises the results of this research. It sets out the Board's preliminary views on such possible reporting requirements and seeks feedback on those preliminary views.

Who will be affected if the preliminary views in this Discussion Paper are implemented?

IN5 If the preliminary views in this Discussion Paper are implemented, they would result in new requirements for business combinations under common control. Any such requirements would apply to the financial statements of the receiving company—the company to which control of one or more companies or businesses has been transferred in the combination. (In Diagram IN.1, the receiving company is Company B.) Typically, those possible reporting requirements would apply to the receiving company's consolidated financial statements only. However, in some circumstances, those possible reporting requirements would also apply to other types of financial statements prepared by the receiving company (see paragraphs 1.20–1.23 and B.16–B.18).

IN6 If the preliminary views are implemented, diversity in practice would be reduced and the reporting of business combinations under common control by the receiving company would be more transparent and result in more relevant and more comparable information about these combinations.

IN7 The preliminary views would not affect reporting by the controlling party, the **transferring company** or the transferred company (companies P, A and C in Diagram IN.1).

How did the Board reach its preliminary views?

IN8 In reaching its preliminary views, the Board considered:

(a) whether and when business combinations under common control are similar to **business combinations** covered by IFRS 3;

(b) what information would be useful to users of the receiving company's financial statements;

(c) whether the benefits of providing particular information would justify the costs of providing it;

(d) how complex particular approaches would be; and

(e) whether particular approaches would create opportunities for accounting arbitrage (sometimes called 'structuring opportunities').

IN9 In exploring these factors, the Board considered research and feedback from consultations conducted during the project, which included:

(a) an analysis of the requirements and guidance in IFRS Standards and the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*);

(b) a review of national requirements and recent consultation documents issued by national standard-setters, guidance published by accounting firms, academic papers, reports, articles and other literature;

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(c) consultations with investors and analysts, national standard-setters, regulators, and preparers of financial statements, including consultations with the following bodies that advise the Board: the Capital Markets Advisory Committee, the Accounting Standards Advisory Forum, the Global Preparers Forum and the Emerging Economies Group;

(d) a desktop review of current reporting practice;[2] and

(e) a review of corporate credit-rating methodologies of two leading credit-rating agencies.[3]

What does this Discussion Paper include?

IN10 This Discussion Paper discusses a range of issues that would need to be addressed to set up reporting requirements for business combinations under common control. The Discussion Paper groups these issues into five broad topics, and provides the Board's preliminary views and questions for respondents on each topic. The topics are:

(a) the project's objective, scope and focus (Section 1);

(b) selection of the measurement method (Section 2);

(c) how to apply the **acquisition method** (Section 3);

(d) how to apply a **book-value method** (Section 4); and

(e) disclosure requirements (Section 5).

What are the next steps?

IN11 The views expressed in this Discussion Paper are preliminary and may change. The Board will consider the comments it receives in response to this Discussion Paper before deciding whether to develop an exposure draft containing proposals to implement any or all of its preliminary views.

Invitation to comment

IN12 The Board invites comments on the Discussion Paper *Business Combinations under Common Control*, particularly on the questions set out in paragraphs IN14–IN19, which are repeated in the related sections of the Discussion Paper. Comments are most helpful if they:

(a) address the questions as stated;

(b) indicate the specific paragraphs or preliminary views to which they relate;

(c) contain a clear rationale;

(d) identify any wording in the preliminary views that is difficult to translate; and

(e) include any alternative the Board should consider, if applicable.

IN13 The Board is requesting comments only on matters addressed in this Discussion Paper.

2 The desktop review covered annual reports published in English from 1 January 2018 to 31 March 2019 in various jurisdictions. The review identified 207 annual reports that disclosed 267 business combinations under common control.

3 More information about the research and consultations with stakeholders conducted in the project is provided in the staff papers considered by the Board during the development of this Discussion Paper. For example, see February 2020 Agenda Paper 23B *Due process* for a summary of consultations with stakeholders (Appendix B), the desktop review of current reporting practice (Appendix C) and the review of academic literature (Appendix D).

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Questions for respondents

Project scope

IN14 Section 1 outlines the project's objective, scope and focus. It explains that the Board's ultimate goal is to fill a 'gap' in IFRS Standards relating to how a receiving company should report a business combination under common control.

Project Scope

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.

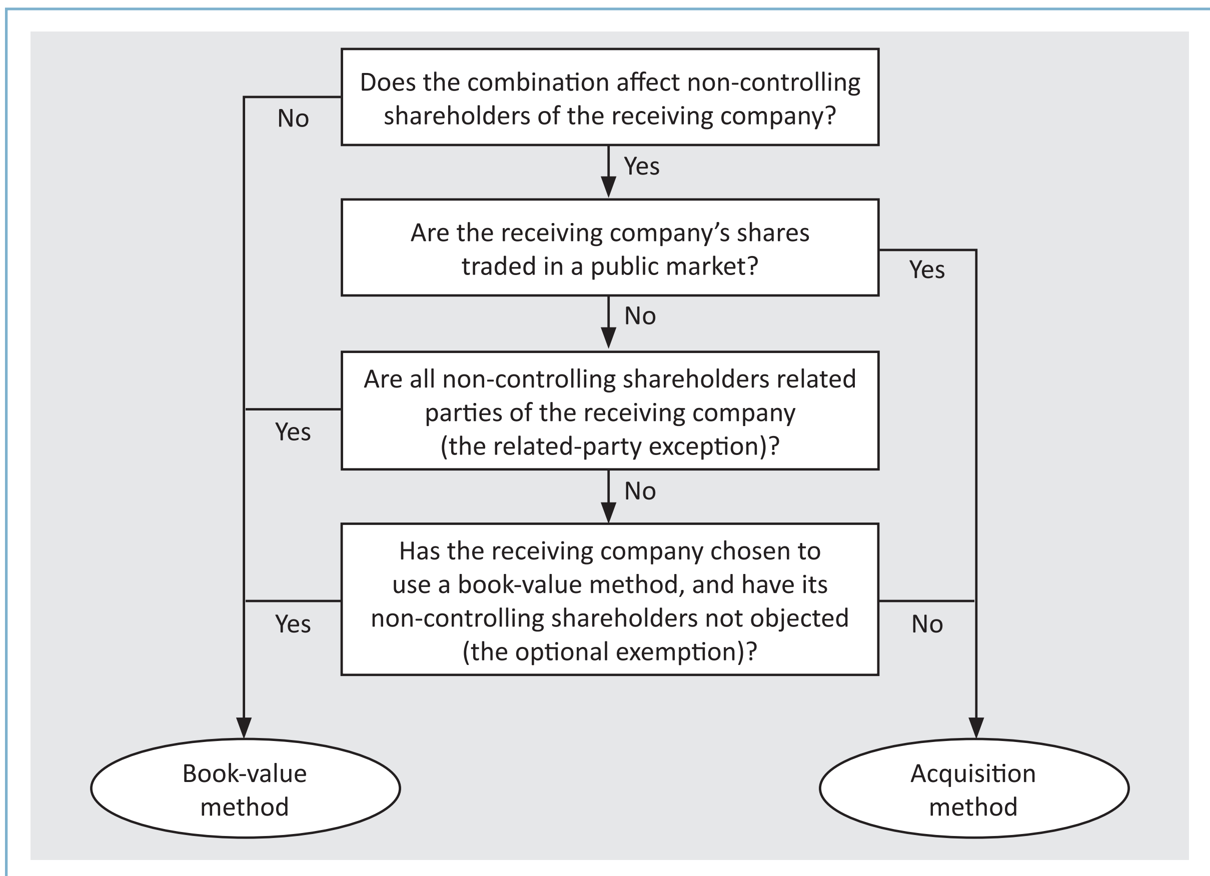
Do you agree with the Board's preliminary view on the scope of the proposals it should develop? Why or why not? If you disagree, what transactions do you suggest that the Board consider and why?

Selecting the measurement method

IN15 Section 2 discusses which measurement methods should apply to business combinations under common control. The Board has reached the preliminary view that neither the acquisition method nor a book-value method should be applied to *all* business combinations under common control. Instead, the acquisition method should be applied to some such combinations and a book-value method should be applied to all other such combinations.

IN16 The Board's preliminary views on when each method should be used are summarised in Diagram IN.2.

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



Selecting the measurement method

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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Selecting the measurement method

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?

Selecting the measurement method

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?

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Applying the acquisition method

IN17 Section 3 discusses how to apply the acquisition method to business combinations under common control. It explains that, in principle, the receiving company should apply the acquisition method as set out in IFRS 3. However, in some such combinations, the amount of the consideration paid might differ from what would have been paid in an arm's length transaction with an unrelated party. Accordingly, the Board considered whether it should develop special requirements for the receiving company to recognise any such difference as a distribution from equity or contribution to equity.

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 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?

Applying a book-value method

IN18 Section 4 discusses how to apply a book-value method to business combinations under common control. In practice, a variety of book-value methods are used. However, the Board would specify a single book-value method in IFRS Standards. The matters discussed in Section 4 include:

(a) measuring the assets and liabilities received;

(b) measuring the consideration paid;

(c) reporting any difference between the consideration paid and the book value of the assets and liabilities received;

(d) reporting transaction costs; and

(e) providing pre-combination information.

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Applying a book-value method

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?

Applying a book-value method

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?

Applying a book-value method

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?

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Applying a book-value method

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?

Applying a book-value method

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?

Disclosure requirements

IN19 Section 5 discusses what information the receiving company should disclose about business combinations under common control. It sets out the Board's preliminary view that all the disclosure requirements in IFRS 3 should apply to combinations to which the acquisition method is applied, including any improvements to those requirements resulting from the Board's Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*. However, only some of those disclosure requirements are appropriate for combinations to which a book-value method is applied.

Disclosure requirements

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?

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Disclosure requirements

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?

Deadline

IN20 The Board will consider all comments received in writing by 1 September 2021.

How to comment

IN21 Please submit your comments electronically.

Online	https://www.ifrs.org/projects/open-for-comment/
By email	commentletters@ifrs.org

IN22 Your comments will be on the public record and posted on our website unless you request confidentiality and we grant your request. We do not normally grant such requests unless they are supported by a good reason, for example, commercial confidence. Please see our website for details on this and on how we use your personal data.

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Section 1—Objective, scope and focus

1.1 This section sets out background information for the research project on **business combinations under common control** (paragraphs 1.2–1.8) and discusses:

(a) the objective of the project (paragraph 1.9);

(b) the scope of the project (paragraphs 1.10–1.23);

(c) the focus of the project (paragraphs 1.24–1.29); and

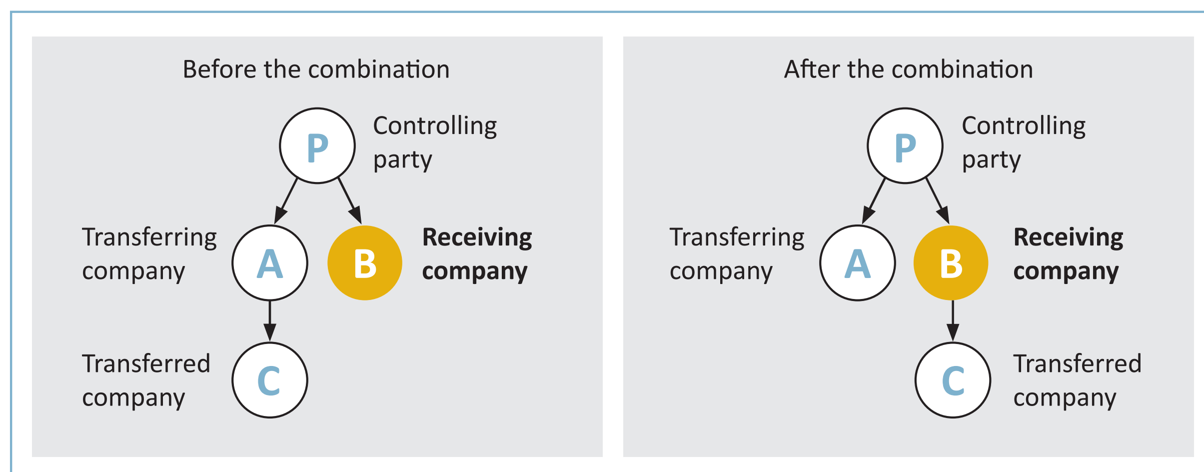
(d) the interaction between the project and the International Accounting Standards Board's (Board's) other projects (paragraph 1.30).

Background

1.2 Accounting requirements for **business combinations**—sometimes called mergers and acquisitions—are set out in IFRS 3 *Business Combinations*. However, the scope of IFRS 3 explicitly excludes business combinations under common control—combinations in which all of the combining companies or **businesses** are ultimately controlled by the same party (or parties), both before and after the combination.

1.3 Diagram 1.1 provides a simple example of a business combination under common control.

Diagram 1.1—A business combination under common control



1.4 In the example in Diagram 1.1, control of Company C is transferred from Company A to Company B. All three companies are ultimately controlled by Company P, the **controlling party**, both before and after the transaction. IFRS Standards provide requirements on how companies P, A and C should report this transaction (see paragraph 1.19). However, no IFRS Standard specifically applies to how Company B (the **receiving company**) should report its combination with Company C (the **transferred company**).

1.5 In the absence of a specifically applicable IFRS Standard, the receiving company is required to develop its own accounting policy for business combinations under common control, applying the requirements on selecting accounting policies in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Developing such a policy involves considering the following sources in descending order:

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(a) the requirements in IFRS Standards dealing with similar and related issues. In some cases, because IFRS 3 deals with business combinations, companies apply the requirements of IFRS 3 to report business combinations under common control, despite the scope exclusion in that Standard.

(b) guidance in the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*).

(c) the most recent pronouncements issued by other standard-setting bodies that meet specified criteria.[4] Some such bodies have issued requirements or guidance on reporting business combinations under common control.

1.6 Feedback provided to the Board indicates that business combinations under common control occur often in many jurisdictions. That feedback also highlights that the lack of a specifically applicable IFRS Standard has resulted in diversity in practice in preparing financial statements applying IFRS Standards. For example, in some cases companies report these combinations using the **acquisition method** set out in IFRS 3, whereas in other cases companies use a **book-value method**. Also, a variety of book-value methods are used in practice.[5]

1.7 Table 1.1 summarises some of the differences in reporting practice for business combinations under common control, using the simple example in Diagram 1.1.

Table 1.1—Differences in reporting practice

	Acquisition method	Book-value method
How does Company B measure the assets and liabilities of Company C received in the combination?	Fair value, with limited exceptions	Book value—various book values are used in practice, for example those reported: • by Company C (the transferred company); or • by Company P (the controlling party).
Does Company B recognise all the identifiable assets and liabilities of Company C received in the combination?	Yes, with limited exceptions	No—only assets and liabilities already recognised before the combination
Does Company B recognise goodwill as a result of the combination?	Yes, unless the combination results in a gain	No
From which date does Company B include in its financial statements the assets, liabilities, income and expenses of Company C?	From the date of the combination	Various approaches are applied—for example, including assets, liabilities, income and expenses of Company C: • from the date of the combination; or • from the beginning of the earliest period presented.

4 As specified in paragraph 12 of IAS 8.

5 Various labels are used for book-value methods applied in practice, including the predecessor method, the pooling (or uniting) of interests method and merger accounting. This Discussion Paper uses the term 'book-value method' as a collective term for all these methods.

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1.8 The differences between the two methods—and the diversity in how book-value methods are applied—result in differences in how companies preparing financial statements applying IFRS Standards report similar transactions. Furthermore, companies often provide little information about business combinations under common control. Stakeholders, notably regulators of capital markets, expressed concerns about this diversity in practice when responding to the Board's 2011 and 2015 agenda consultations. The diversity in practice can make it difficult for users of financial statements to understand how a business combination under common control affected the receiving company and to compare companies that undertake similar transactions.

Objective of the project

1.9 Because of those concerns, the Board began a research project on business combinations under common control. The objective of the project is to explore possible reporting requirements for a receiving company that would reduce diversity in practice and improve the transparency of reporting these combinations. More specifically, the Board aims to provide users of financial statements with better information that is both:

(a) more relevant—by setting up reporting requirements based on user information needs; and

(b) more comparable—by requiring similar transactions to be reported in a similar way.

Scope of the project

1.10 Paragraphs 1.12–1.23 discuss three aspects of the project's scope:

(a) which transactions are within the project's scope (paragraphs 1.12–1.16);

(b) which company's reporting of those transactions is being considered in the project (paragraphs 1.17–1.19); and

(c) the types of financial statements in which those transactions are reported (paragraphs 1.20–1.23).

1.11 Appendix B elaborates on the discussion in paragraphs 1.12–1.23 using illustrative examples and diagrams.

Which transactions are within the project's scope?

1.12 The research project focuses on business combinations under common control, which are excluded from the scope of IFRS 3. IFRS 3 describes a business combination under common control as:

> a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.[6]

6 Paragraph B1 of IFRS 3 *Business Combinations*.

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1.13 A business combination involves the transfer of a business. Accordingly, all transactions being considered in the project involve the transfer of a business under common control. For example, in Diagram 1.1, Company C (the transferred company) must have a business for the transaction to be within the scope of the project. The project is not considering reporting requirements for other types of transactions under common control that do not involve the transfer of a business, for example, transfers of assets (see Examples 1 and 2 in Appendix B). Those transactions are generally addressed by applicable IFRS Standards that do not contain scope exclusions for transactions under common control. Furthermore, the project is not reconsidering reporting requirements for business combinations that are covered by IFRS 3.[7]

1.14 For simplicity, this Discussion Paper discusses business combinations under common control that involve the transfer of a company. However, just as is the case for business combinations covered by IFRS 3, business combinations under common control do not necessarily involve the transfer of an entire company. Instead, they could 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.

1.15 The project is also considering transactions—sometimes called group restructurings—that involve a transfer of a business under common control but do not meet the definition of a business combination in IFRS 3. For example, some transactions might not meet that definition if they involve transferring a business to a newly established parent company. The Board has reached a preliminary view that it should develop proposals on all transfers of a business under common control, even if the transfer does not meet the definition of a business combination in IFRS 3 (see Example 3 in Appendix B). For simplicity, this Discussion Paper uses the term 'business combination under common control' to refer to all such transfers.

1.16 In describing business combinations under common control, IFRS 3 requires that common control is 'not transitory' but does not provide guidance on that notion. Some stakeholders have raised questions about the meaning of 'transitory control', for example, in submissions to the IFRS Interpretations Committee. Those questions arise when considering whether particular combinations are outside the scope of IFRS 3. The Board has not yet considered whether to clarify the meaning of 'transitory control' because the outcome of this project could lead to the Board modifying or removing the scope exclusion in IFRS 3. However, in the light of those application questions, the Board has reached the preliminary view that its proposals should cover all transfers of businesses in which all of the combining companies are ultimately controlled by the same party, irrespective of whether the transfer is:

(a) 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) conditional on a sale of the combining companies to an external party, such as in an initial public offering (see Example 4 in Appendix B).

Which company's reporting?

1.17 In undertaking this project, the Board's goal is to fill a 'gap' in IFRS Standards. Accordingly, the project is considering reporting requirements for a receiving company in a business combination under common control. In the example in Diagram 1.1, the receiving company is Company B.

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7 The Board is conducting another research project on possible improvements to aspects of IFRS 3 (and IAS 36 *Impairment of Assets*), following feedback from the Post-implementation Review of IFRS 3. In that project, the Board published a Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* in March 2020.

1.18 The term 'receiving company' refers not only to the immediate receiving company in the combination. It also refers to those parent companies (if any) of that immediate receiving company that did not control the transferred company before the combination (see Example 5 in Appendix B).

1.19 The project is not considering the reporting requirements for the following other companies involved in the combination illustrated in the example in Diagram 1.1 because IFRS Standards already contain requirements for them:

(a) Company P (the controlling party)—any effects on Company P are covered by IFRS 10 *Consolidated Financial Statements*;

(b) Company C (the transferred company)—the disclosure of information about its new parent (Company B) is covered by IAS 24 *Related Party Disclosures*; and

(c) Company A (the **transferring company**)—the loss of control of its subsidiary (Company C) is covered by IFRS 10.

Which types of financial statements?

1.20 In general, the project is addressing how a receiving company should report a business combination under common control in its consolidated financial statements.[8] In some cases, the receiving company might not be required to prepare such financial statements. However, consolidated financial statements are required if, for example, the receiving company is **publicly traded** or is preparing to issue its **shares** in a **public market**.

1.21 Furthermore, if the combination involves the transfer of an unincorporated business (see paragraph 1.14), the possible reporting requirements developed in this project would also apply in other types of financial statements prepared by the receiving company, such as its separate financial statements.

1.22 This Discussion Paper uses the term 'financial statements' to refer to all financial statements prepared by the receiving company to which the possible reporting requirements developed in the project would apply (see paragraphs B.16–B.18 in Appendix B).

1.23 However, the project is not addressing how a receiving company should report in its separate financial statements an investment in a subsidiary received in a business combination under common control. That topic is addressed by IAS 27 *Separate Financial Statements*.

Focus of the project

1.24 IFRS Standards set reporting requirements for companies that prepare general purpose financial statements. Those financial statements are intended to meet the information needs of the company's existing and potential shareholders, lenders and other creditors who must rely on those financial statements for much of their information needs because they cannot require the company to provide to them information tailored to their information needs.[9] This Discussion Paper refers to those parties as users of the receiving company's general purpose financial statements.

8 In some jurisdictions, the receiving company's consolidated financial statements are sometimes called sub-consolidated financial statements if the receiving company's parent company prepares consolidated financial statements for a wider group.

9 Paragraph 1.5 (including the related footnote 4) of the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*).

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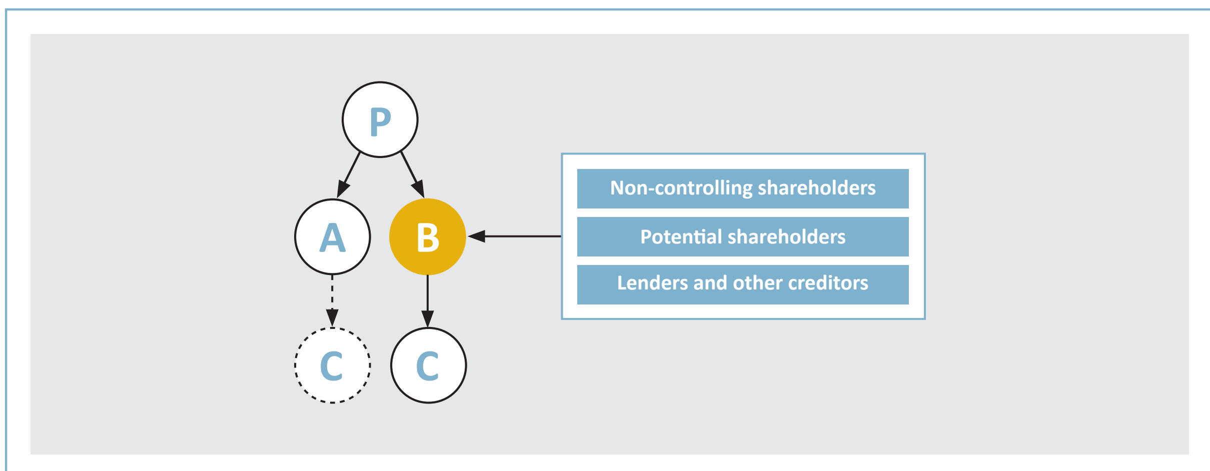
1.25 Existing shareholders of the receiving company in a business combination under common control comprise the controlling party and any **non-controlling shareholders** who own shares in the receiving company at the combination date. However, because the controlling party controls the receiving company, it can obtain the information it needs from the receiving company. One example of such information is information needed to enable the controlling party to prepare its own consolidated financial statements. Another example is information obtained by the controlling party when it exercises its power to direct the activities of the receiving company, such as when the controlling party directs the receiving company to undertake a business combination under common control. In that case, the controlling party would already have information about the combination without using the receiving company's general purpose financial statements. Hence, irrespective of whether the controlling party reviews and analyses those financial statements, that party does not need to rely on those statements for information about the combination.

1.26 In contrast, existing non-controlling shareholders, potential shareholders, and existing and potential lenders cannot direct the receiving company to undertake a business combination under common control and are typically not in a position to require the receiving company to provide them with information about that combination. Instead, they must rely on the receiving company's general purpose financial statements for meeting their information needs.

1.27 Accordingly, this project does not seek to address the controlling party's information needs—nor the information needs of users of the controlling party's financial statements—although the project might result in the receiving company providing information that is useful to those parties. Rather, this project focuses on the information needs of the receiving company's existing non-controlling shareholders, its potential shareholders and its existing and potential lenders and other creditors who must rely on the receiving company's general purpose financial statements for much of their information needs.

1.28 Diagram 1.2 depicts the categories of users of the receiving company's general purpose financial statements whose information needs this project is looking to address.

Diagram 1.2—Users of the receiving company's financial statements



1.29 A receiving company's non-controlling shareholders, potential shareholders and existing and potential lenders and other creditors may have different information needs. In reaching its preliminary views, the Board considered the common information needs of those users of a receiving company's financial statements.[10]

10 Paragraph 1.8 of the *Conceptual Framework*.

Interaction with other projects

1.30 The development of possible reporting requirements for business combinations under common control is not expected to affect the Board's other active projects, but some of the Board's other active projects might affect the development of those requirements, namely:

(a) Goodwill and Impairment—the Board is considering possible improvements to IFRS 3, including improved disclosure requirements. The Board published a Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* in March 2020. That Discussion Paper is open for comments until 31 December 2020. Any amendments to IFRS 3 could affect:

(i) those business combinations under common control to which the acquisition method applies; and

(ii) disclosures about business combinations under common control.

