31 August 2021

Mr Andreas Barckow
Chairman of the International Accounting Standards Board
IFRS Foundation
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London E14 4HD
**United Kingdom**

Submitted to: www.ifrs.org

Dear Andreas

**DP/2020/2 *Business Combinations Under Common Control***

Thank you for the opportunity to comment on DP/2020/2 *Business Combinations Under Common Control* (the DP). The DP has been exposed for comment in New Zealand and some New Zealand constituents may comment directly to you.

Our recommendations and responses to the specific questions for respondents are set out in the Appendix to this letter. Our main comments are summarised below.

- We support the IASB's initiative to 'fill the gap' in IFRS® Standards in relation to BCUCC transactions.
- We agree that the acquisition method is appropriate for some BCUCC transactions, and that the book value method is appropriate for others. However, we have some concerns with the proposal to focus on the existence of non-controlling shareholders (NCS) as the key criterion for determining which accounting method to apply. We recommend that determining the accounting method for a BCUCC transaction should involve consideration of the following:
    - the substance of the transaction – considering factors such as the involvement of NCS and/or other parties in the transaction, whether the transaction was carried out at market terms and the price reflects the fair value of the transferred business (see also the next point) and the purpose/reason for the transaction, and;

  - the extent of judgement and estimation uncertainty involved in determining whether the transaction price faithfully represents the price that would have been paid in an arm's length market transaction i.e. the fair value of the transferred business (plus expected synergies from the combination). [1]

- We note the following regarding the proposed exception and exemption from the acquisition method (subject to our recommendation above).
  - We agree that providing an exception and an exemption from the acquisition method for entities whose shares are privately held is sensible from a cost/benefit perspective. However, we recommend considering whether the exception and exemption should be limited to situations where the entity's shares are expected to continue being privately held in the foreseeable future.
  - The proposal that all NCS must not object to the use of the book value method for the proposed exemption to apply could give rise to practical challenges. For example, NCS may not readily understand the impact of choosing one accounting method over the other, and it would only take an objection from one NCS (which could happen late in the financial statements process) to require the entity to use the acquisition method. As a result of these challenges, entities might attempt to use the proposed exemption only when the number of NCS is small or when NCS are relatively sophisticated investors. If this is the intended outcome, it may be useful to provide guidance explaining that the application of the exemption would most likely be suitable in the abovementioned circumstances, should the proposed condition for applying the exemption remain in the final standard.
- We agree with the IASB's proposals on how the acquisition method should be applied to BCUCC transactions.
- Regarding the book value method:
  - We suggest that the IASB allow pre-combination information that includes the pre-combination assets, liabilities and results of the transferred entity to be disclosed in the notes to the financial statements, as this information can be useful.
  - We recommend that the IASB consider whether restated pre-combination information should be presented in the receiving entity's financial statements if the receiving entity is a newly formed intermediate parent ('newco') that obtains control over existing subsidiaries within the group.

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[1] We are aware that in its submission to the IASB, the New Zealand Office of the Auditor-General recommended that the acquisition method be generally required when the receiving entity's NCS are affected by the BCUCC transaction and the book value method should be required for all other BCUCC transactions (as proposed by the IASB), except that the book value method should also be required for all privately-held receiving entities that have NCS. By contrast, we have recommended considering the substance of the transaction and the extent of fair value estimation uncertainty when determining which accounting method to apply to a BCUCC transaction. This recommendation was informed by feedback from constituents about the importance of considering the substance of the transaction and concerns about the possibility of structuring transactions to achieve a particular outcome, in the for-profit sector context. We note that while we did not recommend mandating the book value method for all entities whose shares are privately held, we agreed that privately-held entities should be allowed an exemption from the acquisition method for cost/benefit reasons.

- o We recommend that the IASB consider whether the receiving entity could recognise the assets and liabilities of the transferred entity using book values as per the controlling party's financial statements in certain situations, i.e. where the transferred entity was recently acquired into the group from an external party, and where the transferred entity does not prepare financial statements in accordance with IFRS Standards.
- o Also, we recommend that the IASB provide additional guidance on certain aspects of the proposed book value method – for example, how to identify the receiving entity in legal amalgamations and other 'merger or equals' situations, and how to account for the transferred entity's equity reserves.

We would like to take this opportunity to thank IASB Vice Chair Sue Lloyd and IASB staff members Yulia Feygina and Richard Brown for their assistance with an outreach event that we held on the DP with New Zealand constituents and which has informed our response to this DP.

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

Carolyn Cordery
**Chair – New Zealand Accounting Standards Board**

**Appendix:**

**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?

***Response to Question 1:***

1. The proposed scope of the project seems to include all those transfers of businesses that are currently outside the scope of IFRS 3 and are not addressed by existing IFRS Standards. We think that the scope is comprehensive and consistent with the IASB's aim of 'closing the gap' that currently exists in IFRS Standards, which we view as a positive initiative.