(b) the Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12—one of the Board's preliminary views set out in this Discussion Paper is based on an existing requirement in IFRS 10 (see paragraph 2.47(b)(i)). The Board has not identified a need to examine that requirement in the first phase of the Post-implementation Review of that Standard. However, any subsequent findings in the Post-implementation Review could affect the Board's future conclusions on the issue discussed in paragraphs 2.42–2.44. The Board plans to publish a Request for Information for the Post-implementation Review in the fourth quarter of 2020.

Question for respondents

Project Scope

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?

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Section 2—Selecting the measurement method

2.1 The absence of specific requirements in IFRS Standards for a **receiving company** in **business combinations under common control** has resulted in diversity in practice, as outlined in paragraphs 1.2–1.8. The areas of diverse practice include the selection of the measurement method. The following methods are commonly used: the **acquisition method** and various forms of a **book-value method**. In practice, companies do not use a single consistent principle to determine which method to apply.

2.2 One way to reduce diversity in practice would be to require a single method for all **business combinations**, including all business combinations under common control—the acquisition method set out in IFRS 3 *Business Combinations*. As explained in Table 1.1 (see paragraph 1.7), the acquisition method requires measuring identifiable assets and liabilities received in the combination at fair value, and requires the recognition of goodwill.

2.3 Another approach, suggested by some stakeholders and often used in practice, would be to require a book-value method for some or all business combinations under common control. As explained in Table 1.1, that method requires measuring assets and liabilities received in the combination at their existing book values.

2.4 Some stakeholders have suggested a third method—a 'fresh start' method (sometimes called a 'new basis' method). That method measures at fair value all assets and liabilities of all of the combining companies, including the receiving company's own assets and liabilities. However, that method is rarely, if ever, used and received little support during the Board's initial consultations with stakeholders. Consequently, the fresh start method is not discussed further in this Discussion Paper.

2.5 Paragraphs 2.6–2.61 discuss:

(a) stakeholder input (paragraphs 2.6–2.14);

(b) the Board's main considerations in selecting the measurement method (paragraphs 2.15–2.34);

(c) the cost–benefit trade-off and other practical considerations for combinations that affect **non-controlling shareholders** (paragraphs 2.35–2.54);

(d) a summary of the Board's preliminary views (paragraph 2.55); and

(e) the effects of implementing the Board's preliminary views (paragraphs 2.56–2.61).

Stakeholder input

2.6 In consultations conducted in developing this Discussion Paper, stakeholders expressed diverse views on reporting business combinations under common control. Broadly, the views expressed can be summarised as follows:

(a) View A—business combinations under common control are different from business combinations covered by IFRS 3. Accordingly, the acquisition method should not be applied to any business combinations under common control. Instead, a book-value method should be applied to all such combinations (paragraphs 2.7–2.9).

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(b) View B—business combinations under common control are similar to business combinations covered by IFRS 3 in most, if not all, cases. Accordingly, the acquisition method should normally be applied to business combinations under common control, except perhaps in some cases when the benefits of information produced by that method do not justify the costs of applying it. In those cases, a book-value method should be applied (paragraphs 2.10–2.11).

(c) View C—some business combinations under common control are similar to business combinations covered by IFRS 3 and others are not similar. Accordingly, neither the acquisition method nor a book-value method should be applied to all business combinations under common control. Instead, the acquisition method should be applied in some cases and a book-value method should be applied in other cases (paragraphs 2.12–2.13).

View A—business combinations under common control are different from business combinations covered by IFRS 3

2.7 Some stakeholders take the view that *all* business combinations under common control differ from business combinations covered by IFRS 3. They argue that business combinations under common control lack economic substance because a transfer of a **business** in such a combination does not change ultimate control of that business. Instead, the **controlling party** controls all combining companies both before and after the combination and simply moves its economic resources from one 'location' to another within the group. In contrast, in a business combination covered by IFRS 3, if another party controls the acquiring company, ultimate control of the **transferred company** passes to that party.

2.8 Accordingly, these stakeholders argue that a book-value method should apply to all business combinations under common control to reflect the controlling party's continued control of the combining companies. They argue that the acquisition method should not apply to these combinations because, in their view, that method is designed for transactions that involve a change in ultimate control of a business. These stakeholders also argue that a book-value method would:

(a) best meet the information needs common to all shareholders, lenders and other creditors of the receiving company, including the controlling party;

(b) be less costly to apply than the acquisition method; and

(c) be aligned with prevailing practice and with requirements or guidance in many jurisdictions.

2.9 These stakeholders further argue that applying the acquisition method to some or all business combinations under common control would not provide the most useful information about those transactions because in their view that method would:

(a) involve significant uncertainty in measuring at fair value assets and liabilities received in a related party transaction;

(b) result in measuring goodwill at an amount that is not evidenced by a transaction price between independent parties;

(c) treat any synergies between the combining companies as newly acquired in the combination, even though some of those synergies may have already existed before the combination; and

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(d) if applied to only some such combinations, decrease comparability between business combinations under common control and create opportunities for accounting arbitrage.

View B—business combinations under common control are similar to business combinations covered by IFRS 3

2.10 Some stakeholders take the view that most, if not all, business combinations under common control are similar to business combinations covered by IFRS 3. They note that all business combinations, including all business combinations under common control, involve a transfer of a business. When viewed from the perspective of the receiving company (rather than the perspective of the controlling party), a business combination under common control transfers control of a business to that company, just as occurs in a business combination covered by IFRS 3, and has economic substance for the receiving company. These stakeholders argue that the perspective of the controlling party is irrelevant for the receiving company and for its financial statements, which this project focuses on.

2.11 Accordingly, these stakeholders argue that the acquisition method would provide the most useful information about business combinations under common control to users of the receiving company's financial statements. They also argue that applying that method would improve comparability between companies because similar transactions would be reported in a similar way. However, they acknowledge that the benefits of providing that improved information might not always outweigh the costs. Therefore, they argue that the acquisition method should apply to business combinations under common control except when cost–benefit considerations justify using a book-value method.

View C—some business combinations under common control are similar to business combinations covered by IFRS 3 and others are not

2.12 Some stakeholders argue that business combinations under common control are not all similar to each other and that different measurement methods may therefore be appropriate in different circumstances. They take the view that some transfers of businesses under common control are similar to business combinations covered by IFRS 3 and that the acquisition method would therefore provide the most useful information in those cases. However, in their view, some other such transfers may not be similar to business combinations covered by IFRS 3 and may, for example, instead result in the pre-existing business continuing its operations in a new legal form. In such cases, they suggest that the acquisition method may not provide the most useful information.

2.13 These stakeholders suggest evaluating whether business combinations under common control are similar to business combinations covered by IFRS 3 using one or more criteria, for example:

(a) whether the receiving company has non-controlling shareholders that are affected by the combination (such as whether those shareholders acquire a significant **ownership interest** in the economic resources transferred in the combination);[11]

(b) the pricing of the combination (such as whether the receiving company would have paid a similar amount of consideration in a combination with an unrelated party);

11 These stakeholders focus on whether the ultimate ownership interests in the economic resources transferred in a business combination under common control change as a result of the combination. Such a change will typically occur when the receiving company has non-controlling shareholders.

(c) evidence of fair value (such as whether the fair value of the consideration transferred is based on independent valuations or on other external evidence);

(d) the decision-making process (such as whether the combining companies initiated the combination and negotiated its terms, or whether the combination was initiated and directed by the controlling party); and

(e) the purpose of the combination (such as whether its purpose was to benefit the combining companies, or whether it was to benefit the controlling party or other companies in the group).

Common ground in stakeholders' views

2.14 As explained in paragraphs 2.6–2.13, stakeholders have expressed diverse views on how business combinations under common control should be reported and why. However, although different stakeholders analyse business combinations under common control in different ways, they sometimes come to similar conclusions, albeit for different reasons. Specifically, the following common ground has emerged:

(a) for combinations that do not affect non-controlling shareholders of a receiving company, many stakeholders who provided feedback during the development of this Discussion Paper generally supported applying a book-value method, even when the combinations affect lenders or other creditors of the receiving company or are undertaken in preparation for a sale of the combining companies, for example, in an initial public offering. Some of those stakeholders, notably investors and analysts who specialise in credit analysis, also expressed the view that the outcome of credit analysis would not depend greatly on whether the acquisition method or a book-value method is applied to combinations under common control. Furthermore, some suggested that if a combination is undertaken in preparation for a sale or listing of wholly-owned combining companies, the information provided to potential shareholders about those companies should not depend on the legal structure chosen for the combination (see Diagram 2.4). Finally, some stakeholders have cost–benefit reasons for supporting a book-value method for combinations that do not affect non-controlling shareholders.

(b) for combinations that affect non-controlling shareholders of a receiving company, many stakeholders who provided feedback during the development of this Discussion Paper generally supported applying the acquisition method, especially when the extent of non-controlling shareholders' interests in the receiving company is 'substantive'. Those stakeholders argued that use of the acquisition method would provide useful information to those non-controlling shareholders. Some of these stakeholders also expressed a view that the presence of non-controlling shareholders may indicate that the transaction is similar to a business combination covered by IFRS 3. However, some stakeholders disagreed with applying the acquisition method to any business combinations under common control, including those that affect non-controlling shareholders of the receiving company (see paragraphs 2.7–2.9).

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Main considerations in selecting the measurement method

2.15 The Board considered the stakeholder input and other research (summarised in paragraphs IN8–IN9) in reaching its preliminary view on which method or methods should be applied to business combinations under common control. In particular, the Board considered:

(a) whether and when business combinations under common control are similar to business combinations covered by IFRS 3;

(b) what information would be most useful to users of the receiving company's financial statements; and

(c) whether the benefits of providing that information would justify the costs of providing it.

2.16 The Board does not agree with the view that all business combinations under common control are different from business combinations covered by IFRS 3 and should be accounted for differently. In the Board's view, although ultimate control of the combining companies does not change in business combinations under common control, that does not mean that such combinations are simply reallocations of economic resources within the group. Instead, such combinations always have economic substance for the receiving company because the receiving company gains control of a business that it did not control before the combination, just as occurs in a business combination covered by IFRS 3.

2.17 In addition, some business combinations under common control result in a change in the ultimate ownership interests in the economic resources transferred in the combination, just as occurs in business combinations covered by IFRS 3. Specifically, this occurs when the receiving company has non-controlling shareholders. In those circumstances, those non-controlling shareholders acquire an ownership interest in those economic resources that they did not previously have, whereas the ownership interest of the controlling party in those economic resources is reduced.[12] Hence, such a business combination under common control has a substantive effect on both the receiving company and its shareholders and is not a mere reallocation of economic resources within the group.

2.18 The Board next considered whether to require companies to evaluate how similar a business combination under common control is to business combinations covered by IFRS 3 in order to determine what information should be provided about that combination. In the Board's view, it would be difficult to provide a workable set of indicators for companies to use in making such an evaluation. Also, the Board's view is that such an evaluation would be subjective and that requiring companies to make such an evaluation may not help reduce diversity in practice. Thus, the Board has reached the view that it should not base the selection of the measurement method on such an evaluation by the receiving company.

2.19 The Board also considers that some of the indicators suggested by stakeholders—for example, the purpose of the combination or the process for deciding the terms of the combination—would not change the conclusion about what information would be most useful to users of the receiving company's financial statements. The Board acknowledges that the pricing of some business combinations under common control can differ from the pricing of business combinations covered by IFRS 3 (see paragraph 2.28) and that evidence of fair value may not always be readily available in a business combination under common control. However, in the Board's view, those considerations relate to the mechanics of how the selected measurement method should be applied rather than to the selection of the measurement method (Section 3 discusses those considerations). Instead, the Board focussed on changes in ownership interests in the economic resources transferred in business combinations under common control, as discussed in paragraphs 2.20–2.34.

12 The effect of the combination on the controlling party will also depend on whether non-controlling shareholders are present in the transferring company.

Combinations that affect non-controlling shareholders

2.20 As discussed in paragraph 2.17, when non-controlling shareholders of the receiving company acquire an ownership interest in the economic resources transferred in a business combination under common control, the combination has a substantive effect not only on the receiving company itself but also on its shareholders. The Board considers that a transfer to non-controlling shareholders of the receiving company of an ownership interest in the economic resources of the transferred company has a pervasive effect on the evaluation of how similar the combination is to a business combination covered by IFRS 3. Specifically, the Board's view is that if such a transfer occurs, that transaction is similar to business combinations covered by IFRS 3. That similarity is illustrated in Diagrams 2.1 and 2.2. In both scenarios, Company B, the receiving company, gains control of Company C, the transferred company, which it did not control before. Furthermore, in both scenarios, non-controlling shareholders of Company B acquire an ownership interest in the economic resources of Company C, regardless of whether ultimate control of Company C changes. Both combinations result in a substantive change in the ownership interests in the economic resources of the transferred company.

Diagram 2.1—Business combination covered by IFRS 3

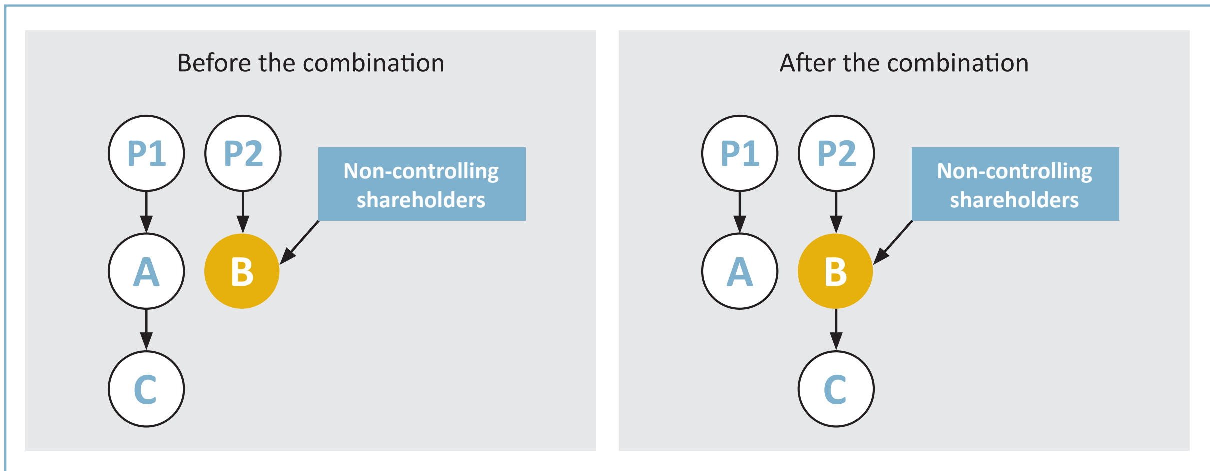
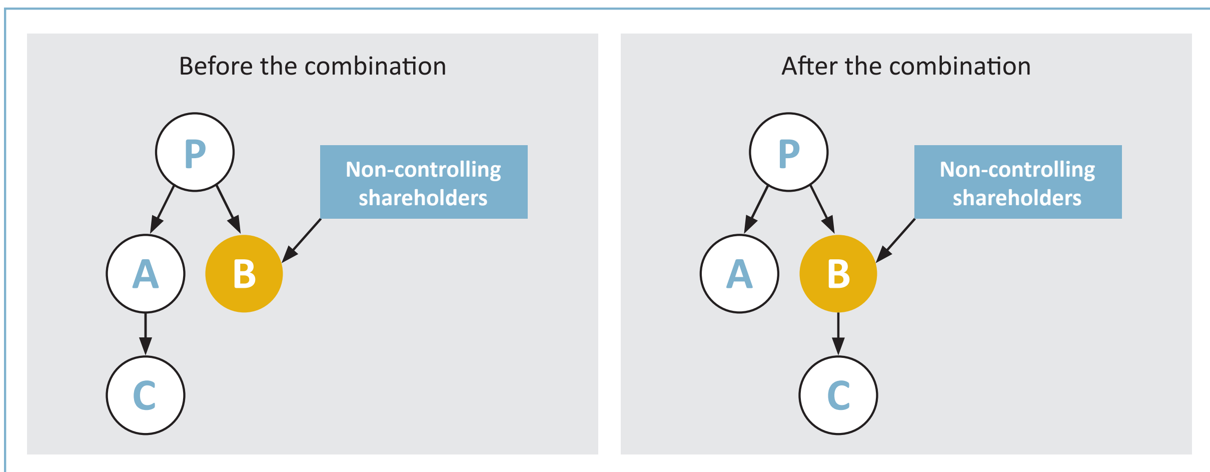


Diagram 2.2—Business combination under common control



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2.21 Furthermore, if a business combination under common control affects non-controlling shareholders of the receiving company, the composition of users who rely on that company's financial statements for meeting their information needs about the combination is also similar to the composition of users in a business combination covered by IFRS 3. Specifically, for both types of business combinations, they comprise those non-controlling shareholders, potential shareholders and lenders and other creditors of the receiving company.

2.22 Therefore, because both the combination itself is similar to a business combination covered by IFRS 3 (paragraph 2.20) and the composition of users of the receiving company's financial statements is similar in both cases (paragraph 2.21), the common information needs of those users in such combinations are also similar.

2.23 Accordingly, in the Board's preliminary view, in principle, the acquisition method should be applied to business combinations under common control that affect 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).

Combinations that do not affect non-controlling shareholders

2.24 In contrast, if the receiving company does not have non-controlling shareholders (such as in a business combination under common control involving wholly-owned companies), not only is there no change in the ultimate control of the combining companies, but also no change in the ultimate ownership interests in the economic resources transferred in the combination. In such circumstances, questions may arise about how similar the combination is to business combinations covered by IFRS 3 and whether the acquisition method should be applied.

2.25 Combinations between wholly-owned companies are illustrated in Diagrams 2.3 and 2.4, using an example of a controlling party, Company P, that wishes to sell its wholly-owned subsidiaries, companies A and B, in an initial public offering. In Scenario 1, Company P owns and controls Company A and Company B via an intermediate holding company, HoldCo. Accordingly, Company P could sell its subsidiaries by selling HoldCo. In contrast, in Scenario 2, Company P owns and controls its subsidiaries directly. In this case, Company P might first need to restructure its subsidiaries. Company P could do that in various ways, as illustrated in Diagram 2.4.

Diagram 2.3—Group structure before initial public offering

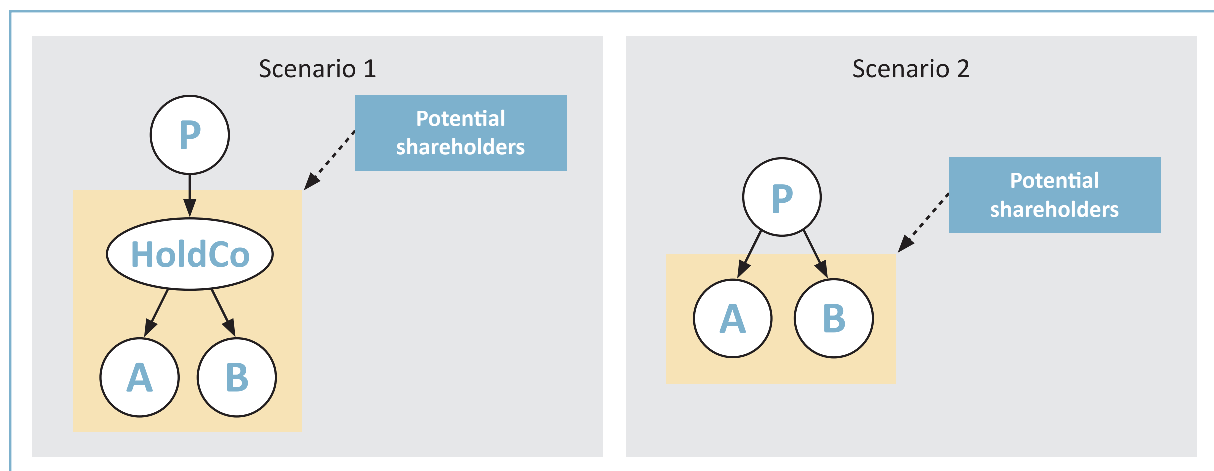
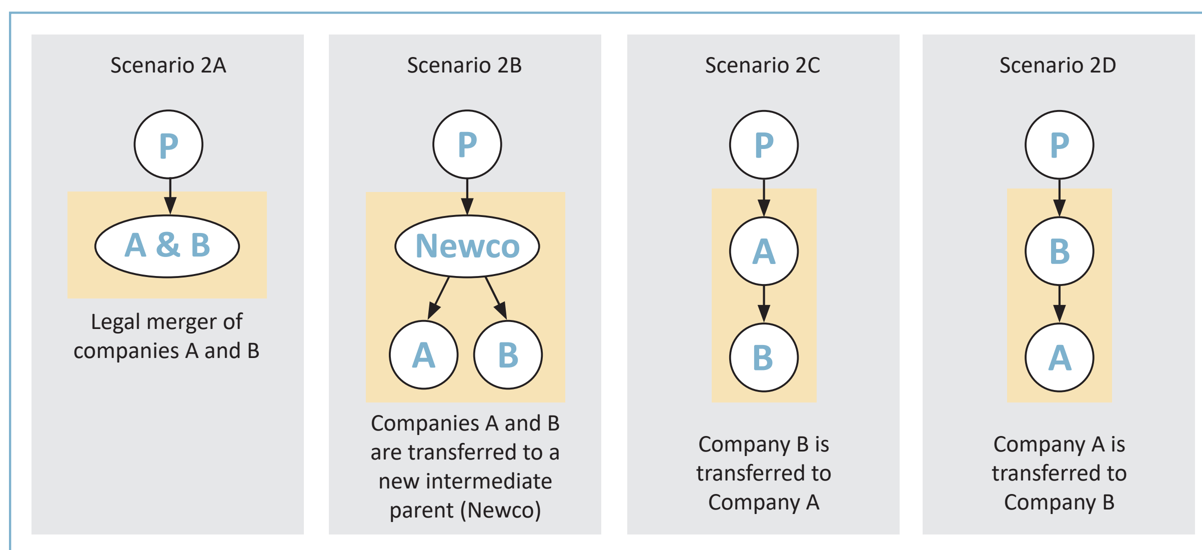


Diagram 2.4—Group restructuring in preparation for an initial public offering



2.26 If the acquisition method was applied to the group restructuring illustrated in Diagram 2.4, one of the combining companies would need to be identified as the 'acquirer'—either Company A or Company B or, in Scenario 2B, possibly Newco.[13] Identifying the acquirer determines which measurement bases are applied to the assets and liabilities of the combining companies, and thus would usually have a fundamental and pervasive effect on what information is provided to potential public shareholders. The assets and liabilities of the company identified as the acquirer continue to be measured at their existing book values, whereas the assets and liabilities of the other combining company (or companies, in Scenario 2B) are measured at fair value. However, from the viewpoint of those shareholders, they would be investing in the same economic resources in all scenarios, as illustrated by the shaded areas in Diagrams 2.3 and 2.4. In contrast, a book-value method would produce similar information in all those scenarios, regardless of whether and how the controlling party restructures its subsidiaries in preparation for the initial public offering.

2.27 Furthermore, identifying the acquirer in a business combination under common control involving wholly-owned companies like the group restructuring illustrated in Diagram 2.4 might be difficult. That difficulty arises because, when applying the acquisition method, the legal structure of the combination does not necessarily determine which company is the acquirer. Instead, IFRS 3 provides application guidance on identifying the acquirer. Some of that guidance considers the effects of the combination on the shareholders of the combining companies.[14] However, such effects would not arise for combining companies that are wholly-owned by the controlling party. In such cases, it might be difficult to identify the acquirer in a way that results in useful information. In contrast, if non-controlling shareholders acquire an ownership interest in the economic resources transferred in the combination, the guidance in IFRS 3 could help identify the acquirer.

13 When a new company is formed to effect a business combination, in some cases paragraph B18 of IFRS 3 does not permit the new company to be identified as the acquirer. In those cases, either Company A or Company B must be identified as the acquirer.

14 Paragraphs B15(a) and B15(b) of IFRS 3.

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2.28 Another difficulty with applying the acquisition method when the receiving company does not have non-controlling shareholders is that the consideration paid might differ from the consideration that would have been paid to an unrelated party. For example, in the group restructuring illustrated in Diagram 2.4, the controlling party, Company P, might direct the combining companies to transact at the book value of the assets and liabilities of the transferred company. However, as discussed further in Section 3, the measurement of goodwill applying the acquisition method is based on the premise that the amount of the consideration paid is determined in an arm's length negotiation and depends on the fair value of the acquired business and the price for any synergies expected from the combination. As a result, goodwill is measured at an amount that is expected to reflect the fair value of the pre-existing goodwill in the acquired business and the price for the synergies expected from the combination. In contrast, if business combinations under common control are not priced at arm's length, applying the acquisition method might measure goodwill at an arbitrary amount that does not provide useful information.

2.29 As also discussed further in Section 3, such a scenario is less likely to arise in a business combination under common control that affects non-controlling shareholders of the receiving company. The research for this project indicates that in such combinations, the consideration paid would typically approximate the consideration that would have been paid between unrelated parties, because many jurisdictions have regulations that are designed to protect non-controlling shareholders. However, those regulations would not apply if a transaction does not affect non-controlling shareholders.

2.30 Furthermore, when a business combination under common control does not affect non-controlling shareholders of the receiving company, questions arise about which method would produce sufficient benefits for users of the receiving company's financial statements to justify the costs of applying that method.