2. However, we think that the scope can be clarified in the following respect. The DP refers to BCUCC transactions as 'transfers of a business' between entities under common control, and proposes accounting requirements for the 'receiving entity', which obtains control over the transferred business. However, we note that some group restructuring scenarios involve the amalgamation of two entities under common control into a single legal entity. In some such amalgamations, it could be argued that there is no clear 'receiving entity' or 'transferred business', and therefore no 'transfer of a business' from one entity to another. We think it would be useful for the IASB to clarify whether such transactions are in the scope of the proposed BCUCC requirements.

3. Given that the DP aims to 'close the gap' in IFRS Standards, we expect that such amalgamations would be included in the scope of the proposed requirements. However, we think this should be clarified. For example, the definition of 'business combination' in IFRS 3 (for combinations between unrelated parties) specifically includes 'true mergers' or 'mergers of equals'. It may be useful to specifically state that the proposed BCUCC accounting requirements also applies to 'true mergers' or 'mergers of equals' under common control.

4. We also note that in the New Zealand PBE sector, the definition of a 'PBE combination' in PBE IPSAS 40 *PBE Combinations* does not refer to a transfer from one entity to another, but rather to 'the bringing together of separate operations into one public benefit entity'. This definition clearly includes the abovementioned amalgamation scenario and other 'mergers of equals'. If the IASB intended to include such transactions in the scope of the proposed BCUCC requirements, perhaps using similar wording to the PBE IPSAS 40 definition may be helpful.

5. We also think that the IASB may need to give further consideration to how the requirements proposed in the DP would apply to the abovementioned amalgamations and other ‘mergers of equals’.

**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?

***Response to Question 2:***

*Proposal to require the application of the acquisition method to some BCUCC transactions and the book value method for others*

6. We agree that some BCUCC transactions are similar in nature to business combinations between unrelated parties, while others are different. Therefore, we agree that some BCUCC transactions should be accounted for using the acquisition method and others should be accounted for using the book value method.

7. We also think that the introduction of specific requirements for determining the accounting method for BCUCC transactions is useful. Such criteria should improve comparability between similar types of BCUCC transactions, and reduce an arbitrary choice of accounting method.

8. Furthermore, we have received feedback that some entities that undertake a BCUCC ahead of an IPO elect to use the acquisition method to recognise internally generated goodwill – with a view to increase asset values. Having specific requirements on when to use the acquisition method and when to use the book value method would help prevent inappropriate use of the acquisition method in situations where the book value method would be more appropriate (and vice versa).

*Whether the main criterion for selecting the accounting method should be based on whether the receiving entity's has non-controlling shareholders that are affected by the transaction*

9. The DP proposes requiring the acquisition method for BCUCC transactions where the receiving entity's non-controlling shareholders (NCS) are affected (subject to an exception and an exemption), and the book value method for all other BCUCC transactions.

10. We acknowledge that when the receiving entity has NCS, then there is a change in the ultimate ownership of the transferred business, because the NCS gain a new ownership interest in the transferred business, just as they would have done if the receiving entity acquired a business from outside the group. By contrast, there is no change in the ultimate ownership of the transferred business if the receiving entity does not have NCS.

11. We also acknowledge that if the receiving entity has NCS, these NCS are a key party affected by the transaction – given that they acquire new ownership interest in the transferred business, and the success of the transaction impacts the future dividends they will receive. Therefore, the information needs of NCS are important.

12. However, we have also considered some possible concerns and arguments against basing the selection of the acquisition method primarily on the existence of NCS, as explained below.

<u>The substance of the transaction</u>

13. We received feedback that the proposed criteria for determining which accounting method to apply to a BCUCC transaction are rather like a 'bright line' test, and that it would be more appropriate to select the accounting method based on the *substance* of the transaction – or at least there should be a 'substance overlay' over the proposed requirements. Under this view, determining the substance of the transaction would involve considering factors such as the involvement of external parties (including NCS) in the transaction, whether the transaction was carried out at fair value, and whether it is an integral part of an IPO.

14. The DP notes that the IASB considered requiring entities to assess how similar a BCUCC transaction is to business combinations covered by IFRS 3 when determining how to account for the transaction – but decided not to propose such a requirement. This is because in the IASB's view, it would be difficult to develop a workable set of indicators to make such an assessment, and the assessment could be subjective.

15. We acknowledge that assessing the substance of a BCUCC transaction could be more subjective than selecting the accounting method based on whether NCS are affected. However, we think it is important that the accounting for a BCUCC transaction reflects the transaction's substance. We think this could be achieved without developing a definitive set of indicators, although it would be helpful to list some factors that could be considered when determining the substance of a transaction (and the involvement of NCS in the transaction could be one of these factors – but not the only factor).

<u>The transaction price may not reflect fair value despite the existence of NCS</u>

16. We have some concerns that there could be situations where the acquisition method would not be appropriate, despite the existence of NCS in the receiving entity. This is because the existence of NCS does not necessarily mean that the transaction is similar in substance to a business combination between unrelated parties. In particular, the existence of NCS does not necessarily mean that the transaction price reflects the price that would have been paid in an arm's length market transaction (i.e. the fair value of the transferred business and the expected synergies from the combination).

17. If NCS have been involved in determining the transaction price (which is likely to be the case if NCS hold a significant interest in the receiving entity), then it is more likely that the transaction price reflects the price that would have been paid in an external arm's length transaction. In this case, the acquisition method is more likely to be appropriate.

18. However, if the involvement of NCS in determining the transaction price was limited (for example, because NCS do not hold a significant interest in the receiving entity), then the transaction price may not be a reflection of what would have been paid in an external arm's length transaction. This could result in inappropriate recognition of the transferred entity's internally generated goodwill under the acquisition method.

19. Furthermore, even if NCS were involved in determining the transaction price, and even if the transaction price is set with a view to reflect the fair value of the transferred entity, there can be situations where the fair value of the transferred entity cannot be measured reliably, due to a high degree of fair value estimation uncertainty. In such cases, the transaction price may not be a faithfully representative reflection of the fair value of the transferred business (and expected synergies from the combination). This could sometimes result in inappropriate recognition and measurement of internally generated goodwill and other assets under the acquisition method.

20. We note that if the transferred business is in the start-up phase of its operations, the judgement and estimation uncertainty involved in determining the fair value of the business (and therefore whether the transaction price represents the price that would have been paid in an arm's length transaction) is likely to be particularly high.

21. We acknowledge that in business combinations between unrelated parties, in situations where the acquired business is not a listed entity, there would not be market evidence in the form of quoted share prices to support the transaction price. However, such a combination would still be an arm's length transaction between independent market participants, and the transaction price would reflect this. While the transaction price in a BCUCC transaction could reflect the price that would have been paid in an arm's length transaction, this would not necessarily be the case – particularly if NCS were not involved in determining the transaction price, or if the transferred business is at the start-up phase of its operations.

22. We also acknowledge that in determining whether the use of the acquisition method is appropriate, the inability to reliably determine the fair value of the transferred business and the risk that the transaction price does not faithfully represent the fair value of the transferred

business need to be considered against the other qualitative characteristics in the *Conceptual Framework for Financial Reporting*, including relevance. For example, when determining the fair value of the transferred business involves estimation uncertainty, using the acquisition method and recognising goodwill based on the BCUCC transaction price may result in more relevant information as compared to the book value method. Nevertheless, we think there could be situations where a high degree of judgement and estimation uncertainty required to estimate the fair value of the transferred business could mean that, on balance, the use of the acquisition method would not be appropriate – despite the receiving entity having NCS.

23. In the DP, the IASB acknowledges that evidence of fair value may not always be readily available in a BCUCC transaction, but notes that this consideration relates to the mechanics of applying the selected measurement method, rather than the selection of the measurement method. However, as explained above, we are concerned that selecting the acquisition method in situations where the fair value of the acquired business cannot be determined reliably due to a high degree of estimation uncertainty may lead to inappropriate results.

<u>Information needs of potential shareholders – upcoming IPO</u>

24. The DP notes that the acquisition method provides useful information to the receiving entity's NCS. We are aware of the argument that if the fair value information provided by the acquisition method is useful to *existing* NCS, this could also be the case for *potential* NCS. The information needs of potential NCS would be relevant for a wholly-owned entity if it is contemplating an IPO after the BCUCC transaction.

25. Having said this, we acknowledge that applying the acquisition method to BCUCC transactions between wholly-owned entities could result in very different accounting outcomes, depending on the legal structure of the BCUCC transaction and which entity is recognised as the acquirer – yet in each case, potential investors are invited to invest in the same pool of resources. This could possibly negate the benefits to potential investors from fair value measurement under the acquisition method.

26. Furthermore, we are aware of the concern that when a BCUCC transaction occurs in anticipation of an IPO, some entities may use the acquisition method to recognise internally generated goodwill and increase the transferred entity's other assets. As noted above, we think it is important that the selection of the accounting method for a BCUCC transaction reflects the substance of the transaction. Furthermore, in some pre-IPO situations it may not be possible to reliably determine the fair value of the transferred business, and therefore what the price of the transferred business would have been in an arm's length transaction. While this does not necessarily make the use of the acquisition method inappropriate, a high degree of estimation uncertainty when determining the fair value of the transferred business could, in some cases, lead to inappropriate recognition and measurement of the transferred entity's internally generated goodwill. Please see paragraphs 19–22 above.