2.31 Cost is a pervasive constraint on the information that can be provided by financial reporting. It is important that the costs of reporting particular information are justified by the benefits of reporting that information.[15] If a business combination under common control does not affect non-controlling shareholders of the receiving company, that company's only existing shareholder is the controlling party and, as discussed in paragraph 2.24, the combination does not change that party's control of the combining companies nor its ownership interest in them. Also, as discussed in paragraph 1.25, because the controlling party controls the receiving company, it does not need to rely on that company's general purpose financial statements to meet its information needs.

15 Paragraph 2.39 of the *Conceptual Framework*.

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2.32 Some question, therefore, whether the costs of applying the acquisition method to these combinations would be justified. Feedback received from stakeholders in the project indicates that a book-value method is typically less costly to apply and would provide useful information:

(a) to potential shareholders of the receiving company. This is because a book-value method provides potential shareholders with similar information about the combined economic resources in all scenarios, regardless of whether a combination under common control is undertaken in preparation for a sale to potential shareholders and regardless of how the combination is legally structured (as discussed in paragraphs 2.25–2.26 and illustrated in Diagrams 2.3 and 2.4).

(b) to lenders and other creditors of the receiving company. This is because their economic interest in the receiving company is typically limited to receiving payments of principal and interest. Thus, lenders and other creditors need information about the receiving company's cash flows and debt commitments in order to assess the company's ability to service its existing debt and to raise new debt. That information is largely unaffected by whether the acquisition method or a book-value method is used to account for a business combination under common control. In addition, although information about fair values of particular assets received in such a combination can be useful to lenders and other creditors in some cases, the outcome of their analysis would not depend greatly on whether they receive that information.

2.33 Accordingly, in the Board's preliminary view, a book-value method should be applied to business combinations under common control that do not affect non-controlling shareholders of the receiving company, including all combinations between wholly-owned companies.

Selecting the measurement method

The Board's preliminary views

2.34 The Board's preliminary views are that:

(a) neither the acquisition method nor a book-value method should be applied to *all* business combinations under common control;

(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); and

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

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

2.35 Having reached the preliminary view that, in principle, the acquisition method should be applied to business combinations under common control that affect non-controlling shareholders of the receiving company, the Board next considered whether that method should be applied to *all* or only to *some* such combinations.

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2.36 Some stakeholders consulted in the project suggested that the acquisition method should be applied only if non-controlling shareholders hold a 'substantive' ownership interest in the receiving company and that a book-value method should be applied in all other cases. Some of those stakeholders argued that the acquisition method would be more costly to apply than a book-value method. They expressed concerns that the costs of applying the acquisition method may not be justified by the benefits of the information provided by that method when non-controlling shareholders have only a 'small' ownership interest in the receiving company. Some stakeholders also suggested that those costs may not be justified when all non-controlling shareholders are **related parties** of the receiving company, who may not need to rely on the company's financial statements to meet their information needs.

2.37 Some stakeholders also expressed concerns about opportunities for accounting arbitrage. They noted that the acquisition method would require a receiving company to recognise goodwill and other intangible assets, and to measure assets at fair value, when IFRS Standards would not permit doing so if the receiving company had always owned the transferred business. They suggested that requiring the acquisition method for all business combinations under common control that affect non-controlling shareholders would allow a receiving company to structure a combination in a particular way to achieve those accounting outcomes.

2.38 Accordingly, the Board considered whether, in some circumstances, applying the acquisition method to combinations that affect non-controlling shareholders might not produce benefits that justify the costs of applying that method, or might create opportunities for accounting arbitrage. The Board first considered whether it should set a quantitative threshold specifying that the acquisition method should not be applied if the extent of the ownership interest of non-controlling shareholders is below that threshold. However, the Board has rejected such an approach because a quantitative threshold would be arbitrary and would lack a conceptual basis. In addition, it could give rise to further concerns about opportunities for accounting arbitrage. Accordingly, the Board next considered qualitative factors.

2.39 First, the Board has reached the preliminary view that the acquisition method should be applied to business combinations under common control if the receiving company's **shares** are traded in a **public market**. The Board noted that minimum listing requirements or capital markets regulations for public trading in many jurisdictions typically prevent the listing of shares when the ownership interest of non-controlling shareholders in the company is insignificant. Accordingly, a condition based on trading in a public market would not itself impose an arbitrary quantitative threshold, but would apply quantitative considerations indirectly without being arbitrary. In the Board's view, such a condition is objective and easy to apply, and would not create opportunities for accounting arbitrage. Furthermore, a similar condition is already used in IFRS Standards to determine which information must be provided in some specified cases.[16]

2.40 Second, the Board considered how to weigh the benefits of applying the acquisition method against the costs if the receiving company's shares are not **publicly traded**, and whether and when a book-value method should instead be applied to combinations that affect non-controlling shareholders in such companies. The Board has reached the preliminary view that for **privately held** companies (that is, companies whose shares are not publicly traded) there should be:

16 See paragraph 4(a)(ii) of IFRS 10 *Consolidated Financial Statements*, paragraph 2(b)(i) of IFRS 8 *Operating Segments* and paragraph 2(b)(i) of IAS 33 *Earnings per Share*. These Standards describe a public market as a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets.

(a) an optional exemption from the acquisition method—the receiving company should be *permitted* to use a book-value method rather than the acquisition 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 (see paragraphs 2.41–2.44) (the optional exemption from the acquisition method); and

(b) an exception to the acquisition method—the receiving company should be *required* to use a book-value method rather than the acquisition method if all of its non-controlling shareholders are related parties of the company, as defined in IAS 24 *Related Party Disclosures* (see paragraph 2.45) (the related-party exception to the acquisition method).

2.41 The Board considers that for privately held companies, the benefits of information provided by the acquisition method may not outweigh the costs of providing that information. For example, the benefits might not outweigh the costs if non-controlling shareholders of a privately held company:

(a) do not hold a significant ownership interest in the company;

(b) do not need to rely on the company's financial statements to meet their information needs (for example, if the terms and conditions of agreements between the company and the private shareholders give them a right to obtain information); or

(c) do not routinely rely on analysis of detailed financial information, performed either by themselves or by financial intermediaries.

2.42 Therefore, the Board has reached the view that it should allow privately held companies to 'opt out' from the acquisition method and to apply a book-value method instead, on condition that all of its non-controlling shareholders have been informed about the use of a book-value method for a combination and have not objected to its use. This condition is based on one already used in IFRS Standards for exempting privately held companies from some requirements in specified circumstances when, in the Board's view, the costs of applying those requirements may outweigh the benefits of doing so.[17]

2.43 The condition would not require any action from non-controlling shareholders unless they object to the use of a book-value method. The Board's view is that designing the condition in this way would lead to a more appropriate trade-off between benefits and costs than requiring companies to seek explicit consent for the use of a book-value method. This is because when non-controlling shareholders are largely indifferent about which information they receive, they are unlikely to respond to a request about which method to use. However, the Board has also reached the view that it should allow non-controlling shareholders to require the use of the acquisition method so they receive fair value information when it is important to them.

2.44 Practical questions may arise about applying such an exemption, for example, about how and when the company should notify its non-controlling shareholders or how long those shareholders should be given to raise any objections. However, such a condition is already used in IFRS Standards. Accordingly, the Board expects that such an exemption would be workable in practice, especially for a small number of concentrated and stable shareholdings in a privately held company.

17 See paragraph 4 of IFRS 10 and paragraph 17 of IAS 28.

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2.45 The Board has also reached the preliminary view that a privately held receiving company should not be permitted to use the acquisition method if all of its non-controlling shareholders are related parties of the company, as defined in IAS 24. The Board's reason is that the receiving company's related parties might not need to rely on its general purpose financial statements to meet their information needs. Hence, the benefits of applying the acquisition method in those cases might not justify the costs. In addition, requiring a book-value method in those cases would prevent opportunities to structure a combination by issuing shares to related parties for the sole purpose of qualifying for the acquisition method.

2.46 The Board's preliminary views on when the acquisition method should be applied to combinations that affect non-controlling shareholders and when a book-value method should be applied to such combinations are all based on conditions already used in IFRS Standards. The Board considers that an approach relying on conditions already used would generally involve less complexity than introducing into IFRS Standards new conditions that have not been applied in practice.

Selecting the measurement method

The Board's preliminary views

2.47 For business combinations under common control that affect non-controlling shareholders of the receiving company, the Board's preliminary views are that:

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

(b) 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); and

(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).

2.48 In reaching the preliminary views expressed in paragraph 2.47, the Board considered whether the optional exemption and the related-party exception should apply not only to privately held companies, but also to publicly traded companies.

2.49 First, some stakeholders suggested that, even for a publicly traded receiving company, the benefits of information provided to non-controlling shareholders by the acquisition method may not be enough to justify the costs if those non-controlling shareholders do not object to receiving information about book values of assets and liabilities of the transferred company instead of fair value information. In considering this suggestion, the Board noted that for publicly traded companies such an exemption:

(a) might be more difficult to apply (see paragraph 2.50); and

(b) might be more difficult to justify on cost–benefit grounds (see paragraph 2.51).

2.50 The optional exemption might be more difficult to apply for publicly traded companies because such companies often have many shareholders, with frequent changes in share ownership, whereas privately held companies are likely to have a more stable and concentrated ownership structure. Accordingly, the practical challenges discussed in paragraph 2.44 for privately held companies could be much more difficult to overcome for publicly traded companies.

2.51 The optional exemption might also be more difficult to justify on cost–benefit grounds for publicly traded companies because:

(a) non-controlling shareholders in a publicly traded receiving company are likely to hold, in aggregate, a significant ownership interest in that company (paragraph 2.39) and would need to rely on its financial statements for much of their information needs—unlike non-controlling shareholders in a privately held receiving company who:

(i) might not hold a significant ownership interest in that company;

(ii) might not need to rely on the company's financial statements to meet their information needs; or

(iii) might not routinely analyse detailed financial information (paragraph 2.41).

(b) share ownership in publicly traded companies is likely to change more often than in a privately held company. As a result, the non-controlling shareholders in a publicly traded company who will use the information about the combination might not be the same as the shareholders who were consulted when the receiving company proposed to use a book-value method, and their response might have been different. This possibility also exists for privately held companies, but it is less likely to be the case for those companies because their holdings are generally less liquid and those companies are therefore more likely to have a stable ownership base.

2.52 For those reasons, the Board has reached the view that if it wished to extend the optional exemption from the acquisition method to publicly traded companies, that exemption might need to be designed in a different way than the exemption for privately held companies in order for it to achieve appropriate accounting outcomes and be workable in practice.

2.53 Second, some stakeholders suggested that the related-party exception to the acquisition method should also apply to publicly traded companies. In other words, a publicly traded receiving company would be required to use the book-value method if all its non-controlling shareholders are related parties of the company. In considering this suggestion, the Board noted that listing requirements or capital market regulations often limit how many shares of a publicly traded company can be held by parties that are considered to be related to the company. Accordingly, the Board expects it would be unusual for all the non-controlling shareholders of a publicly traded receiving company to be related parties of that company. Hence, extending the related-party exception to publicly traded companies may have little practical effect.

2.54 Although the Board is not proposing to extend the optional exemption from or the related-party exception to the acquisition method to publicly traded companies, the Board is requesting feedback from stakeholders about whether (and, if so, how) such extensions should be made.

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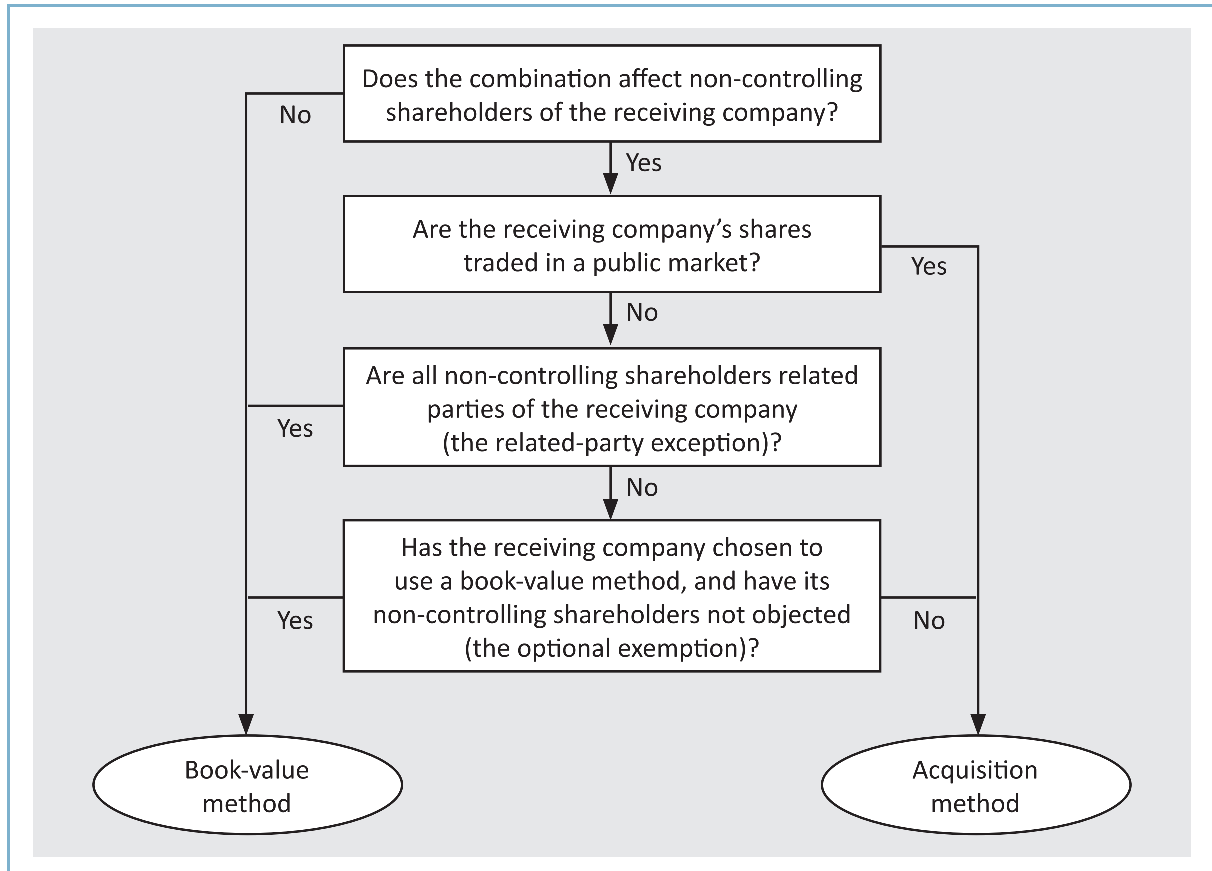
Summary of the Board's preliminary views

2.55 The Board's preliminary views on which method to use and when are summarised in Diagram 2.5.

Diagram 2.5—Summary of the Board's preliminary views



The effects of implementing the Board's preliminary views

2.56 If the Board's preliminary views are implemented, the acquisition method would apply to business combinations under common control in specified circumstances and a book-value method would apply in all other cases. Some stakeholders suggested that applying a single method—for example, a book-value method—to all business combinations under common control would more effectively reduce diversity in practice and improve comparability in reporting such combinations than the approach outlined in the Board's preliminary views. In addition, some stakeholders argued that applying a book-value method to all business combinations under common control would result in less complexity, be less costly and provide fewer opportunities for accounting arbitrage than the Board's approach.

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2.57 However, the Board considers that an approach based on its preliminary views would meet the project's objective of reducing diversity in practice, improving transparency of reporting and providing better information about business combinations under common control—that is, information that is both more relevant and more comparable—while taking appropriate account of the cost–benefit trade-off. In particular:

(a) diversity in practice would be reduced by specifying:

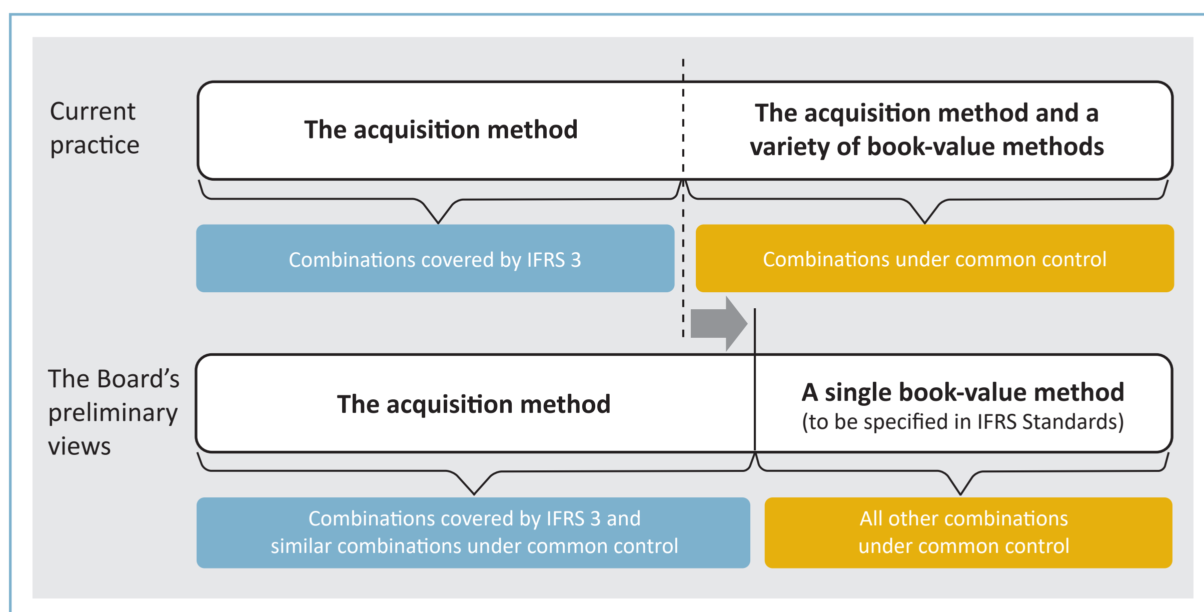
(i) which method should be applied in which circumstances so companies undertaking similar combinations would apply the same accounting policies.

(ii) how a book-value method should be applied, thus eliminating the diversity in practice caused by the variety of book-value methods used.

(b) the acquisition method would be applied both to business combinations covered by IFRS 3 and to business combinations under common control that are similar to business combinations covered by IFRS 3 when the benefits of applying that method outweigh the costs. As a result, users of the receiving company's financial statements would receive more relevant and more comparable information about business combinations under common control and the transparency of reporting these combinations will be improved.

2.58 Those overall effects of implementing the Board's preliminary views are illustrated in Diagram 2.6.[18]

Diagram 2.6—The overall effects of implementing the Board's preliminary views



18 Diagram 2.6 is designed to illustrate the overall effects of implementing the Board's preliminary views. It is not intended to illustrate the likely scale of the change to current practice.

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2.59 In contrast, requiring a book-value method for all business combinations under common control would result in companies reporting transactions that are similar to transactions covered by IFRS 3 applying a method that is different from the method required by IFRS 3. Hence, if the Board pursued such an approach, users of the receiving company's financial statements would receive information that is less relevant and less comparable.

2.60 Furthermore, the Board's view is that requiring one of two specified methods and specifying when each should be used would not introduce undue complexity for either preparers or users of financial statements because both methods are already in use. Besides, the criteria developed by the Board for determining which method should be applied are objective and are all based on conditions already used in IFRS Standards. In fact, the Board's view is that complexity would be reduced because companies would be subject to the requirements in IFRS Standards instead of having to develop their own accounting policy.

2.61 Finally, because IFRS 3 already requires the acquisition method for business combinations within its scope, if the Board decided to pursue a single measurement method for all business combinations that would mean extending the scope of the acquisition method to all business combinations under common control. Although such an approach might appear simpler, many of the Board's stakeholders consulted during the project do not support it and, on the basis of the Board's analysis set out in this section, the Board concurs with that view.

Questions for respondents

Selecting the measurement method

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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Selecting the measurement method

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?

Selecting the measurement method

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?

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Section 3—Applying the acquisition method

3.1 Section 2 discusses the Board's preliminary view that the **acquisition method** set out in IFRS 3 *Business Combinations* should be applied to **business combinations under common control** that affect **non-controlling shareholders** of the **receiving company** (with an exemption and an exception, as set out in paragraph 2.47). This section discusses whether the Board would need to develop any special requirements on how to apply that method to such combinations.

3.2 The reasons for the Board's preliminary views discussed in Section 2 on when to apply the acquisition method include the following:

(a) these combinations are similar to **business combinations** covered by IFRS 3; and

(b) the composition of users of information about these combinations—and hence their common information needs and cost–benefit considerations—are similar to those in business combinations covered by IFRS 3.

3.3 Accordingly, in principle, the acquisition method should be applied as set out in IFRS 3. However, business combinations under common control may contain one feature that is not present in business combinations covered by IFRS 3. Specifically, the consideration paid in business combinations under common control might be directed by the **controlling party** and therefore might differ from an arm's length price that would have been negotiated between unrelated parties in a business combination covered by IFRS 3.

3.4 However, the measurement of goodwill applying the acquisition method is based on the premise that the amount of the consideration paid is determined in an arm's length negotiation and depends on:

(a) the fair value of the acquired **business**; and

(b) the price paid for any synergies expected from the combination.[19]

3.5 More specifically, as explained in Table 1.1 (see paragraph 1.7), applying the acquisition method, an acquirer recognises the identifiable assets and liabilities acquired in the business combination and measures them at fair value. The acquirer also recognises goodwill and measures it as a residual amount: the excess of the fair value of the consideration paid over the fair value of the identifiable acquired assets and liabilities.[20] As a result, goodwill is measured at an amount that is expected to reflect the fair value of the pre-existing goodwill in the acquired business and the price paid for any synergies expected from the combination.[21] These key features of the acquisition method are illustrated in Diagram 3.1.

19 Paragraph BC316 of the Basis for Conclusions to IFRS 3.

20 Paragraph 3.5 summarises requirements explained more precisely in paragraph 32 of IFRS 3.

21 As illustrated in Diagram 3.1, the fair value of the pre-existing goodwill in the acquired business is the excess of the fair value of the acquired business as a whole over the aggregate fair value of its identifiable assets and liabilities. Expected synergies relate to the benefits that arise from combining the acquired business with the acquirer's business and are unique to each combination.

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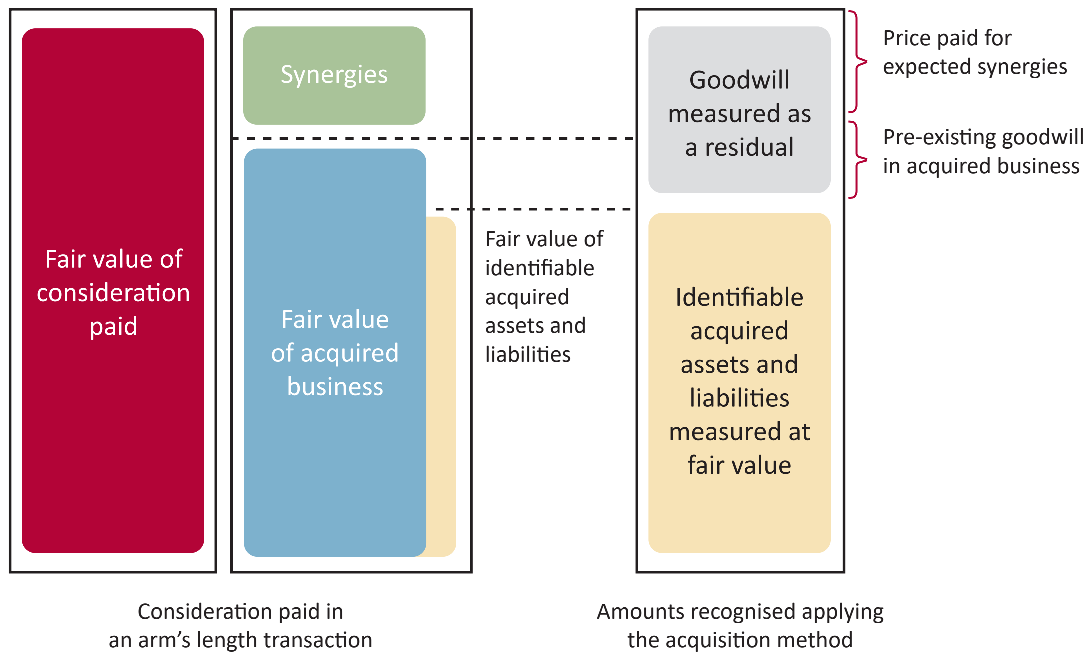
Diagram 3.1—Key features of the acquisition method



3.6 However, in a business combination under common control, the receiving company and the **transferring company** might not have been involved in deciding how much consideration is paid. Instead, the controlling party might have determined the amount of consideration. Any difference between that amount and the amount that would have been paid to an unrelated party in an arm's length transaction indicates that the combination includes an additional component—a transaction with the owners acting in their capacity as owners. Specifically, as illustrated in Diagram 3.2:

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

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

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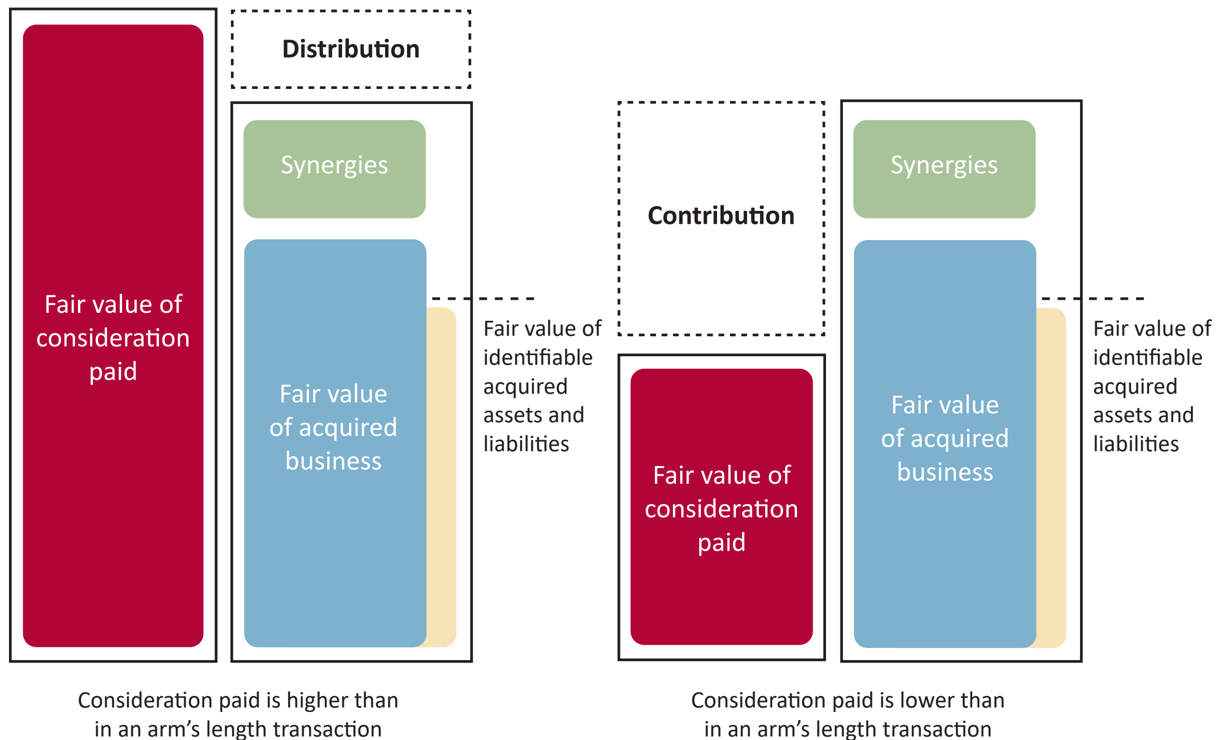
Diagram 3.2—Distribution from equity or contribution to equity



3.7 Applying IAS 1 *Presentation of Financial Statements*, transactions with owners in their capacity as owners should be reported in the receiving company's statement of changes in equity.[22]

3.8 Accordingly, the Board considered whether it should develop special requirements for the receiving company, when applying the acquisition method to a business combination under common control, to identify and recognise:

(a) distributions from equity (paragraphs 3.11–3.16); and

(b) contributions to equity (paragraphs 3.17–3.20).

3.9 The Board has not identified a need to consider any other special requirements on how to apply the acquisition method to business combinations under common control.

3.10 Paragraphs 5.8–5.12 discuss whether the Board should develop disclosure requirements for business combinations under common control in addition to those required by IFRS 3, for example, disclosures about the terms of these combinations.

22 Paragraph 106 of IAS 1 *Presentation of Financial Statements*.

Distributions from equity

3.11 If the Board were to require the receiving company to identify and recognise a distribution from equity in a business combination under common control, the Board would need to specify how to measure any such distributions. The Board considered a similar issue when it developed IFRS 3: whether to provide special requirements for business combinations in which a buyer 'overpays' for the acquisition. No such requirements are included in IFRS 3, because the Board concluded that, in practice, an overpayment is unlikely to be detectable or known at the acquisition date and that the overpayment would be difficult, if not impossible, to quantify. Accordingly, if an overpayment occurs, it is initially included in goodwill recognised in a business combination and is addressed through subsequent testing of goodwill for impairment.[23]

3.12 In the Board's view, similar difficulties would arise in identifying and measuring a distribution to the controlling party in a business combination under common control. Appendix C discusses such difficulties.

3.13 The Board also considered whether a distribution from equity would be likely to occur in practice in business combinations under common control that affect non-controlling shareholders of the receiving company. In effect, any such distribution would transfer wealth from those non-controlling shareholders to the transferring company, and ultimately to the controlling party. Research for this project and stakeholder input suggest that distributions to the controlling party are unlikely to occur in such combinations. Such distributions are unlikely to occur because many jurisdictions have legal requirements and regulations that are designed to protect the interests of non-controlling shareholders.

3.14 For the reasons discussed in paragraphs 3.12–3.13, the Board has reached the preliminary view that it should not develop a requirement for the receiving company to identify, measure and recognise a distribution to the controlling party applying the acquisition method. Accordingly, in the unlikely event that an overpayment occurs in a business combination under common control that affects non-controlling shareholders, it would be initially included in goodwill and addressed through subsequent testing of goodwill for impairment, just as occurs in a business combination covered by IFRS 3. Many stakeholders who provided their views on this matter during the development of this Discussion Paper (see paragraph IN9), notably investors and analysts, agreed with that conclusion.

3.15 However, investors and analysts also emphasised that they need information about the economics of the combination to help them make their own assessment of whether the consideration paid includes an overpayment. Disclosure requirements when applying the acquisition method to business combinations under common control are discussed further in Section 5 (see paragraphs 5.5–5.12). In particular, that section explains that in another active project—Goodwill and Impairment—the Board is considering possible improvements to IFRS 3, including improved disclosure requirements designed to help investors and analysts understand whether the price paid in a business combination was reasonable.[24] Any such improved disclosures would also provide useful information about the consideration paid in a business combination under common control to which the acquisition method is applied.

23 Paragraph BC382 of the Basis for Conclusions to IFRS 3.

24 See Section 2 of the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*, published in March 2020.

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The Board's preliminary view

3.16 The Board has reached the preliminary view that 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.

Contributions to equity

3.17 The Board also considered whether the receiving company should be required to recognise a contribution to equity when applying the acquisition method to a business combination under common control. The Board first considered whether such a contribution would be likely to occur if such a combination affects non-controlling shareholders of the receiving company. The legal protections discussed in paragraph 3.13 might not apply in this situation, because any such contribution would transfer wealth from the controlling party to the non-controlling shareholders of the receiving company and so would not adversely affect those shareholders. Nevertheless, the controlling party is unlikely to allow a transfer of wealth to non-controlling shareholders. Therefore, the Board has reached the view that such contributions are also unlikely to occur in practice.

3.18 However, in the unlikely event that a contribution did occur, the question arises whether it could be identified and measured and, if so, whether it should be recognised. As illustrated in Diagram 3.2, in a business combination under common control, economically the amount of any contribution to equity equals the excess of the consideration that would have been negotiated between unrelated parties in an arm's length transaction over the consideration actually paid. In an arm's length transaction between unrelated parties, the amount of consideration is expected to reflect the fair value of the acquired business and the price paid for any synergies expected from the combination (as discussed in paragraph 3.4). However, that amount would be difficult, if not impossible, to measure in practice. Hence, measuring the full amount of the contribution (as indicated by the dashed box in Diagram 3.2) would not be workable in practice.

3.19 The Board next considered whether any portion of the contribution could be identified and measured. In considering that question, the Board analysed the requirements of IFRS 3 for bargain purchase gains. A bargain purchase gain arises if the fair value of the consideration paid is below the fair value of identifiable assets and liabilities acquired in a business combination, as illustrated in Diagram 3.3. The Standard explains that a bargain purchase gain might happen occasionally, for example, in a forced sale in which the seller is acting under compulsion.[25] IFRS 3 requires such a gain to be recognised in the statement of profit or loss. However, based on the discussion in paragraph 3.6, in a business combination under common control, any excess fair value of the identifiable acquired assets and liabilities over the consideration paid constitutes a contribution to equity and therefore should be reported as a change in the receiving company's equity. Accordingly, the Board has reached the preliminary view that it should develop a requirement for the receiving company in a business combination under common control to recognise any excess of the fair value of the identifiable acquired assets and liabilities over the consideration paid as a contribution to equity, rather than as a gain in the statement of profit or loss. The measurement of a contribution is illustrated in Diagram 3.3.

25 Paragraph 35 of IFRS 3.

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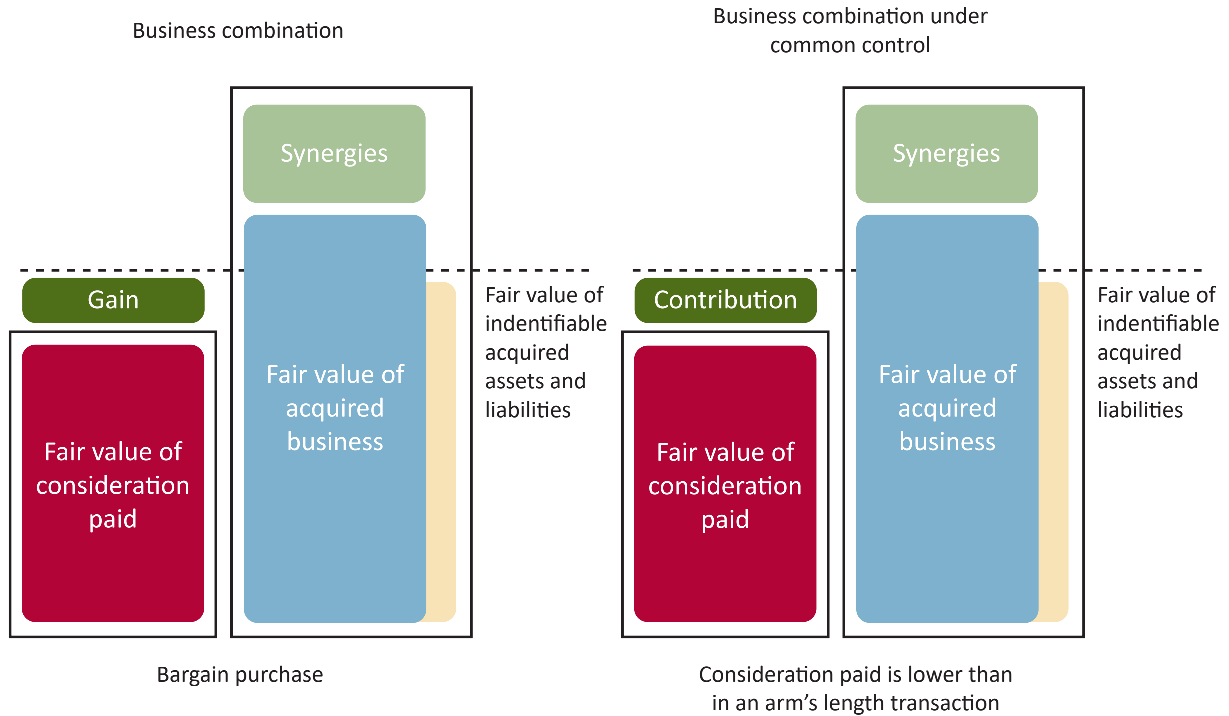
Diagram 3.3—Measuring a bargain purchase gain and a contribution to equity



Applying the acquisition method

The Board's preliminary view

3.20 The Board has reached the preliminary view that 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.

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Question for respondents

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 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?

Section 4—Applying a book-value method

4.1 Section 2 discusses the Board's preliminary view that a **book-value method** should be applied to:

(a) all **business combinations under common control** that do not affect **non-controlling shareholders** of the **receiving company**—including combinations that affect potential shareholders or lenders or other creditors of the receiving company; and

(b) some business combinations under common control that affect non-controlling shareholders of a **privately held** receiving company in specified circumstances (see paragraph 2.47(b)).

4.2 This section discusses the Board's preliminary views on how a book-value method should be applied to such combinations.

4.3 IFRS Standards do not refer to any book-value methods and do not specify how such a method should be applied. As discussed in paragraph 1.6, a variety of book-value methods are used in practice. In particular, the variations relate to:

(a) measuring the assets and liabilities received—the receiving company uses either the **transferred company**'s book values or the **controlling party**'s book values to measure those assets and liabilities.[26]

(b) providing pre-combination information—the receiving company includes the transferred company's assets, liabilities, income and expenses in its financial statements:

(i) either prospectively from the date of the combination,[27] without restating pre-combination information; or

(ii) retrospectively from the beginning of the earliest period presented as if the receiving company and transferred company had always been combined, with pre-combination information restated.[28]

4.4 Paragraphs 4.6–4.65 discuss:

(a) input from stakeholders (paragraphs 4.6–4.9);

(b) how to measure the assets and liabilities received (paragraphs 4.10–4.19);

(c) how to measure the consideration paid (paragraphs 4.20–4.43);

(d) how to report any difference between the consideration paid and the book value of the assets and liabilities received (paragraphs 4.44–4.50);

(e) how to report transaction costs (paragraphs 4.51–4.56); and

(f) how to provide pre-combination information (paragraphs 4.57–4.65).

26 In some cases, the transferring company's book values are used.

27 The date on which control of a company (or business) is transferred to the receiving company.

28 In practice, retrospective restatement might apply only from the beginning of the reporting period or only from the date when the combining companies first came under common control by the controlling party.

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4.5 This section focuses on the key features of a book-value method. The Board will consider the comments received on this Discussion Paper in deciding whether to confirm its preliminary views and develop detailed proposals on how the receiving company should apply a book-value method. Such future detailed proposals might address, for example, how to determine the book values of the assets and liabilities received when those book values are not readily available.

Stakeholder input

4.6 Stakeholder views on *how* a receiving company should apply a book-value method are often linked to their views on *when* and *why* the receiving company should apply that method (summarised in paragraphs 2.6–2.13). Paragraphs 4.7–4.9 discuss how stakeholder views on those topics are interrelated.

View A—business combinations under common control are different from business combinations covered by IFRS 3

4.7 As discussed in paragraphs 2.7–2.9, some stakeholders argue that a book-value method should be applied to all business combinations under common control. They argue that all such combinations are different from **business combinations** covered by IFRS 3 *Business Combinations*. These stakeholders view business combinations under common control from the perspective of the controlling party, which controls all combining companies both before and after the combination. In their view, the controlling party simply moves its economic resources from one 'location' to another within the group. To reflect the controlling party's continuing control of the combining companies, these stakeholders typically advocate:

(a) measuring the assets and liabilities received using the controlling party's book values; and

(b) including the transferred company's assets, liabilities, income and expenses in the receiving company's financial statements retrospectively from the beginning of the earliest period presented as if the receiving company and transferred company had always been combined, with pre-combination information restated.

View B—business combinations under common control are similar to business combinations covered by IFRS 3

4.8 As discussed in paragraphs 2.10–2.11, some stakeholders argue that most, if not all, business combinations under common control are similar to business combinations covered by IFRS 3. These stakeholders view business combinations under common control from the perspective of the receiving company (rather than the perspective of the controlling party). However, they agree with using a book-value method in some cases for cost–benefit reasons and, in effect, view that method as a series of practical expedients that simplify the **acquisition method** and avoid, for example, the need to determine the fair value of assets and liabilities received. For these reasons, these stakeholders typically express the following views on how to apply a book-value method:

(a) measuring the assets and liabilities received:

(i) some favour using the transferred company's book values because that approach adopts the perspective of the combining companies rather than the controlling party's perspective.

(ii) others favour using the controlling party's book values because in some cases those values may be more up to date (see paragraph 4.11).

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(b) providing pre-combination information—they advocate including the transferred company's assets, liabilities, income and expenses in the receiving company's financial statements prospectively from the date of combination, which is consistent with the requirements in IFRS 3. Such a prospective approach does not restate pre-combination information.

View C—some business combinations under common control are similar to business combinations covered by IFRS 3 and others are not

4.9 As discussed in paragraphs 2.12–2.13, some stakeholders argue that business combinations under common control are not all similar to each other. In their view, some such combinations are similar to business combinations covered by IFRS 3 and other such combinations may not be similar. For the latter combinations, in their view, a book-value method should be used. These stakeholders express the following views on how to apply that method:

(a) measuring the assets and liabilities received:

(i) some favour using the transferred company's book values because such an approach treats the receiving company and the transferred company on the same basis and produces an outcome that is similar to **combined financial statements**.

(ii) others favour using the controlling party's book values, for cost–benefit reasons. They suggest that using those book values may simplify internal reporting within the group and hence reduce the cost of reporting.

(b) providing pre-combination information:

(i) some favour including the transferred company's assets, liabilities, income and expenses in the receiving company's financial statements retrospectively from the beginning of the earliest period presented, as if the receiving company and the transferred company had always been combined, with pre-combination information restated. In their view, this approach is consistent with the concept of combined financial statements (see paragraph 4.59) and provides useful information about the combined company.

(ii) others favour including the transferred company's assets, liabilities, income and expenses in the receiving company's financial statements prospectively from the date of the combination, without restating pre-combination information. They agree that pre-combination information for all combining companies could be useful. However, they argue that such information would be both subjective and costly to provide. In addition, they point out that such an approach would depict a combined company that in fact did not exist before the combination.

Measuring the assets and liabilities received

4.10 The Board considered whether the receiving company should measure the assets and liabilities received at the transferred company's book values or at the controlling party's book values.[29] Those book values would typically be identical if the controlling party has controlled the transferred company since the creation of that company. However, those book values could differ if, for example, the transferred company had previously been acquired from an external party (that is, a party outside the group), especially if that external acquisition was recent.

29 Regardless of the approach used, the book values of the assets and liabilities received might need to be adjusted to align them with the receiving company's accounting policies.

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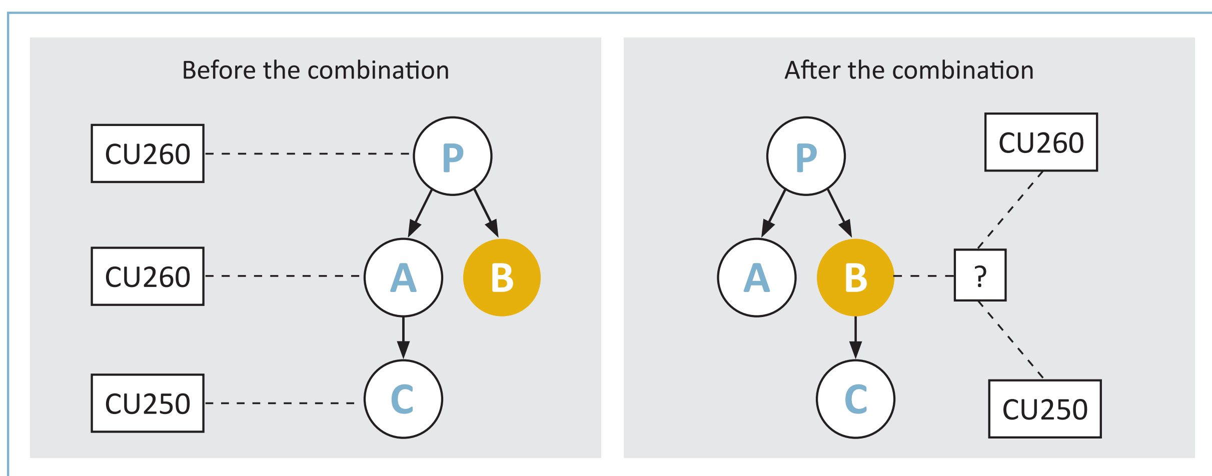
4.11 A difference between the transferred company's book values and the controlling party's book values is illustrated in the example in Diagram 4.1. In that example, Company P controls and wholly owns companies A, B and C. In the past, Company A acquired Company C from an external party. Applying the acquisition method, the assets and liabilities of Company C were measured at fair value at the acquisition date both by Company A, the immediate acquirer, and by Company P, the controlling party. Subsequently, Company C is transferred from Company A to Company B.[30] At the time of this business combination under common control, the book value of Company C's assets and liabilities in its financial statements is CU250,[31] and the book value of those assets and liabilities in both Company A's and Company P's consolidated financial statements is CU260.[32] The latter book value reflects a more recent valuation of Company C's assets and liabilities that was performed at the time when Company A acquired that company from the external party.

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



4.12 In the example in Diagram 4.1, using the controlling party's book values to measure the assets and liabilities received in the business combination under common control would:

(a) provide information based on a more recent valuation of the assets and liabilities of Company C, the transferred company. However, the controlling party's book values would typically not reflect the fair value of those assets and liabilities at the date of the business combination under common control, especially if the prior external acquisition occurred a long time ago.

(b) be, arguably, inconsistent with the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*) which focuses on information about transactions and events from the perspective of the company that prepares the financial statements—in this case, the receiving company.[33] From that perspective, the book values recorded by the controlling party, arguably, have no relation to the combination between Company B, the receiving company, and Company C, the transferred company, because the controlling party is not a party to that combination.

30 In describing business combinations under common control, IFRS 3 requires that common control is not transitory. As discussed in paragraph 1.16, the Board has not yet considered whether to retain the notion of 'transitory control' and whether to clarify its meaning.

31 In this Discussion Paper, monetary amounts are denominated in 'currency units' (CU).

32 The amounts of CU250 and CU260 are both aggregate net amounts that comprise: (a) the total book value of the assets; minus (b) the total book value of the liabilities.

33 Paragraph 3.8 of the *Conceptual Framework*.

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(c) treat the assets and liabilities of the combining companies, Company B and Company C, on a different basis. That is, following the combination, the assets and liabilities of Company B, the receiving company, would continue to be measured at the book values reported by that company whereas the assets and liabilities of Company C, the transferred company, would be measured at the book values reported by the controlling party. Such an approach means that different information would be provided about the assets and liabilities of the combining companies, depending on how the combination is structured (that is, depending on whether Company C is transferred to Company B or vice versa).

4.13 In contrast, using the transferred company's book values to measure the assets and liabilities received in the business combination under common control would:

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

(b) present the combination from the perspective of the combining companies, Company B and Company C, rather than from the perspective of the controlling party; and

(c) treat the assets and liabilities of the combining companies, Company B and Company C, on the same basis. That is, following the combination, each company's assets and liabilities would continue to be measured at the book values previously reported by that company. Such an approach would provide similar information about the assets and liabilities of the combining companies, irrespective of how the combination is structured (that is, irrespective of whether Company C is transferred to Company B or vice versa).

4.14 The Board considers that using the transferred company's book values, rather than the controlling party's book values, would be more consistent with the Board's reasons for requiring or permitting a book-value method in specified circumstances. Specifically, as discussed in paragraphs 2.24–2.27 and illustrated in Diagrams 2.3 and 2.4, using a book-value method for business combinations under common control that do not affect non-controlling shareholders would:

(a) provide useful information to potential shareholders of the combining companies because the information produced by that method does not depend on how the combination is legally structured; and

(b) avoid the difficulties that would arise if the acquisition method was applied because a book-value method does not rely on identifying the 'acquirer' in order to provide useful information.

4.15 Extending this logic to *how* a book-value method should be applied suggests that the assets and liabilities of each combining company should be treated on the same basis. That is, each company's assets and liabilities should continue to be measured at the book values previously reported by that company—instead of using different approaches for measuring the assets and liabilities of the combining companies depending on how the combination is legally structured.

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4.16 The Board also considered the other arguments summarised in paragraphs 4.12–4.13 for using the transferred company's book values or the controlling party's book values. The Board acknowledged that, in principle, both information about more recent valuations (discussed in paragraph 4.12(a)) and uninterrupted historical information for analysing trends (discussed in paragraph 4.13(a)) could be useful to users of financial statements. However, the Board's view is that from a conceptual standpoint, using the transferred company's book values is more appropriate than using the controlling party's book values because the controlling party is not a party to the combination of the receiving company with the transferred company.

4.17 From a practical perspective, the Board noted that whether the transferred company's book values or the controlling party's book values are less costly to use would depend on the facts and circumstances of each combination. For example, one factor that would affect the costs of applying a book-value method is whether the transferred company or the controlling party has prepared its financial statements applying IFRS Standards.

4.18 On the basis of the above analysis, the Board has reached the preliminary view that using the transferred company's book values would be likely to provide the most useful information to users of the receiving company's financial statements at a cost justified by the benefits of that information.

Applying a book-value method

The Board's preliminary view

4.19 The Board has reached the 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.

Measuring the consideration paid

4.20 The consideration paid in a business combination under common control can take various forms. Research for this project indicates that the consideration is usually paid in cash or in the receiving company's own **shares**, but sometimes in non-cash assets or by incurring or assuming liabilities.

4.21 That research also indicates that when a book-value method is applied in practice, the consideration paid is measured either at fair value or at book value or, in the case of the consideration paid in own shares, at their par value or a nominal value. Accordingly, the Board considered how the receiving company should measure the consideration paid:

(a) in own shares (paragraphs 4.25–4.28);

(b) in assets (paragraphs 4.29–4.36); and

(c) by incurring or assuming liabilities (paragraphs 4.37–4.42).

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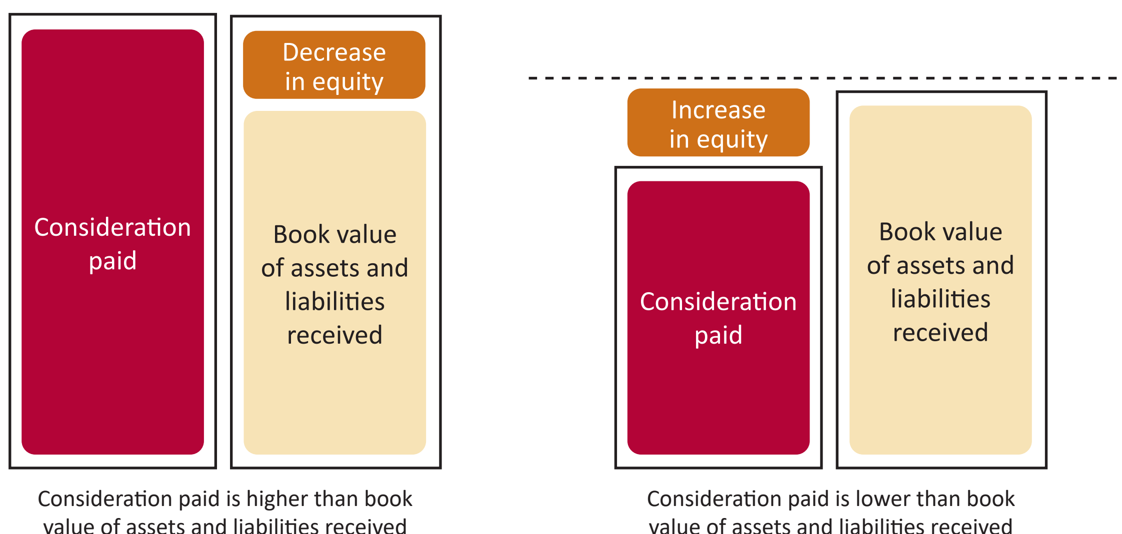
4.22 As discussed in paragraph 3.5, the acquisition method generally measures both the consideration paid and the identifiable acquired assets and liabilities at fair value. Any difference between the fair value of the consideration and the fair value of those assets and liabilities is recognised as goodwill or, in unusual cases, as a gain on a bargain purchase. As also discussed in that paragraph, the acquisition method measures goodwill at an amount that is expected to reflect the fair value of the pre-existing goodwill in the acquired **business** and the price paid for any synergies expected from the combination (see Diagram 3.1 for the illustration of the key features of the acquisition method).

4.23 However, as discussed in paragraphs 4.10–4.19, a book-value method measures the assets and liabilities received at their book values rather than their fair values. In addition, book-value methods applied to business combinations under common control in practice typically do not recognise goodwill or a gain. Instead, any difference between the consideration paid and the book value of the assets and liabilities received is typically recognised as a decrease or an increase within the receiving company's equity and, as discussed in paragraphs 4.44–4.50, the Board concurs with such an approach. Accordingly, the reasons for requiring fair value measurement of the consideration paid when applying the acquisition method do not apply to a book-value method.

4.24 The interaction between the key features of a book-value method, discussed in paragraph 4.23, is illustrated in Diagram 4.2.

Diagram 4.2—The key features of a book-value method



Consideration paid in own shares

4.25 The Board considered whether it should specify how the receiving company should measure the consideration paid in its own shares—for example, at their fair value or at their par value or a nominal value.

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4.26 As explained in paragraph 4.23, there is an interaction between the question of how to measure the consideration paid and the question of how to report any difference between that consideration and the book value of the assets and liabilities received. In the Board's view, discussed in paragraphs 4.44–4.50, that difference should be recognised within equity. If that difference is recognised within equity, the measurement of the consideration paid in own shares would not affect the receiving company's assets, liabilities, income or expenses or its total equity, but could affect the amounts reported for particular components of the receiving company's equity.

4.27 The potential effects on the receiving company's financial statements of the measurement of the consideration paid in the receiving company's own shares are shown in Diagram 4.3. Continuing with the example presented in Diagram 4.1, Company B, the receiving company, issues 100 shares in consideration for Company C, the transferred company. Par value of Company B's shares is CU2 per share and their fair value at the combination date is CU2.7 per share. The book value of Company C's assets and liabilities in its financial statements at the combination date is CU250. The measurement approach for the consideration paid by issuing Company B's own shares could affect the amounts reported for particular components of Company B's equity, as illustrated in Diagram 4.3.

Diagram 4.3—Measuring consideration paid in own shares

(all amounts are in CU)	Issued shares at par value	Issued shares at fair value
Company B's equity		
Issued shares	200	270
Difference between the consideration paid and the book value of the assets and liabilities received	50	(20)
Net increase in equity	**250**	**250**

4.28 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. For those reasons, the Board has reached a preliminary view that it should not prescribe how to measure the consideration paid in the receiving company's own shares.

Consideration paid in assets

4.29 The Board next considered how the receiving company should measure the consideration paid in assets—at the fair value of those assets or at their book value in the receiving company's financial statements at the date of combination. If the consideration is paid in cash, its fair value would also be its book value so both measurement approaches would produce the same outcome. However, if the consideration is paid in assets other than cash, the measurement of the consideration would affect whether the receiving company recognises a gain or loss on disposal of those assets in the statement of profit or loss, as follows:

(a) if the consideration paid is measured at the book value of those assets, no gain or loss would be recognised.

(b) if the consideration paid is measured at the fair value of those assets, the receiving company would recognise a gain or loss on disposal of those assets if their book values differ from their fair values.

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4.30 In addition, the measurement of the consideration paid in assets could affect the amounts reported for particular components of the receiving company's equity, just as occurs when the consideration is paid in the receiving company's own shares (as discussed in paragraph 4.27).

4.31 The potential effects on the receiving company's financial statements of measuring the consideration paid in assets other than cash at the fair value or at the book value of those assets are illustrated in Diagram 4.4. Continuing with the example presented in Diagram 4.1, Company B, the receiving company, transfers non-cash assets in consideration for Company C, the transferred company. The book value of those assets in Company B's financial statements at the combination date is CU220 and their fair value is CU270. The book value of Company C's assets and liabilities in its financial statements at the combination date is CU250. Depending on how the consideration paid by transferring non-cash assets is measured, Company B would or would not report a gain on disposal of those assets in the statement of profit or loss. In addition, the amounts reported for particular components of Company B's equity could also vary.

Diagram 4.4—Measuring the consideration paid in assets

(all amounts are in CU)	Assets transferred at book value	Assets transferred at fair value
Company B's statement of profit or loss		
Gain on disposal	–	50
Company B's equity		
Retained earnings or other appropriate component of equity	–	50
Difference between the consideration paid and the book value of the assets and liabilities received	30	(20)
Net effect on equity	**30**	**30**

4.32 As explained in paragraph 4.28, the Board does not generally prescribe the reporting of components within a reporting company's equity because this matter is often affected by national requirements and regulations. However, because the measurement of the consideration paid in assets other than cash would affect the amounts recognised in the receiving company's statement of profit or loss, the Board considered whether this form of consideration should be measured at the fair value of those assets or at their book value.

4.33 It could be argued that measuring the consideration paid in assets at the book value of those assets rather than at their fair value would result in different accounting outcomes depending on the structure of the transaction. For example, if the receiving company first sells the assets at their fair value, and then uses the cash proceeds as the consideration in the business combination under common control, it recognises a gain or loss on disposal of those assets in the statement of profit or loss. Alternatively, if the receiving company uses those assets as the consideration in the combination and measures the consideration at the book value of those assets, it will not recognise a gain or loss on disposal. This argument suggests that the consideration paid in assets should be measured at the fair value of those assets, which would result in similar information about the disposal of the assets, regardless of how that disposal occurred.

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4.34 However, measuring the consideration paid in assets at their fair values could be costly and could involve significant measurement uncertainty. In contrast, such challenges would not arise if the assets are sold for cash and those cash proceeds are used as the consideration paid in the combination. It could also be argued that measuring the consideration paid in assets at their book values, rather than at their fair values, would be more consistent with measuring the assets and liabilities received at their book values. Such an approach would, arguably, be more appropriate if a business combination under common control is viewed as a single transaction—an exchange of the consideration for the business—rather than two separate transactions—a disposal of assets and an acquisition of a business.

4.35 Furthermore, information about the gain or loss on disposal may be of limited use to users of the receiving company's financial statements in business combinations under common control to which a book-value method would be applied. Under the Board's preliminary views set out in Section 2, such combinations would typically affect lenders and other creditors of the receiving company. As explained in paragraph 2.32(b), lenders and other creditors need information about the receiving company's cash flows and debt commitments, so they can assess the company's ability to service its existing debt and to raise new debt. That assessment would not depend greatly on information about a gain or loss on disposal of an asset.

4.36 Having considered the arguments discussed in paragraphs 4.33–4.35, the Board has reached the view that the benefits of measuring the consideration paid in assets at the fair value of those assets may not outweigh the costs of doing so. Therefore, the Board has reached the preliminary view that the receiving company should measure the consideration paid in assets at the receiving company's book values of those assets at the combination date.

Consideration paid by incurring or assuming liabilities

4.37 Finally, the Board considered how the receiving company should measure the consideration paid by incurring a liability to the **transferring company** or by assuming a liability of the transferring company to another party.

4.38 This form of consideration paid—and the related liability—could be measured at:

(a) the fair value of the liability at the combination date; or

(b) the amount determined on initial recognition of the liability at the combination date applying IFRS Standards.

4.39 The Board considered the potential effects of those measurement approaches on the receiving company's financial statements. The measurement approach would affect:

(a) the initial measurement of the liability; and

(b) the amount recognised within the receiving company's equity for any difference between the consideration paid and the book value of the assets and liabilities received.

4.40 However, in some cases, for example for financial liabilities, the applicable IFRS Standard would require measuring the liability on initial recognition at fair value. In those cases, both measurement approaches would produce the same outcome.

4.41 Except for the effects discussed in paragraphs 4.39–4.40, the measurement approach for the consideration paid by incurring or assuming a liability would not have any other effects on the receiving company's financial statements at the combination date. Moreover, as stated in paragraphs 4.28 and 4.36, the Board has reached preliminary views that would not require the receiving company to measure other forms of consideration paid at fair value when applying a book-value method.

4.42 Accordingly, the Board has not identified convincing reasons to require the consideration paid by incurring or assuming liabilities to always be measured at fair value. Instead, the Board has reached a preliminary view that such consideration should be measured at the amount determined on initial recognition of the liability at the combination date applying IFRS Standards. As stated in paragraph 4.40, in some cases the applicable IFRS Standard would require measuring the liability at fair value.

Applying a book-value method

The Board's preliminary views

4.43 The Board's preliminary views are that:

(a) the Board should not prescribe how the receiving company should measure the consideration paid in 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.

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

4.44 As discussed in paragraph 4.23, research for this project indicates that, in practice, when applying a book-value method, any difference between the consideration paid and the book value of the assets and liabilities received in a business combination under common control is typically recognised within the receiving company's equity.

4.45 The Board considered whether it should require that approach or a different approach. Under IFRS Standards, changes in equity arise from one of two sources—from transactions with owners in their capacity as owners (such as a contribution of equity or a distribution of dividends to shareholders) or as a result of the company's financial performance for the period. Economically, not all of the difference that may arise when applying a book-value method necessarily constitutes a contribution to, or distribution from, the receiving company's equity, nor does all of it necessarily represent income or an expense. Instead, that difference may include one or more of the following components:

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(a) any difference between the consideration paid and what would have been paid to an unrelated party in an arm's length transaction. As discussed in paragraph 3.6, such a difference constitutes a contribution to or a distribution from the receiving company's equity.

(b) unrecognised goodwill, comprising the pre-existing goodwill in the transferred company and any synergies arising as a result of the combination. Applying a book-value method, such goodwill is not recognised because (among other reasons) the consideration paid in some business combinations under common control may not approximate the fair value of the acquired business together with the price for the expected synergies (see paragraphs 2.28–2.29). Accordingly, recognising goodwill in those circumstances might result in measuring goodwill at an arbitrary amount that does not provide useful information.

(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 (discussed in paragraphs 4.20–4.43).

4.46 An approach that requires the difference described in paragraph 4.45 to be segregated into components could be costly and complex to apply. For example, determining whether any of that difference relates to differences between the book values and fair values of the assets and liabilities received would require the receiving company to determine those fair values. Moreover, as discussed in paragraphs 3.11–3.12, the Board has reached the view that a requirement to identify and measure components within the difference between the consideration paid and the fair value of the identifiable acquired assets and liabilities applying the acquisition method would be difficult, if not impossible, to apply in practice—those challenges would also arise if the Board were to require the receiving company to segregate the difference arising applying a book-value method into components. Finally, segregating that difference into components and recognising those components separately would, in effect, remove the differences between a book-value method and the acquisition method. Such an outcome would negate the Board's preliminary view, discussed in Section 2, that a book-value method should be applied to particular business combinations under common control.

4.47 Accordingly, the Board has reached the view that the receiving company should not be required to segregate into components any such difference arising when applying a book-value method. The Board has also reached the view that recognising that difference in the receiving company's equity is more appropriate than recognising it as an asset, liability, income or expense. The Board's reasons include that, in accordance with the Board's preliminary views set out in Section 2, a book-value method would be applied to business combinations under common control which might not be subject to any regulations applicable to related party transactions (see paragraphs 2.28–2.29) and which might therefore include a contribution to or distribution from the receiving company's equity (see paragraph 4.45(a)).

4.48 The Board next considered whether it should prescribe within which component of equity a receiving company should present any difference arising when applying a book-value method. In practice, locations for presenting this difference include:

(a) reserves, for example, a special reserve (such as 'reorganisation reserve') or in general reserves;

(b) retained earnings or a similar component of equity; or

(c) share premium, additional paid-in-capital or a similar component of equity.

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4.49 As discussed in paragraph 4.28, IFRS Standards generally do not prescribe within which component of equity particular amounts should be presented. Often, the presentation of components of equity depends on national laws, regulations or other requirements in particular jurisdictions. Accordingly, the Board has reached the preliminary view that it should not prescribe within which component of equity the receiving company should present any difference between the consideration paid and the book value of the assets and liabilities received.

Applying a book-value method

The Board's preliminary views

4.50 The Board's preliminary views are 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.

Reporting transaction costs

4.51 In undertaking business combinations under common control, companies might incur transaction costs, such as advisory, legal, accounting, valuation and other professional fees and the costs of issuing shares or debt instruments.

4.52 In developing its preliminary view on how such transaction costs should be treated under a book-value method, the Board considered:

(a) the requirements of IFRS 3 and the rationale for those requirements; and

(b) reporting practices applying a book-value method.

4.53 Under the acquisition method, transaction costs are recognised as expenses in the statement of profit or loss in the period in which they are incurred, with one exception. That exception is for the costs of issuing shares or debt instruments, which are accounted for in accordance with the applicable IFRS Standards.[34]

4.54 In developing IFRS 3, the Board concluded that transaction costs incurred to effect a business combination are not part of the exchange between the buyer and the seller of the business. Rather, they are separate transactions in which the buyer pays for services received. Accordingly, the costs of those services received and consumed during the period should be recognised as expenses (except for costs to issue shares or debt instruments).[35] In practice, book-value methods typically use the same approach for transaction costs.

4.55 The Board has identified no reason for a book-value method to treat transaction costs differently from the approach required by IFRS 3. The approach required by IFRS 3 is also generally used in practice when applying a book-value method.

34 IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments.*

35 Paragraphs BC365–BC370 of the Basis for Conclusions to IFRS 3.

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The Board's preliminary view

4.56 The Board has reached the 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.

Providing pre-combination information

4.57 As discussed in paragraph 4.3, in some cases when applying a book-value method, companies combine the assets, liabilities, income and expenses of the transferred company retrospectively. In other words, 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 from the beginning of the earliest period presented. In other cases, companies combine those items prospectively, that is, from the date of the combination, as is required for business combinations covered by IFRS 3. The prospective approach does not require the receiving company to restate pre-combination information.

4.58 As discussed in paragraphs 4.14–4.15, in developing its preliminary views on how a book-value method should be applied, the Board considered the reasons for its preliminary view on when a book-value method should be applied to business combinations under common control. Specifically, as discussed in paragraphs 2.24–2.27 and illustrated in Diagrams 2.3 and 2.4, using a book-value method for business combinations under common control that do not affect non-controlling shareholders would:

(a) provide useful information to potential shareholders of the combining companies because the information produced by that method does not depend on how the combination is legally structured; and

(b) avoid the difficulties that would arise if the acquisition method was applied because a book-value method does not rely on identifying the 'acquirer' in order to provide useful information.

4.59 Extending this logic to *how* a book-value method should be applied in relation to pre-combination information suggests that pre-combination information should be prepared in a way that does not depend on how the combination is legally structured. That is, the receiving company should combine the transferred company's assets, liabilities, income and expenses retrospectively, so the receiving company's financial statements are prepared as if the combining companies had always been combined. Such an approach would result in the same information being provided, regardless of how the combination is legally structured. Also, such an approach would be similar to the concept of combined financial statements discussed in the *Conceptual Framework*, which implies a retrospective approach.[36]

36 Paragraph 3.12 of the *Conceptual Framework*.

4.60 However, in discussing this issue, many users of financial statements and other stakeholders did not agree with using a retrospective approach in the primary financial statements. As explained in paragraph 4.9(b)(ii), although they agreed that pre-combination information for all combining companies could be useful, they expressed a view that such a retrospective approach would provide a picture of a group in a period when that group did not exist. Some stakeholders call such information 'pro forma' (or hypothetical) information and consider it inappropriate to include such information in primary financial statements. Some stakeholders also expressed concerns that preparing such information may involve significant judgement and uncertainty. Finally, some stakeholders pointed out that historical information about each of the combining companies would typically be required by capital market regulations if the combination is undertaken in preparation for an initial public offering.

4.61 From a practical perspective, the Board noted that the retrospective approach would be more costly to apply than a prospective approach. Furthermore, the two approaches would provide different information only in the financial statements for the period in which the combination occurs (including when presenting comparative information) and in the financial statements for the following period (only when presenting comparative information). The differences between the approaches would not cause differences in the financial statements for later periods.

4.62 After considering the stakeholder input and analysis summarised in paragraphs 4.57–4.61, the Board has reached the view that the benefits of information provided by a retrospective approach may be limited and may not outweigh the costs of providing that information. Accordingly, the Board has reached the preliminary view that the receiving company should combine the transferred company's assets, liabilities, income and expenses prospectively from the combination date. (However, that preliminary view would not preclude requiring the receiving company to disclose pre-combination information in the notes to its financial statements. That issue is discussed in paragraphs 5.23–5.25.)

4.63 The Board next considered whether it should provide application guidance on identifying the receiving company for accounting purposes or whether the legal structure of the transaction should determine this in all cases. This question arises because a prospective approach provides pre-combination information for the receiving company only. For example, Diagram 2.4 in Section 2 illustrates a combination of two wholly-owned subsidiaries in preparation for an initial public offering. Because the combination could be structured in various ways, the question is whether only the legal structure of the transaction should always determine which company is the receiving company for accounting purposes. An alternative approach might be to develop application guidance on identifying which company is the receiving company for accounting purposes. As explained in paragraph 2.27, IFRS 3 already provides application guidance on identifying the acquirer for accounting purposes when applying the acquisition method, such as in reverse acquisitions. However, as explained in paragraph 2.27, that guidance may not help with identifying which company is the receiving company in the circumstances when a book-value method would be applied.

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4.64 As discussed in paragraph 4.58(b), one of the Board's reasons for its preliminary view that a book-value method should be applied to business combinations under common control that do not affect non-controlling shareholders is the difficulty of identifying the acquirer in a way that would provide useful information (see paragraphs 2.26–2.27). A similar difficulty would be likely to arise if the Board were to require companies to look beyond the legal structure of the combination when applying a book-value method and to consider other facts and circumstances to identify the receiving company for accounting purposes. Also, when using a book-value method, identifying the receiving company does not affect the recognition and measurement of the assets, liabilities, income and expenses at the combination date or subsequently—as explained in paragraph 4.61, only pre-combination information is affected. Accordingly, in the Board's view, the costs of requiring companies to look beyond the legal structure of the combination to identify the receiving company when applying a book-value method are likely to outweigh the benefits of the information provided by such an approach. Hence, the Board has reached the view that it should not develop application guidance on identifying the receiving company when applying a book-value method that considers factors other than the legal structure of the transaction.

Applying a book-value method

The Board's preliminary view

4.65 The Board has reached the 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.

Questions for respondents

Applying a book-value method

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?

Applying a book-value method

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?

Applying a book-value method

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?

Applying a book-value method

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?

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Applying a book-value method

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?

Section 5—Disclosure requirements

5.1 This section discusses what information the Board should require **receiving companies** to disclose in the notes about **business combinations under common control** to improve the transparency of reporting these combinations. In practice, companies often provide little information, particularly when applying a **book-value method**.

5.2 When developing its preliminary views on disclosure, the Board considered:

(a) its preliminary views on when and how the **acquisition method** and a book-value method should apply to business combinations under common control;

(b) the disclosure requirements in IFRS 3 *Business Combinations*, together with possible improvements to those requirements, as discussed in the Board's Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* (IFRS 3 Discussion Paper);[37] and

(c) the fact that business combinations under common control are related party transactions, which means that in some cases the terms of such combinations might differ from those of an arm's length transaction.

5.3 Paragraphs 5.5–5.28 discuss:

(a) disclosure when applying the acquisition method (paragraphs 5.5–5.12); and

(b) disclosure when applying a book-value method (paragraphs 5.13–5.28).

5.4 The Board's discussion on disclosure is necessarily preliminary, because:

(a) decisions on disclosure in the context of a particular method are linked to decisions about when and how that method applies, and the Board's preliminary views expressed in Sections 2–4 might change after considering feedback on this Discussion Paper;

(b) the Board's preliminary views set out in its IFRS 3 Discussion Paper might change after it considers feedback on that Discussion Paper; and

(c) the Board has not yet fully developed the book-value method it would require.

Disclosure when applying the acquisition method

5.5 Section 2 discusses the Board's preliminary view that the acquisition method should be applied to business combinations under common control that affect **non-controlling shareholders** of the **receiving company** (with an exemption and an exception, as set out in paragraph 2.47). One of the Board's reasons for its preliminary view is that business combinations under common control that affect non-controlling shareholders of the receiving company are similar to **business combinations** covered by IFRS 3. Furthermore, the composition of users of the receiving company's financial statements is similar in both cases. Hence, as discussed in paragraph 2.22, the common information needs of those users in such business combinations are also similar. Therefore, the Board's preliminary view is that, in principle, the disclosure requirements in IFRS 3, together with possible improvements to those requirements set out in the IFRS 3 Discussion Paper, should also apply to business combinations under common control when the acquisition method is used.

37 This Discussion Paper was published in March 2020 and is open for comments until 31 December 2020.

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5.6 Requiring the same disclosures about those business combinations under common control as are required for business combinations covered by IFRS 3 would be consistent with the practice of some companies that apply the disclosure requirements in IFRS 3 to business combinations under common control reported using the acquisition method.

5.7 In addition to developing its overall approach to establishing disclosure requirements for these combinations, the Board considered each of the disclosure requirements in IFRS 3 and each possible improvement to those requirements discussed in the IFRS 3 Discussion Paper. The Board has found no reason to exclude any of those requirements or any of those improvements for business combinations under common control when the acquisition method is used.

5.8 The Board also considered whether additional information should be required for those combinations. In particular, a feature of business combinations under common control is that such combinations may not be priced at arm's length, because they involve **related parties**. Therefore, as discussed in paragraph 3.3, the amount of the consideration paid might differ from the amount that would have been paid to an unrelated party in an arm's length transaction. Hence, the Board considered whether it should require additional disclosure about the terms of these combinations to help users of the financial statements understand how the amount of the consideration paid was determined and whether it was reasonable (see paragraph 3.15).

5.9 The Board's preliminary views on possible improvements to the IFRS 3 disclosure requirements discussed in the IFRS 3 Discussion Paper would help address the issue discussed in paragraph 5.8. These possible improvements include the disclosure of additional information to help users of the financial statements assess whether the price paid in a business combination was reasonable, such as information about expected synergies.[38] The Board considers that such information would also be useful to users of the receiving company's financial statements in a business combination under common control reported applying the acquisition method.

5.10 Furthermore, IAS 24 *Related Party Disclosures* applies to business combinations under common control. In particular, that Standard requires the disclosure of information about the nature of the related party relationship, the amount of the consideration paid and any outstanding balances.[39] IAS 24 also states that disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such terms can be substantiated.

5.11 The Board considered whether those requirements in IAS 24 are sufficient to require the receiving company to provide users of its financial statements with the information they need about the terms of a business combination under common control. The Board noted that those requirements would need to be applied together with the requirements in IFRS 3 (including any improved requirements resulting from the IFRS 3 Discussion Paper) when disclosing information about business combinations under common control, for example, information about the terms of those combinations. The Board has reached the preliminary view that it should provide application guidance to help companies apply those disclosure requirements to such combinations. For example, that guidance could explain that companies should disclose information about the governance process over the terms of the combination, such as whether those terms were supported by an independent appraisal or were subject to an approval process involving shareholders or the governing body of the receiving company.

38 See Section 2 of the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* (IFRS 3 Discussion Paper) for more information (for example, paragraphs 2.53–2.68).

39 Paragraph 18 of IAS 24.

Disclosure requirements

The Board's preliminary views

5.12 The Board's preliminary views are 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 those combinations, particularly information about the terms of the combination.

Disclosure when applying a book-value method

5.13 Section 2 discusses the Board's preliminary views that a book-value method should apply to all business combinations under common control that do not affect non-controlling shareholders of the receiving company, and some combinations that affect such shareholders in specified circumstances (see paragraphs 2.34 and 2.47). The Board has reached the view that those combinations may not be similar to business combinations covered by IFRS 3 (see paragraphs 2.24–2.29). For example, those combinations involve no change in ultimate **ownership interests** in the economic resources transferred in the combination. Furthermore, if there are no non-controlling shareholders in the receiving company, the composition of users that rely on the receiving company's financial statements for their information needs is also different from business combinations covered by IFRS 3. Specifically, those users only include potential shareholders and existing and potential lenders and other creditors. As a result, the common information needs of those users in such business combinations under common control may also differ from user information needs in business combinations covered by IFRS 3. In addition, the cost–benefit considerations may also be different in those cases.

5.14 Section 4 discusses the Board's preliminary views on how a book-value method should be applied to business combinations under common control, in particular, how to measure the assets and liabilities received and the consideration paid, and what pre-combination information should be provided.

5.15 The matters discussed in Sections 2 and 4 affect what information the Board should require companies to disclose about those business combinations under common control to which a book-value method would be applied. Specifically, those matters affect the nature and extent of the information necessary to meet common user information needs, as well as whether the benefits of disclosing particular information outweigh the associated costs.

5.16 In identifying possible disclosure requirements for such combinations when a book-value method applies, the Board considered the disclosure requirements in IFRS 3 as a starting point. However, in the Board's view, because of the differences in both common user information needs and the cost–benefit trade-off, as well as the differences between how a book-value method and the acquisition method would be applied, only some of the disclosure requirements in IFRS 3 would be appropriate when a book-value method applies.

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5.17 The Board has reached the preliminary view that the requirement in IFRS 3 for companies to provide information to help users of financial statements evaluate the nature and financial effect of the combination is appropriate for business combinations under common control.[40] The Board has also reached the preliminary view that the related possible requirement discussed in the IFRS 3 Discussion Paper, for companies to provide information to help users understand the benefits expected from the combination, is also appropriate for these combinations.

5.18 However, the specific information needed to meet these requirements might differ from the information needed for business combinations covered by IFRS 3. For example, the benefits expected from the combination might include synergies and other benefits for the **controlling party** and the group it controls. Information about those other benefits might be necessary for users of the receiving company's financial statements to understand the nature and effect of the combination.

5.19 The Board has also reached the preliminary view that when a book-value method is used, companies should be required to disclose:

(a) the name and a description of the **transferred company**, the combination date, the percentage of voting equity interests transferred to the receiving company, the primary reasons for the combination and a description of how the receiving company obtained control (paragraphs B64(a)–(d) of IFRS 3);

(b) the recognised amounts of each major class of assets received and liabilities assumed, including information about recognised amounts of liabilities arising from financing activities and defined benefit pension liabilities (paragraph B64(i) of IFRS 3 and the related preliminary view discussed in the IFRS 3 Discussion Paper);

(c) the carrying amount of any non-controlling interest in the transferred company (paragraph B64(o) of IFRS 3);

(d) aggregate information for individually immaterial combinations that are material collectively (paragraph B65 of IFRS 3);

(e) information about combinations that occur after the end of the reporting period but before the financial statements are authorised for issue (paragraph B66 of IFRS 3);

(f) the amount and an explanation of any gain or loss recognised in the current reporting period that relates to assets and liabilities received in a business combination under common control that occurred in the current or previous reporting period, if such disclosure is relevant to understanding the receiving company's financial statements (paragraph B67(e) of IFRS 3); and

(g) whatever additional information is necessary to meet the disclosure requirements discussed in paragraph 5.17 (paragraph 63 of IFRS 3).

5.20 However, in the Board's preliminary view, other disclosures required by IFRS 3 should not be required for business combinations under common control to which a book-value method is applied. For example, the Board's view is that it should not require disclosure of the combination-date fair value of the consideration transferred, such as the fair value of non-monetary assets transferred (paragraph B64(f) of IFRS 3). The Board's preliminary views on measuring the consideration transferred when applying a book-value method would not require fair value measurement (see paragraphs 4.20–4.43) and, in the Board's view, the costs of disclosing such information would outweigh the benefits.

40 Paragraph 59 of IFRS 3.

5.21 Table 5.1 summarises those disclosure requirements set out in IFRS 3 (including possible improvements to those requirements discussed in the IFRS 3 Discussion Paper) which, in the Board's preliminary view, should not be required for business combinations under common control to which a book-value method applies. Table 5.1 also notes the main reason for the Board's view on each requirement (although more than one reason applies in some cases).

Table 5.1—IFRS 3 disclosures that should not be required when a book-value method is applied

Main reason for the Board's preliminary view	Disclosure requirement
These combinations may not be similar to combinations covered by IFRS 3	Strategic rationale, management's objectives for the acquisition and subsequent performance of the acquisition (preliminary view discussed in the IFRS 3 Discussion Paper relating to paragraph B64(d) of IFRS 3)
	Description, timing and estimated amount of expected synergies (preliminary view discussed in the IFRS 3 Discussion Paper relating to paragraph B64(e) of IFRS 3)
The book-value method differs from the acquisition method	Description of factors that make up acquired goodwill and reconciliation of its carrying amount at the beginning and at the end of the reporting period (paragraphs B64(e) and B67(d) of IFRS 3)
	Description and estimate of financial effects of contingent liabilities recognised (paragraphs B64(j) and B67(c) of IFRS 3)
	Amount of gain recognised in a bargain purchase (paragraph B64(n) of IFRS 3)
The costs of providing the information outweigh the benefits	Fair value of the consideration transferred and of each major class of consideration at the acquisition date (paragraph B64(f) of IFRS 3)
	Fair value and gross contractual amount of acquired receivables (paragraph B64(h) of IFRS 3)
	Amount of goodwill deductible for tax purposes (paragraph B64(k) of IFRS 3)
	Pro forma information for the current period as though the acquisition had occurred at the beginning of the annual reporting period (paragraph B64(q) of IFRS 3 and the related preliminary view discussed in the IFRS 3 Discussion Paper)
The Board has not yet discussed all aspects of a book-value method and the disclosure relates to a matter not yet considered	Amount at the acquisition date (and subsequent changes in that amount) and description of contingent consideration and indemnification assets (paragraphs B64(g) and B67(b) of IFRS 3)
	Description and amount recognised for separate transactions (paragraphs B64(l) and B64(m) of IFRS 3)
	Fair value of the equity interest in the acquiree in a business combination achieved in stages (paragraph B64(p) of IFRS 3)
	Information to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods (paragraphs 61, 62 and B67(a) of IFRS 3)

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5.22 In addition to considering the disclosure requirements in IFRS 3 and the possible improvements to those requirements, the Board considered whether it should specify any other disclosure requirements for business combinations under common control when a book-value method applies.

5.23 In particular, the Board considered whether it should require disclosure of pre-combination information. Section 4 explains that the Board reached the preliminary view that the assets, liabilities, income and expenses of the transferred company should be combined with those of the receiving company prospectively, from the combination date, without restating pre-combination information. However, that preliminary view would not preclude requiring the receiving company to disclose pre-combination information in the notes to its financial statements.

5.24 For example, the Board could require a complete set of pre-combination information for all the combining companies, such as a full or condensed set of **combined financial statements**. Alternatively, the Board could require limited pre-combination information, such as the revenue and profit or loss of the combined company for the current reporting period, as if the combination had occurred at the beginning of the reporting period (as required by paragraph B64(q)(ii) of IFRS 3). (The IFRS 3 Discussion Paper discusses possible improvements to this requirement, such as adding a requirement to disclose cash flows from operating activities.)

5.25 In considering whether it should require disclosure of pre-combination information, the Board noted feedback from users of financial statements that such information could be useful, for example, in performing trend analysis. However, some stakeholders (including preparers of financial statements) argued that this information is costly to prepare, for example, when it would be necessary to align accounting policies of the combining companies retrospectively rather than prospectively. On balance, in the Board's view, the benefits of the disclosure of pre-combination information in the circumstances when a book-value method is applied would not outweigh the costs of doing so. Accordingly, the Board has reached the preliminary view that it should not require the disclosure of pre-combination information.

5.26 The Board next considered its preliminary view, as discussed in paragraphs 4.44–4.50, that when a book-value method applies:

(a) any difference between the amount of the consideration paid and the book value of the assets and liabilities received should be recognised within the receiving company's equity; and

(b) the Board would not prescribe the component, or components, of equity within which that difference should be presented.

5.27 In the Board's view, information about that difference would be useful to users of the receiving company's financial statements. Accordingly, the Board has reached the preliminary view that the receiving company should disclose the amount recognised in equity for any difference between the consideration paid and the book value of the assets and liabilities received, together with the component, or components, of equity that includes this difference.

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Disclosure requirements

The Board's preliminary views

5.28 The Board's preliminary views are 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.

Questions for respondents

Disclosure requirements

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?

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Disclosure requirements

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?

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Appendix A—Terms used in this Discussion Paper

In general, this Discussion Paper uses simple, non-technical language (as discussed in the Introduction). However, the following terms are used in this Discussion Paper with meanings specified in this appendix.

acquisition method	The method required in IFRS 3 *Business Combinations* to account for business combinations within the scope of that Standard.
book-value method	A method in which a receiving company measures assets and liabilities received in a business combination under common control using the book values (carrying amounts) of those assets and liabilities determined by applying IFRS Standards. A variety of book-value methods are used in practice and various labels are used for those methods, including the predecessor method, the pooling (or uniting) of interests method or merger accounting. This Discussion Paper uses the term 'book-value method' as a collective term for all these methods.
business	An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating income from ordinary activities.[41]
business combination	A transaction or other event in which an acquirer obtains control of one or more businesses. Business combinations are sometimes called mergers or acquisitions.[42]
business combination under common control	A business combination in which all of the combining companies or businesses are ultimately controlled by the same party, both before and after the combination.[43] For simplicity, this Discussion Paper uses this term to refer to all transactions within the scope of the project (as described in paragraphs 1.12–1.16), irrespective of whether those transactions meet the definition of a business combination in IFRS 3.
combined financial statements	The financial statements of a reporting entity that comprises two or more entities that are not all linked by a parent-subsidiary relationship.[44] The *IFRS for SMEs®* Standard describes an approach to preparing combined financial statements (for example, intercompany transactions and balances are eliminated).[45]

41 Appendix A of IFRS 3.

42 Appendix A of IFRS 3.

43 Paragraphs B1–B4 of IFRS 3.

44 Paragraph 3.12 of the *Conceptual Framework*.

45 Paragraph 9.29 of the *IFRS for SMEs* Standard.

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controlling party The party or parties that control all of the combining companies both before and after a business combination under common control. IFRS 3 explains that in these combinations, the controlling party could be a company, an individual or, in specified circumstances, a group of individuals.[46] For simplicity, this Discussion Paper uses examples of business combinations under common control in which the controlling party is a company, rather than an individual or a group of individuals. For example, in Diagram 1.1, the controlling party is Company P.

In some combinations, there may exist more than one party that controls all of the combining companies both before and after the combination. For example, if Company P in Diagram 1.1 was controlled by another party—say Company U—then both companies U and P would be a 'controlling party' because both companies would control companies A, B and C. In this case, Company U would be the ultimate controlling party.

non-controlling shareholders Shareholders other than the controlling party (sometimes called minority shareholders). For example, in Diagram 2.2, if 70% of shares in Company B, the receiving company, are held by the controlling party and the other 30% of its shares are held by other parties, those other parties are non-controlling shareholders in Company B.

For simplicity, this Discussion Paper uses the term 'shareholders' to refer to all holders of the company's equity instruments, as defined in IAS 32 *Financial Instruments: Presentation*, and the term 'shares' to refer to all those equity instruments (also see the definition of the term 'shares').

ownership interest An economic interest held in a company by its shareholders. This Discussion Paper uses the term 'ownership interest' broadly to refer not only to the shareholders' legal interest in the company's shares, but also to their economic interest in the economic resources of that company and of its subsidiaries.

privately held Shares that are not traded in a public market or a company whose shares are not traded in a public market.

public market A domestic or foreign stock exchange or an over-the-counter market, including local and regional markets.[47]

publicly traded Shares that are traded in a public market or a company whose shares are traded in a public market.

related party A related party as defined in IAS 24 *Related Party Disclosures*.[48]

receiving company The company to which control of a company (or business) is transferred in a business combination under common control. For example, in Diagram 1.1, Company B is the receiving company. The term 'receiving company' refers not only to the immediate receiving company but also to those parent companies (if any) of that immediate receiving company that did not control the transferred company before the combination.

46 Paragraphs B2 and B3 of IFRS 3.

47 Paragraph 4(a)(ii) of IFRS 10 *Consolidated Financial Statements*, paragraph 2(b)(i) of IFRS 8 *Operating Segments* and paragraph 2(b)(i) of IAS 33 *Earnings per Share*.

48 Paragraph 9 of IAS 24.

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shares Equity instruments, as defined in IAS 32, issued by the receiving company. For simplicity, this Discussion Paper focuses on receiving companies with simple capital structures, comprising only ordinary shares that meet the definition of an equity instrument and simple debt instruments that meet the definition of a liability. In the next phase of the project, the Board will consider the implications of more complex instruments.

transferred company The company (or business) that is transferred from one company to another in a business combination under common control. For example, in Diagram 1.1, Company C is the transferred company.

transferring company The company that loses control of one or more companies (or businesses) in a business combination under common control. For example, in Diagram 1.1, Company A is the transferring company. The term 'transferring company' refers not only to the immediate transferring company, but also to those parent companies (if any) of that immediate transferring company that also lose control of the transferred company as a result of the combination.

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Appendix B—Scope of the project

B.1 Paragraphs 1.10–1.23 of Section 1 discuss the scope of the project. This appendix elaborates on:

(a) which transactions are within the project's scope (paragraphs B.2–B.12);

(b) which company's reporting of those transactions is considered in the project (paragraphs B.13–B.15); and

(c) in which types of financial statements those transactions are reported (paragraphs B.16–B.18).

Which transactions are within the project's scope?

B.2 Paragraph 1.13 explains that the project is not considering reporting requirements for transactions involving companies under common control that do not involve the transfer of a **business**, for example, transfers of assets. Examples 1 and 2 illustrate transactions that are outside the scope of the project.

B.3 Paragraphs 1.15–1.16 explain the Board's preliminary view that it should develop proposals for reporting by the **receiving company** of all transfers of a business under common control, irrespective of whether 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

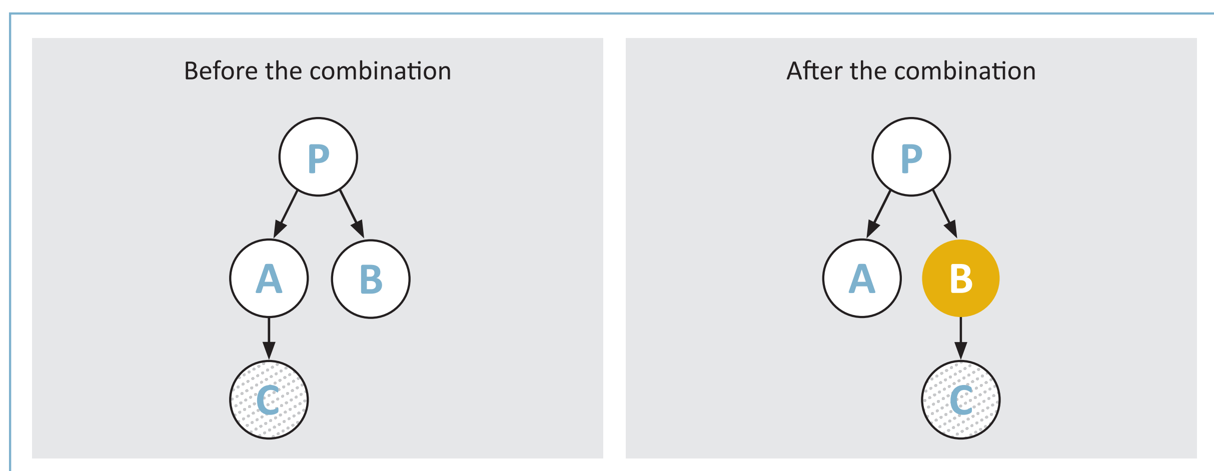
(b) is conditional on a sale of the combining companies to an external party, such as in an initial public offering.

B.4 Examples 3 and 4 illustrate transactions that are within the project's scope.

Example 1—A transfer of a company that does not have a business

B.5 In Example 1, control of Company C is transferred from Company A to Company B. All three companies are ultimately controlled by Company P. However, Company C does not have a business—it has no business activities and its only asset is vacant land.

Diagram B.1—A transfer of a company that does not have a business



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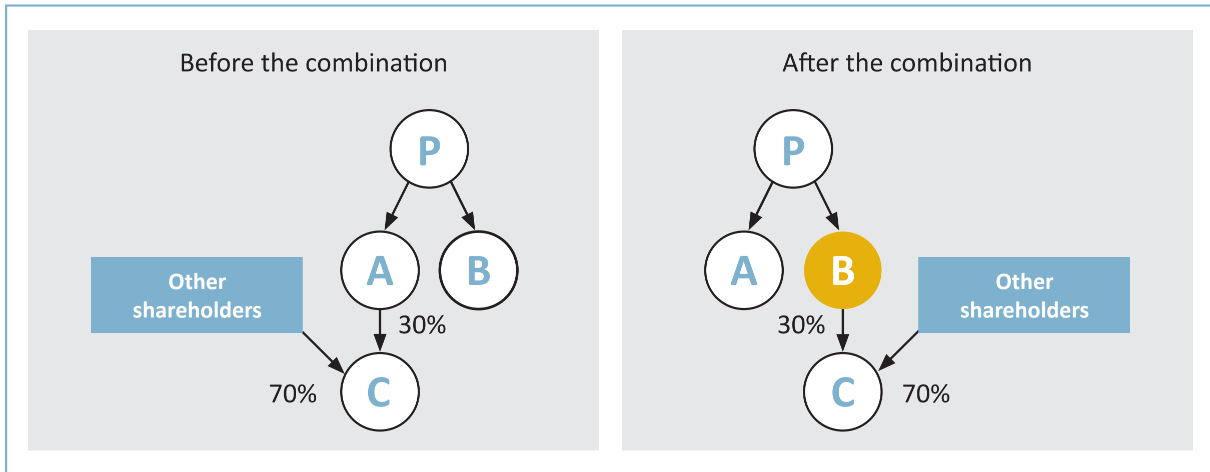
B.6 In this transaction, the transfer of Company C to Company B results in Company B receiving an asset, not a business. Therefore, this transaction is outside the scope of the project.

Example 2—A transfer of an associate

B.7 In Example 2, Company A has an investment in an associate, Company C. Company A transfers its investment in Company C to Company B. Companies A and B are controlled by Company P.

Diagram B.2—A transfer of an associate

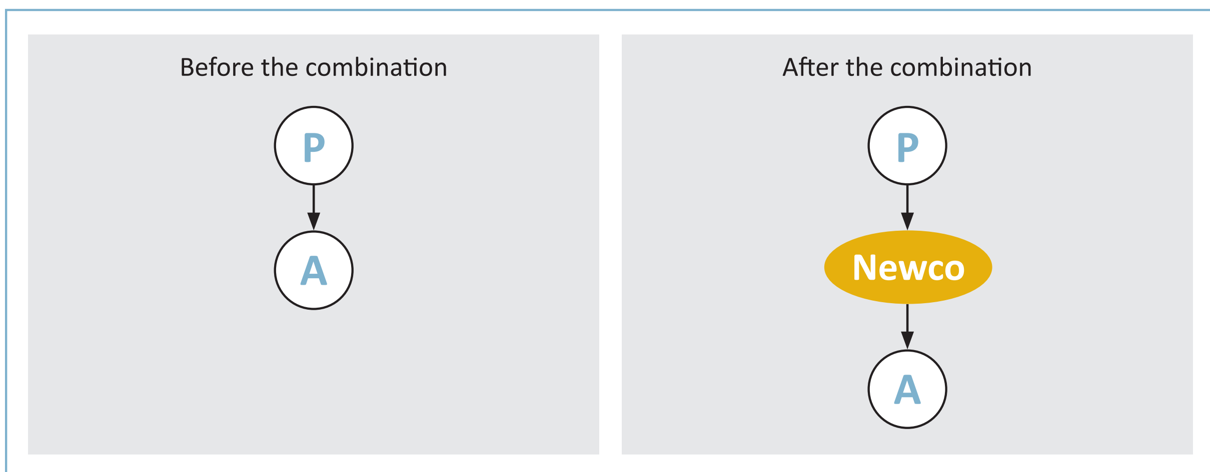


B.8 In this transaction, Company B receives an asset—an investment in an associate, Company C—not a business. Therefore, this transaction is outside the scope of the project.

Example 3—A transfer of a business that may not meet the definition of a business combination

B.9 In Example 3, Company A is controlled by Company P. Company P forms a new company, Newco, and transfers control of Company A to Newco.

Diagram B.3—A transfer of a business that may not meet the definition of a business combination



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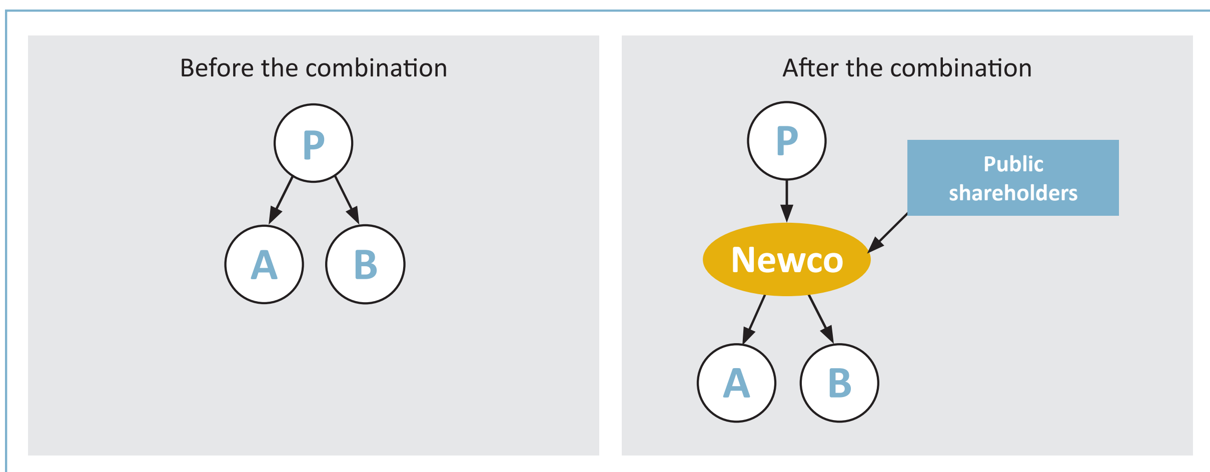
B.10 IFRS 3 *Business Combinations* defines a **business combination** as a transaction or other event in which an acquirer obtains control of one or more businesses.[49] Paragraph B18 of IFRS 3 limits the circumstances when a new company formed to effect a business combination can be identified as the acquirer. If Newco cannot be identified as the acquirer in the 'combination' of Newco and Company A, the only other possible 'acquirer' in that 'combination' would be Company A—that is, the transaction would be viewed as Company A acquiring Newco (rather than the other way around). However, because Newco is a newly established company, it could be just a legal shell that does not have a business. If Newco does not have a business, the transaction would not meet the definition of a business combination. Nevertheless, the transaction involves a transfer of a business, Company A, under common control. Therefore, applying the Board's preliminary view, the transaction is within the scope of the project.

Example 4—A combination that is conditional on an external sale in an initial public offering

B.11 In Example 4, companies A and B are controlled by Company P. In preparation for an initial public offering, Company P forms a new company, Newco. Control of Companies A and B is transferred to Newco, but that transfer is conditional on the success of the initial public offering of **shares** in Newco. If that offer is successful, Company P will lose control of Newco, Company A and Company B.

Diagram B.4—A combination that is conditional on an external sale in an initial public offering



B.12 In this situation, questions might arise about whether Company P's control of Newco is 'transitory' and, therefore, whether the combination of Newco with companies A and B is a **business combination under common control** as described in IFRS 3. Nevertheless, applying the Board's preliminary view, the combination is within the scope of the project.

49 Appendix A of IFRS 3.

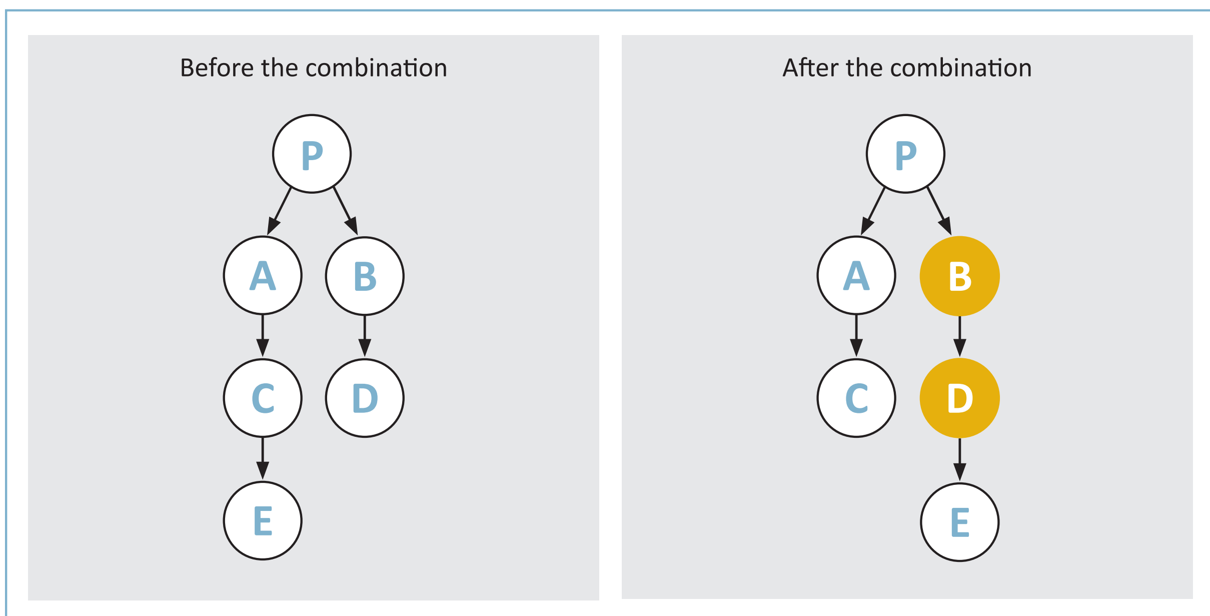
Which company's reporting?

B.13 Paragraphs 1.17–1.19 explain that the project is considering possible reporting requirements for a receiving company in a business combination under common control. However, the term 'receiving company' refers not only to the immediate receiving company in the combination. It also refers to those parent companies (if any) of that immediate receiving company that did not control the **transferred company** before the combination. Example 5 illustrates a business combination under common control in which there is more than one receiving company.

Example 5—A combination with more than one receiving company

B.14 In Example 5, companies A, B, C, D and E are all ultimately controlled by Company P. Control of Company E is transferred from Company C to Company D. After the combination, Company E's immediate parent is Company D, whose immediate parent is Company B.

Diagram B.5—A combination with more than one receiving company



B.15 Companies B and D are both receiving companies in the combination because the combination resulted in both companies gaining control of Company E—Company D now controls Company E as its immediate parent, and Company B now controls Company E through its control of Company D. Accordingly, possible reporting requirements explored by the Board in this project would apply to both companies B and D. They would not apply to any of the other companies.

Which types of financial statements?

B.16 Paragraphs 1.20–1.23 explain which types of financial statements prepared by the receiving company would be subject to possible reporting requirements explored by the Board in this project.

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B.17 Specifically, for the transfer of a company, those possible reporting requirements:

(a) would apply to the receiving company's consolidated financial statements.

(b) would *not* apply to the receiving company's separate financial statements. As discussed in paragraph 1.23, the project is not addressing how the receiving company should report in its separate financial statements an investment in a subsidiary received in a business combination under common control.

B.18 Furthermore, if the combination involves the transfer of an unincorporated business, those possible reporting requirements would apply as follows:

(a) if the receiving company has subsidiaries, those requirements would apply to both consolidated and separate financial statements of the receiving company.

(b) if the receiving company does not have any subsidiaries, but has an investment in an associate or a joint venture, those requirements would apply to both individual and separate financial statements of the receiving company.

(c) if the receiving company does not have any subsidiaries, associates or joint ventures, those requirements would apply to the individual financial statements of the receiving company.[50]

50 Separate financial statements are those that report a company's investments in subsidiaries, joint ventures and associates at cost or by applying one of the other methods permitted by IAS 27 *Separate Financial Statements*. The term 'individual financial statements' is sometimes used to refer to the financial statements of a company with no subsidiaries.

Appendix C—Measuring distributions from equity

C.1 Section 3 sets out the Board's preliminary view that 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**.

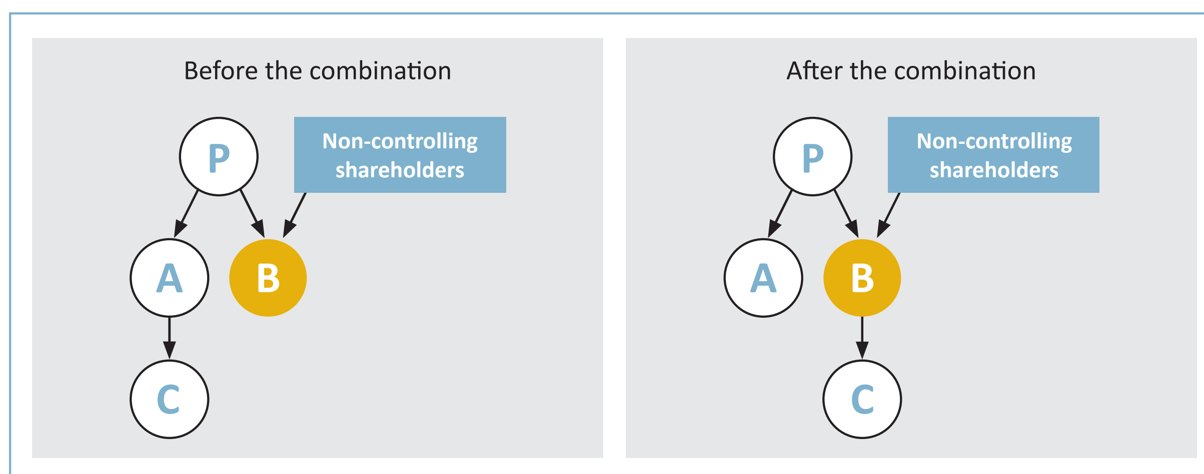
C.2 If the Board were, nevertheless, to require the receiving company to identify and recognise a distribution, it would need to consider how the receiving company should measure that distribution. This appendix discusses two possible approaches:

(a) measuring a distribution as the excess of the fair value of the consideration transferred over the fair value of the acquired **business** (the fair-value-based approach) (paragraphs C.6–C.8); and

(b) measuring a distribution by applying the requirements on testing goodwill for impairment in IAS 36 *Impairment of Assets* (the impairment-based approach) (paragraphs C.9–C.10).

C.3 This Appendix uses a simple example of a business combination under common control illustrated in Diagram C.1 to explain how those possible approaches would apply.

Diagram C.1—A business combination under common control



C.4 In the example in Diagram C.1, control of Company C is transferred from Company A to Company B. Suppose that:

(a) the fair value of Company C's identifiable assets and liabilities is CU90;[51]

(b) the fair value of Company C's business is CU100; and

(c) the fair value of the consideration paid by Company B is CU130 (see Diagram C.2).

51 The amount of CU90 is an aggregate net amount that comprises: (a) the total fair value of the assets; minus (b) the total fair value of the liabilities.

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C.5 Applying the acquisition method, the receiving company, Company B, will measure goodwill as a residual amount—the excess of the fair value of the consideration paid over the fair value of the identifiable acquired assets and liabilities.[52] In this example, this residual amount is CU40 (CU130 minus CU90). If the consideration paid of CU130 includes a distribution from equity, a requirement to measure that distribution would entail finding a way to divide the excess consideration of CU40 between that distribution and goodwill. Paragraphs C.6–C.10 outline two possible approaches considered by the Board. Paragraph C.11 includes a diagram that summarises these two approaches.

The fair-value-based approach

C.6 The fair-value-based approach would require the receiving company, Company B, to measure:

(a) a distribution from equity as the excess of the fair value of the consideration paid (CU130) over the fair value of the acquired business (CU100). That excess is CU30 in the example in Diagram C.1; and

(b) goodwill at the excess of the fair value of the acquired business (CU100) over the fair value of the identifiable acquired assets and liabilities (CU90). That excess is CU10 in the example in Diagram C.1.

C.7 As discussed in paragraph 3.5, in a **business combination** between unrelated parties, goodwill reflects both:

(a) the fair value of the pre-existing goodwill in the acquired business; and

(b) the price paid for any synergies expected from the combination.

C.8 In contrast, the fair-value-based approach would limit the initial measurement of goodwill to the first element—the fair value of the pre-existing goodwill in the acquired business. The receiving company would therefore, in effect, include the price paid for any synergies expected from the combination in measuring the distribution from equity, not in measuring goodwill. Accordingly, this approach would understate goodwill and overstate the distribution from equity if the consideration paid includes a price paid for expected synergies (see Diagram C.2). Also, this approach would typically involve significant measurement uncertainty and be costly to apply, because it would require the receiving company to measure the fair value of the acquired business.

52 Paragraph C.5 summarises requirements explained more precisely in paragraph 32 of IFRS 3.

The impairment-based approach

C.9 The impairment-based approach would build on the requirements in IAS 36 on testing goodwill for impairment. Hence, unlike the fair-value-based approach, this approach would not introduce a new type of measurement or require the receiving company to measure the fair value of the acquired business. Instead, it would use the goodwill impairment test as a means of allocating the excess consideration paid in a business combination under common control over the fair value of the identifiable acquired assets and liabilities (CU40 in the example in Diagram C.1) between goodwill and a distribution from equity. The impairment-based approach would require the receiving company, Company B, to:

(a) apply the goodwill impairment test at the combination date;

(b) measure goodwill at the recoverable amount calculated in the impairment test; and

(c) treat any excess goodwill over that recoverable amount as a distribution from equity rather than as an impairment loss.

C.10 However, this approach might not allow the receiving company to identify appropriately which portion of the consideration paid is a distribution from equity rather than goodwill. This portion is difficult to identify because the goodwill impairment test requires allocating goodwill to cash-generating units and does not measure the recoverable amount of goodwill directly.[53] If the recoverable amount of the cash-generating unit containing an allocation of goodwill exceeds the book value of that unit, no impairment loss and no distribution from equity would be identified and recognised, even if goodwill is in fact not recoverable (see Diagram C.2).

Summary of the two approaches

C.11 Diagram C.2 illustrates how the fair-value-based approach and the impairment-based approach would work in theory. It assumes that:

(a) the consideration paid is higher than the consideration that would have been paid in an arm's length transaction between unrelated parties;

(b) the fair value of the acquired business can be estimated without significant measurement uncertainty; and

(c) the goodwill impairment test is able to measure the excess of the consideration paid over the sum of (i) the fair value of the acquired business, and (ii) the price that would have been paid for expected synergies in an arm's length transaction between unrelated parties.

53 In the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*, the Board expressed the preliminary view that significantly improving the effectiveness of the impairment test for goodwill at a reasonable cost is not feasible.

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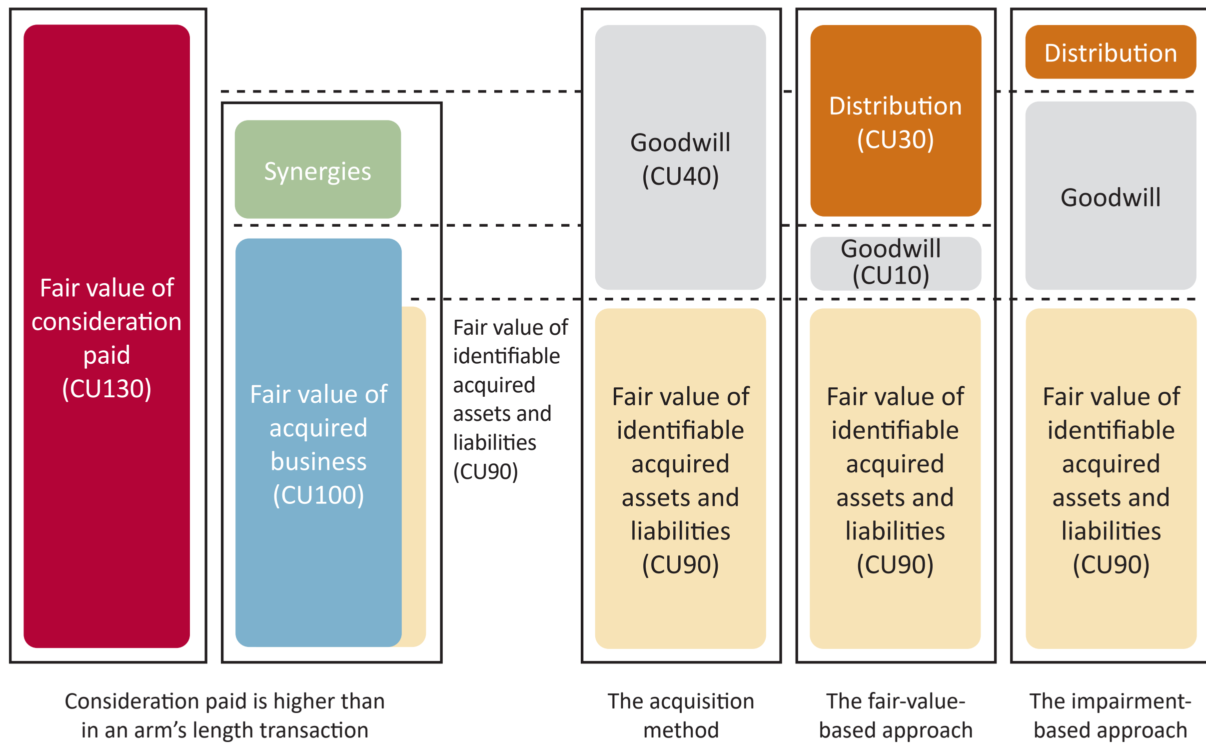
Diagram C.2—Possible approaches to measuring a distribution from equity



C.12 As discussed in Section 3, the Board has reached the preliminary view that 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. The Board did not discuss which, if any, of the two approaches discussed in paragraphs C.6–C.10 it should propose if it were to require companies to recognise a distribution from equity.

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November 2020

IFRS® Standards
Discussion Paper

Snapshot

Business Combinations under Common Control

This Snapshot provides an overview of the Discussion Paper *Business Combinations under Common Control* published by the International Accounting Standards Board (Board).

The Board's objective:	To explore possible reporting requirements for business combinations under common control that would reduce diversity in practice, improve transparency in reporting these combinations and provide users of financial statements with better information.
Project stage:	The Board has published a Discussion Paper that sets out its preliminary views. The Board is seeking comments on: • the selection of the measurement method; • how to apply each measurement method; and • the disclosure of information about these combinations.
Next steps:	The Board will consider the comments received on the Discussion Paper before deciding whether to develop an exposure draft containing proposals to implement any or all of its preliminary views.
Comment deadline:	1 September 2021

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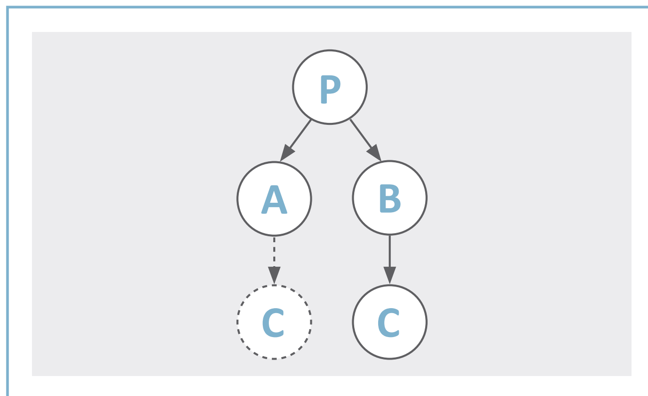
Why is the Board undertaking this project?

What are business combinations under common control?

Business combinations under common control are mergers and acquisitions involving companies within the same group. Diagram 1 shows a simple example of a business combination under common control. Companies A, B and C are all controlled by the same party, Company P. Company C is transferred from Company A to Company B.

Diagram 1—A business combination under common control



What problem is the project trying to solve?

IFRS 3 *Business Combinations* sets out reporting requirements for business combinations and requires the use of the acquisition method. However, no IFRS Standard specifically applies to business combinations under common control.

As a result of this gap in IFRS Standards, companies report these combinations in different ways. In some cases, they use the acquisition method. That method measures the assets and liabilities received in the combination at fair value and recognises goodwill. In other cases, companies use a book-value method. That method measures those assets and liabilities at their existing book values. There is a variety of book-value methods used in practice. Furthermore, companies often provide little information about these combinations.

What has the Board heard?

Diversity in practice makes it difficult for investors to understand the effects of these transactions and to compare companies that undertake them.

These combinations are common in many countries around the world, particularly in emerging economies.

Developing reporting requirements for these combinations should be a priority. Listed companies and those preparing for listing are a particular concern.

The project is considering whether and when the acquisition method and a book-value method should be used for business combinations under common control to provide users of financial statements with better information about these combinations.

What is the scope of the project?

The project focuses on filling the gap in IFRS Standards.

Which transactions?

The project is considering transfers of businesses under common control. In Diagram 2, Company C is a business, and its transfer is therefore within the scope of the project. The project is not considering transfers of assets under common control or transfers of companies that do not have a business.

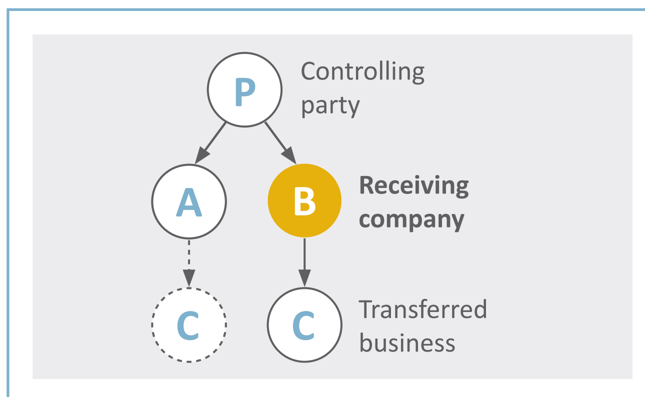
Which company?

The project is considering reporting by the receiving company. In Diagram 2, the receiving company is Company B. The project is not considering reporting by other parties affected by the transaction.

Which financial statements?

The possible reporting requirements explored in the project will typically affect the receiving company's consolidated financial statements only.

Diagram 2—Illustrating the scope of the project



The possible reporting requirements explored in this project would apply, for example, to receiving companies that are listed on a stock exchange and to those preparing for listing.

Users of financial statements

This project focuses on the information needs of users of the receiving company's financial statements who must rely on that company's financial statements for much of the information they need. Such users are the receiving company's existing non-controlling shareholders, potential shareholders, and its lenders and other creditors.

The project does not seek to address the controlling party's information needs. In Diagram 2, the controlling party is Company P. The controlling party controls the receiving company and, therefore, can direct that company to provide the information the controlling party needs. It does not need to rely on the receiving company's financial statements for that information.

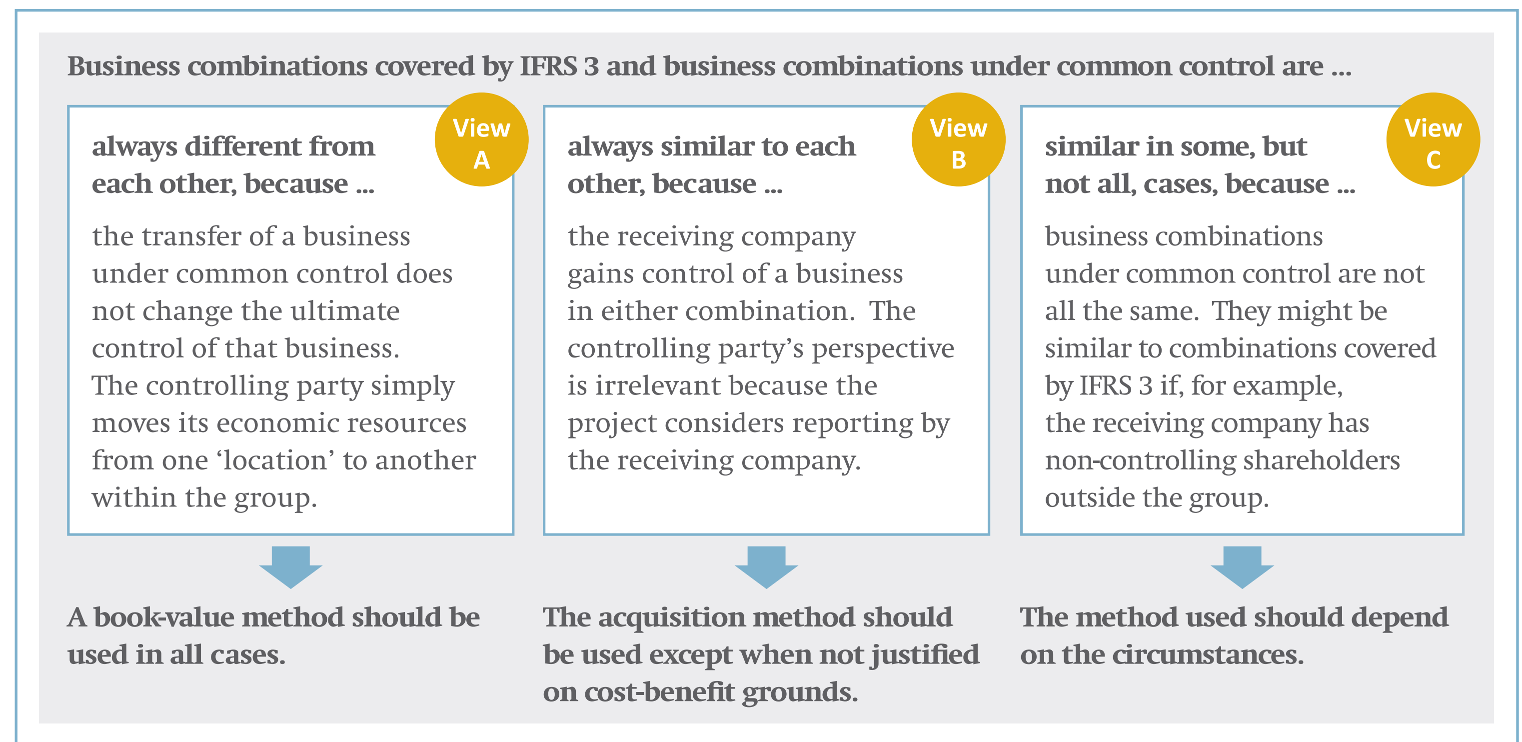
When to apply each method—introduction

How did the Board reach its preliminary views?

The Board considered:

- whether and when business combinations under common control are similar to business combinations covered by IFRS 3;
- what information would be useful to investors and other users of the receiving company's financial statements;
- the trade-off between the costs and the benefits of providing particular information; and
- whether particular approaches would be complex, or could create opportunities to structure transactions to achieve a particular accounting outcome.

What has the Board heard?



The Board's view is that one size does not fit all—for some business combinations under common control, the acquisition method should be used, and for the others a book-value method should be used.

When to apply each method—outside shareholders

Combinations that affect non-controlling shareholders

Diagrams 3 and 4 illustrate a business combination and a business combination under common control that affect non-controlling shareholders of the receiving company. In both scenarios, Company B gains control of Company C. As a result, non-controlling shareholders acquire an ownership interest in the economic resources transferred in the combination in both scenarios. From the point of view of both the receiving company and those shareholders, the transactions are similar.

The users of the receiving company's financial statements are also similar in both scenarios and comprise its existing non-controlling shareholders, potential shareholders, and its lenders and other creditors. Because both the combinations are similar and the users of the financial statements are similar, the users' information needs about these combinations are similar too.

The Board's view is that the acquisition method should be used for combinations that affect non-controlling shareholders, subject to the cost-benefit trade-off.

Diagram 3—Non-controlling shareholders: Combination covered by IFRS 3

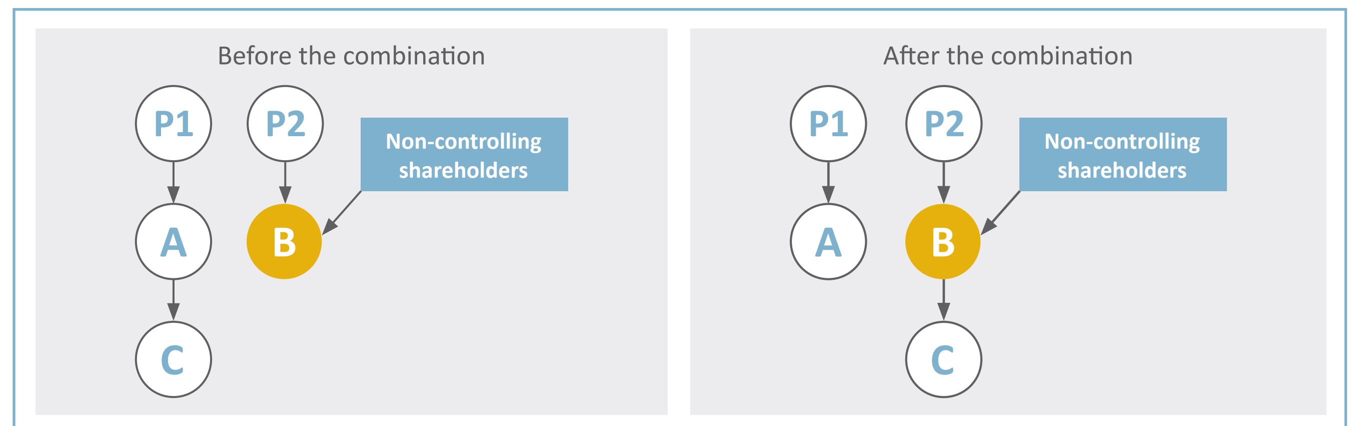
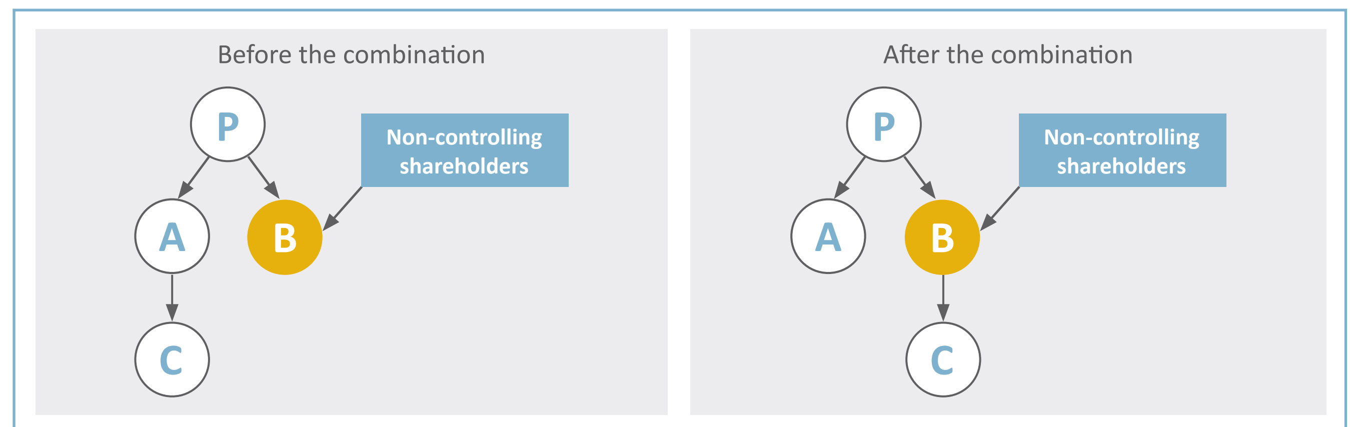


Diagram 4—Non-controlling shareholders: Common control



When to apply each method—costs and benefits

What has the Board heard?

The acquisition method should be applied only if the ownership interest of non-controlling shareholders is 'substantive'.

The costs of applying the acquisition method might not be justified when those shareholders have only a 'small' ownership interest.

If all of the receiving company's shareholders are its related parties, the costs of applying the acquisition method might not be justified.

Opportunities to structure transactions to achieve a particular accounting outcome might arise if the acquisition method is required for *all* combinations that affect non-controlling shareholders.

Receiving company's shares are publicly traded

The Board's view is that the costs of applying the acquisition method would be justified for publicly traded companies. Typically, listing requirements or capital market regulations would:

- prevent the listing of a 'small' number of shares; and
- limit how many shares can be held by the company's related parties.

Therefore, the Board's view is that publicly traded receiving companies should be required to apply the acquisition method.

Receiving company's shares are privately held

The Board's view is that the costs of applying the acquisition method might not always be justified for privately held companies and is therefore suggesting special conditions for such companies, namely:

An optional exemption—a privately held receiving company would be *permitted* to use a book-value method if it has informed all of its non-controlling shareholders that it proposes to use that method and they have not objected.

A related-party exception—a privately held receiving company would be *required* to use a book-value method if all non-controlling shareholders are related parties of the company.

The Board is not suggesting that the related-party exception to or the optional exemption from the acquisition method should apply to publicly traded companies. However, the Board is seeking feedback about whether (and, if so, how) the exception or the exemption should also apply to such companies.

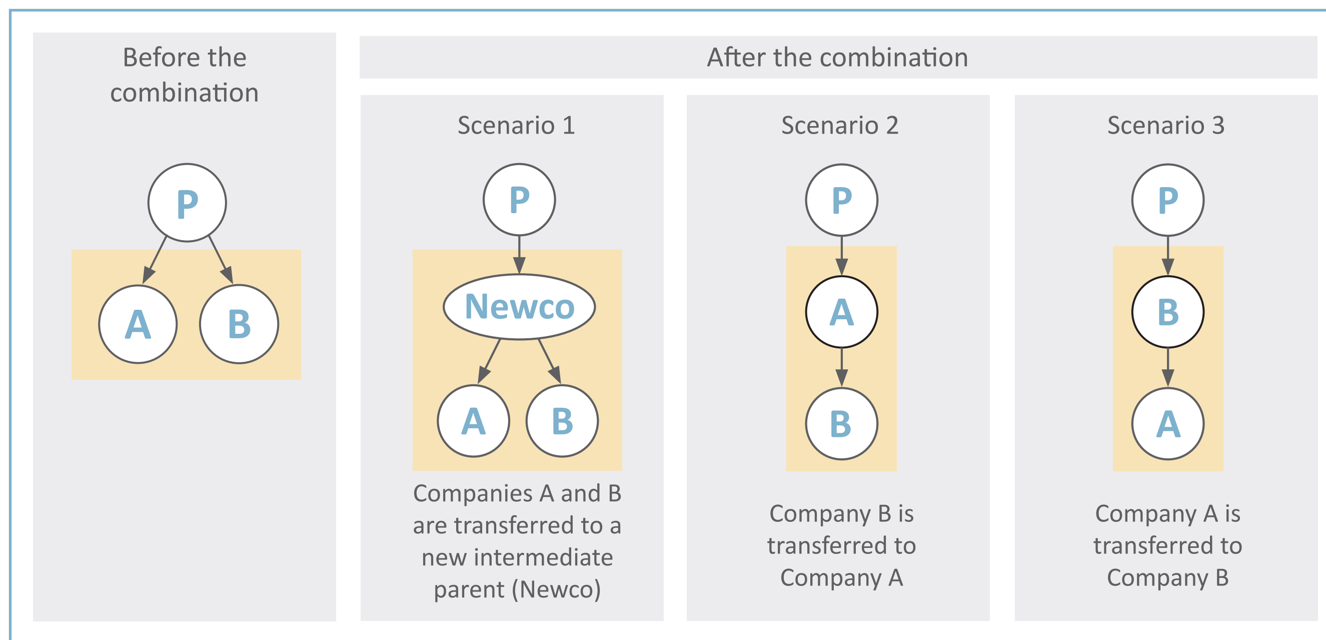
When to apply each method—no outside shareholders

Combinations that do not affect non-controlling shareholders

In Diagram 5, the controlling party, Company P, decides to restructure its wholly-owned subsidiaries, companies A and B, in preparation for an initial public offering. It could undertake that restructuring in various ways. However, in all scenarios potential shareholders would be investing in the same economic resources, as indicated by the shaded area in Diagram 5.

A book-value method would provide useful information about these combinations to potential shareholders of the combining companies, because the information produced by that method does not depend on how the combination is structured. A book-value method would also avoid the difficulties that could arise if the acquisition method was applied to combinations that do not affect non-controlling shareholders. For example, it would avoid the need to decide which company is the 'economic' acquirer. That decision is fundamental in applying the acquisition method but could be difficult to make for combinations illustrated in Diagram 5.

Diagram 5—Group restructuring in preparation for an initial public offering



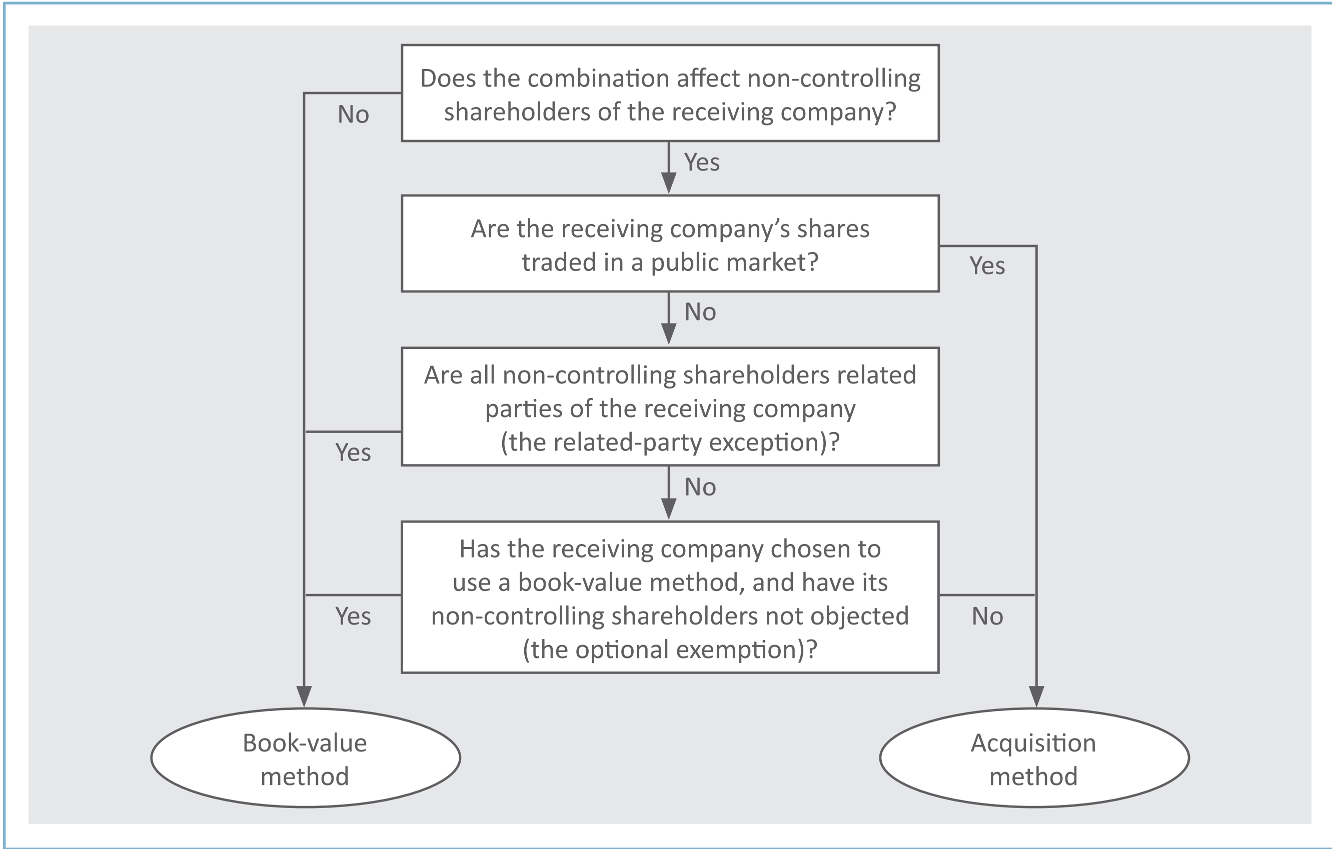
The Board's view is that a book-value method should be applied to business combinations under common control that do not affect non-controlling shareholders of the receiving company.

When to apply each method—in summary

Diagram 6 summarises the criteria that would determine when a receiving company should use the acquisition method and when it should use a book-value method. All those criteria are objective and designed to produce similar outcomes in similar circumstances, while taking into account cost-benefit considerations.

The Board's view is that its suggested approach would not be unduly complex, because both methods are already in use. Furthermore, all of the criteria for selecting the method are based on conditions already used in IFRS Standards. For example, IFRS Standards describe a public market and define related parties. The condition used in the optional exemption is also used in IFRS Standards for exempting privately held companies from particular requirements in specified circumstances.

Diagram 6—Summary of the Board's preliminary views



How to apply the acquisition method

A recap of the acquisition method

The acquisition method set out in IFRS 3 assumes that the consideration paid in the combination is negotiated at arm's length and reflects the fair value of the acquired business and the price paid for any synergies expected from the combination.

The acquisition method measures the assets and liabilities received in the combination at fair value.[1] The difference between the fair value of those assets and liabilities and the fair value of the consideration paid is recognised as goodwill. In an arm's length transaction, goodwill is expected to comprise, as illustrated in Diagram 7A:

- goodwill that exists in the acquired business. It is measured as the difference between the fair value of that business as a whole and the fair value of its assets and liabilities.
- the price paid for the expected synergies.

In a rare case of a bargain purchase, a gain is recognised in the statement of profit or loss. The gain is equal to the difference between the fair value of the consideration paid and the fair value of the assets and liabilities received.

1 The acquisition method recognises all identifiable assets and liabilities acquired in a business combination.

What is the issue?

In principle, the Board's view is that the acquisition method should be applied just as set out in IFRS 3. However, in a business combination under common control, the consideration paid might not have been negotiated. Instead, it might have been set by the controlling party. If that consideration differs from the consideration that would have been paid in an arm's length transaction, that difference suggests that the combination includes an additional component that is not present in a combination between unrelated parties—a distribution from, or a contribution to, the receiving company's equity, as illustrated in Diagrams 7A and 7B.

Diagram 7A—Consideration paid is higher than in an arm's length transaction

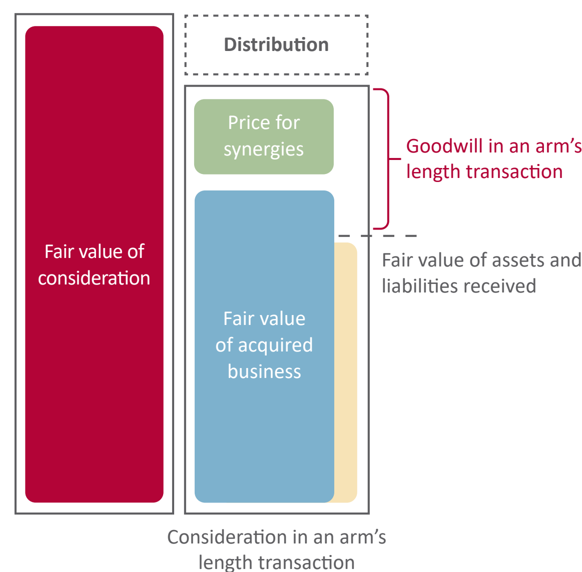
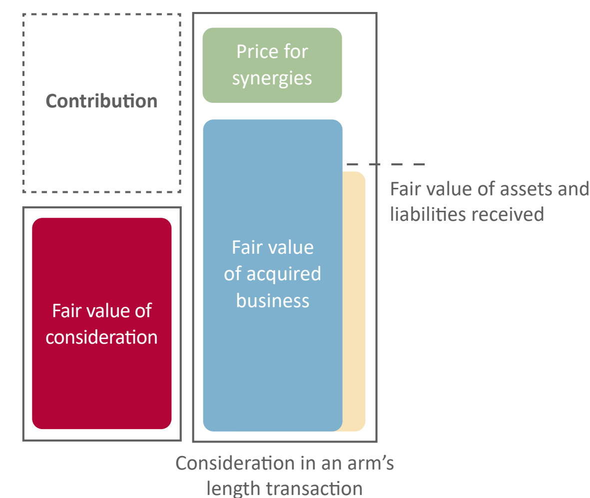


Diagram 7B—Consideration paid is lower than in an arm's length transaction



How to apply the acquisition method (continued)

Should the receiving company identify, measure and recognise a distribution from, or a contribution to, equity in a business combination under common control when the acquisition method is used?

What has the Board heard?

A distribution or a contribution is unlikely to occur in a transaction that affects non-controlling shareholders.

A distribution would be difficult to measure. An 'overpayment' can also occur in a business combination covered by IFRS 3 and is not reported separately.

Investors need information about how the transaction price was set so that they can make their own assessments.

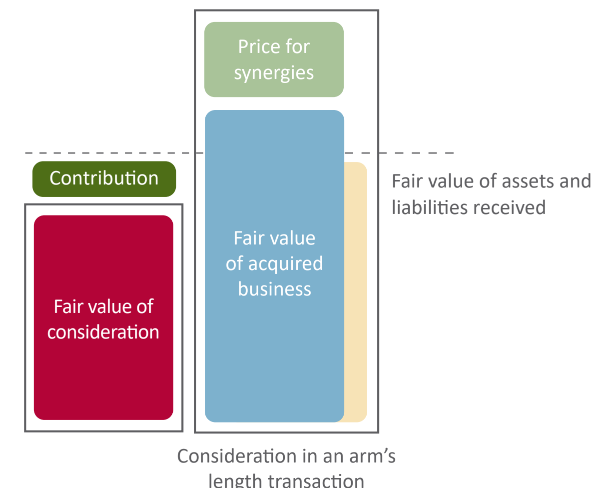
Should a distribution from equity be recognised?

The Board's view is that the receiving company should not be required to identify, measure and recognise a distribution from equity. Instead, the receiving company should disclose information about the terms of the combination, including how the transaction price was set. Any 'overpayment' would be included in goodwill that would be subject to impairment testing, just as occurs in reporting a business combination covered by IFRS 3.

Should a contribution to equity be recognised?

The Board's view is that the receiving company should recognise a contribution to equity if the fair value of the assets and liabilities received in a business combination under common control exceeds the fair value of the consideration paid, as illustrated in Diagram 8—instead of recognising that difference as a gain on a bargain purchase in the statement of profit or loss, as required by IFRS 3.

Diagram 8—Measuring a contribution to equity



How to apply a book-value method

What is the issue?

A book-value method is not described in IFRS Standards. In practice, a variety of book-value methods are used. The Board's view is that IFRS Standards should prescribe a single book-value method.

The Board focused on how the receiving company should:

- measure the assets and liabilities received;
- measure the consideration paid;
- report the difference between those amounts; and
- provide pre-combination information.

The Board also considered what disclosures a company should provide when it applies a book value method.

How to measure the assets and liabilities received?

In practice when applying a book-value method, companies sometimes measure the assets and liabilities received using their book values reported by the transferred company. In other cases, they use the book values reported by the controlling party.

Those book values would typically be identical if the controlling party has controlled the transferred company since the creation of that company. However, those book values could differ if, for example, the transferred company has previously been acquired from a party outside the group.

The Board's view is that the receiving company should measure the assets and liabilities received at their book values reported by the transferred company.

How to measure the consideration paid?

In practice when applying a book-value method, companies sometimes measure the consideration paid at fair value. In other cases, they measure the consideration paid at book value—or, in case of the consideration paid in the receiving company's own shares, at their par value or a nominal value.

The Board's view is that the consideration paid should be measured as follows:

- If consideration is paid in assets—at the book values of those assets.
- If consideration is paid by incurring a liability—at the amount determined on recognition of that liability applying IFRS Standards.

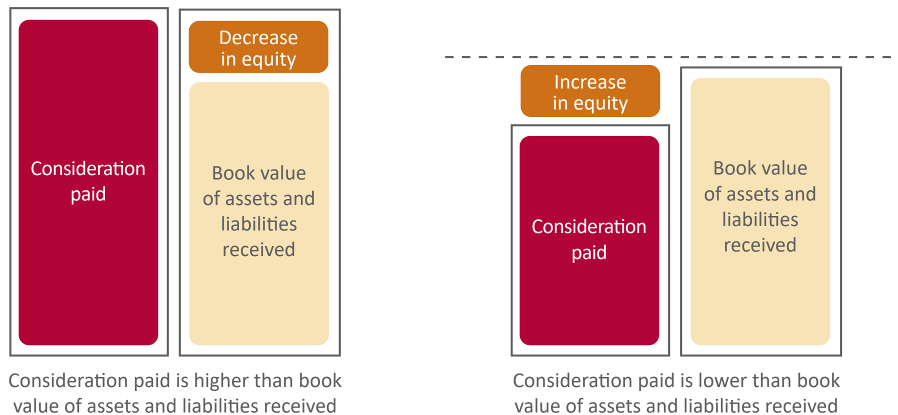
The Board's view is that it should not prescribe how the consideration paid in the receiving company's own shares should be measured.

How to apply a book-value method (continued)

How to report the difference between the consideration paid and the assets and liabilities received?

The Board's view is that the difference between the consideration paid and the assets and liabilities received should be recognised in equity, as illustrated in Diagram 9. This approach is consistent with current practice.

Diagram 9—Illustrating a book-value method



How to provide pre-combination information?

In practice when applying a book-value method, companies sometimes include the transferred company in their financial statements from the combination date and do not restate pre-combination information.

In other cases, companies include the transferred company in their financial statements from the beginning of the comparative period and restate pre-combination information.

The Board's view is that the receiving company should include the transferred company in its financial statements from the date of combination and, hence, should not restate its pre-combination information.

What information to disclose?

The Board's view is that:

- some, but not all, of the disclosure requirements in IFRS 3 are appropriate when applying a book-value method; and
- the receiving company should disclose the amount recognised in equity for the difference between the consideration paid and the book value of the assets and liabilities received, and the component, or components, of equity that includes that difference.

How to apply each method—in summary

	How to apply the acquisition method?	How to apply a book-value method?
	Generally, the acquisition method should be applied as set out in IFRS 3.	**IFRS Standards would specify a single book-value method.**
How to measure the assets and liabilities received?	Measure the assets and liabilities received at their fair values.	Measure the assets and liabilities received at their existing book values reported by the transferred company.
How to measure the consideration paid?	Measure all forms of the consideration paid at fair value.	In general, measure the consideration paid at book value (the Board would not prescribe how to measure the consideration paid in own shares).
How to report the difference between those amounts?	Recognise any such difference as goodwill or, in rare cases, as a contribution to equity instead of as a gain in the statement of profit or loss.	Recognise any such difference as a decrease or increase in equity.
How to provide pre-combination information?	Include the transferred company from the combination date, without restating pre-combination information.	Include the transferred company from the combination date, without restating pre-combination information.
What information to disclose?	• Disclose all information required by IFRS 3. • Provide information about the terms of the combination, including how the transaction price was set.	• Disclose some, but not all, information required by IFRS 3. • Provide information about the difference between the consideration paid and the assets and liabilities received.

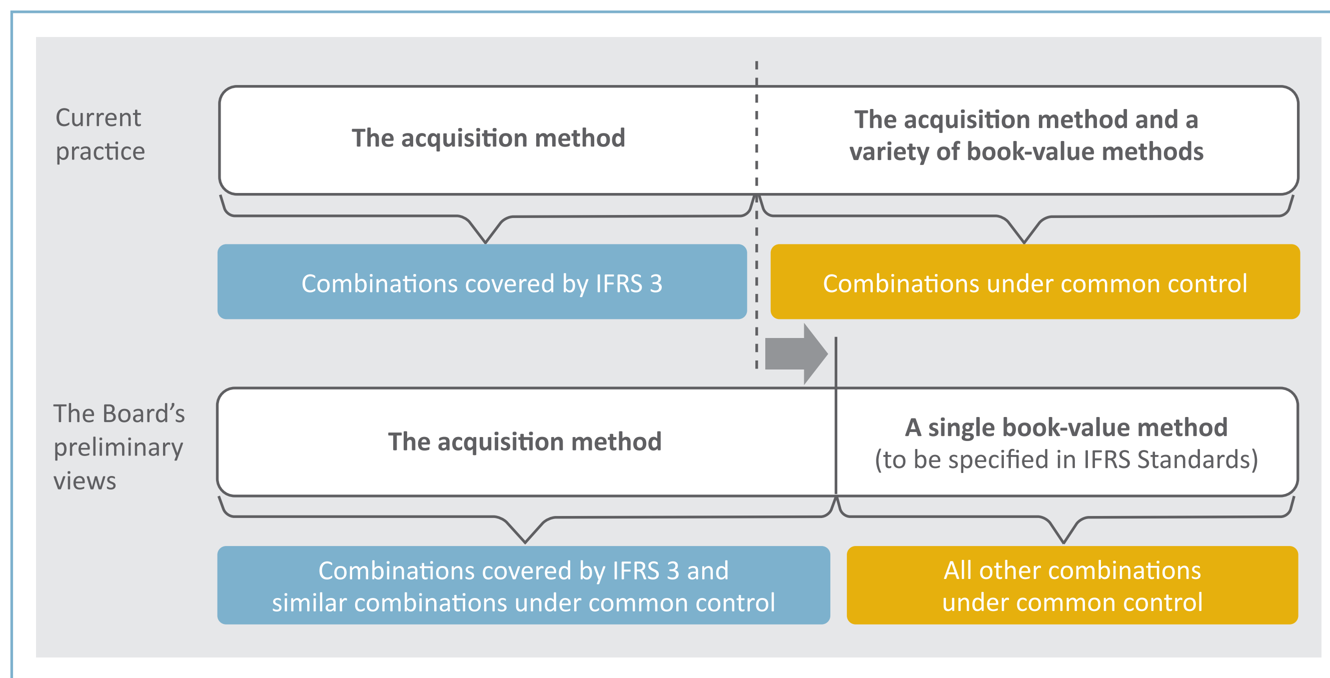
The effects of the Board’s preliminary views

If the Board confirms its preliminary views and they are implemented, diversity in practice would be reduced, transparency in reporting would be improved and users of financial statements would receive better information because:

- the acquisition method would be applied both to business combinations covered by IFRS 3 and to similar business combinations under common control when the benefits of applying that method outweigh the costs;
- IFRS Standards would specify which method should be applied in which circumstances, so that companies undertaking similar transactions would apply the same accounting policies; and
- IFRS Standards would specify a single book-value method, thus eliminating the diversity caused by the variety of book-value methods currently used.

The overall effects of the Board's preliminary views are illustrated in Diagram 10.

Diagram 10—The overall effects of implementing the Board’s preliminary views



Further information

The deadline for comments on the Discussion Paper is 1 September 2021.

All parties are invited to respond to the questions in the Discussion Paper. The Board will welcome responses even if respondents do not comment on all questions.

To stay up to date with the latest developments in this project and to sign up for email alerts, please visit www.ifrs.org/projects/work-plan/business-combinations-under-common-control/.

This document

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EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

APPROVAL NZASB 130

Approval to Issue *PBE Interest Rate Benchmark Reform—Phase 2*

In accordance with the protocols established between the New Zealand Accounting Standards Board (NZASB) and the External Reporting Board (XRB Board), the NZASB has:

- approved for issue *PBE Interest Rate Benchmark Reform—Phase 2;* and
- provided a signing memo outlining the due process followed before reaching that decision, and other related information.

I have reviewed the signing memo and am satisfied with the information provided. Accordingly, the NZASB is hereby authorised to issue *PBE Interest Rate Benchmark Reform—Phase 2* pursuant to section 12(a) of the Financial Reporting Act 2013.

Dated this 6th day of November 2020

…………………………..

Michele Embling
Chair
External Reporting Board