27. Therefore, while the acquisition method might be appropriate for some BCUCC transactions conducted in anticipation of an IPO, we do not think that the acquisition method should be required for all such transactions.

Information needs of potential shareholders – convertible debt holders

28. The arguments above (in relation to potential NCS) also apply to an entity that does not have NCS, but has issued *convertible debt* instruments to its debt holders.

29. Such debt holders are able to convert their debt into equity in the receiving entity, thereby becoming NCS. It could be argued that convertible debt holders are in a similar position to NCS and have similar information needs as them – even more so than potential shareholders in an IPO situation. This is because convertible debt holders have an *existing right* to convert their debt into an ownership interest in the entity (as long as they meet the conditions specified in their contract with the entity).

30. However, the risks mentioned above in relation to upcoming IPOs also apply to situations where the receiving entity has convertible debt. That is, the acquisition method may result in different accounting outcomes depending on the legal structure of the BCUCC transaction. Also, it may not be possible to reliably determine the price that would have been paid to acquire the transferred business in an arm's length transaction. This could, in some cases, result in inappropriate recognition and measurement of the transferred entity's internally generated goodwill and other assets.

Recommendation for the IASB's consideration

31. Based on the discussion above, we recommend that determining which accounting method applies to a BCUCC transaction should involve consideration of:

    (a) the economic substance of the transaction, and how similar this substance is to that of a business combination between unrelated parties – considering factors such as the involvement of NCI and/or other parties in the transactions, whether the transaction was carried out at market terms and the price reflects the fair value of the acquired business, and the reason/purpose of the transaction (e.g. whether the transaction is an integral part of an IPO and/or has a business purpose, or whether it was done for an administrative purpose), and;

    (b) the extent of judgement and estimation uncertainty involved in determining whether the transaction price faithfully represents the price that would have been paid in an arm's length market transaction, i.e. the fair value of the transferred business (plus expected synergies from the combination).

32. Subject to the recommendations above, we also agree with the proposal to provide an exception and an exemption from the acquisition method as proposed in the DP, but with certain modifications to that proposal – as outlined in our response to Question 3.

**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?

***Response to Question 3:***

*Proposed exception and exemption from the acquisition method for entities whose shares are privately held*

33. We acknowledge that proposing an exception and exemption from the acquisition method for entities whose shares are privately held is a practical way of ensuring that the costs of applying the acquisition method do not outweigh its benefits. Therefore, we agree in principle with the proposal to provide an exception and exemption from the acquisition method for entities whose shares are privately held – subject to the recommendations below, and subject to our recommendations in Question 2 above.

34. We note that some entities whose shares are privately held may list on the stock exchange soon after the BCUCC transaction. It could be argued that for such entities, the costs and benefits of using the acquisition method are similar to those entities whose shares are already publicly traded at the time of the BCUCC transaction. Furthermore, it could be argued that this is also the case for entities whose shares are not publicly traded but who have publicly traded convertible debt.

35. Therefore, we recommend that the exception and exemption from the acquisition method be provided to entities whose shares are privately held *only when it is expected that their shares will continue to be privately held* in the foreseeable future. This recommendation is subject to our comments below about the practicality of applying the proposed exemption (and subject to our recommendations on Question 2 above).

*Practicality of applying the exemption from the acquisition method*

36. The DP proposes an optional exemption from the acquisition method for entities whose shares are privately held, when all NCS have been informed of the proposal to use the book value method and none of the NCS objected. We note there could be practical issues in applying this exemption.

37. Some NCS may not understand the difference between the acquisition method and the book value method without a thorough explanation. We acknowledge that IFRS 10, for example, already contains an exemption from preparing consolidated financial statements for privately-held entities whose NCS do not object to the lack of consolidation. However, it is arguably easier to explain to NCS the difference between consolidated and separate financial statements, as compared to explaining the impact of using the book value method versus the acquisition method. This could lead to challenges when applying the proposed exemption from the acquisition method.
    (a) If an entity does not provide sufficient explanation on the impact of selecting the book value method as compared to the acquisition method, there is a risk that NCS will not be able to make an informed decision as to whether they object to the book value method or not.
    (b) On the other hand, the level of information that some shareholders may require to make an informed decision may be a comparison of the two methods in terms of the impact on the financial statements. This would effectively require the entity to apply both the acquisition method and the book value method, which may defeat the cost-benefit rationale of the proposed exemption.

38. We also note the following challenges in relation to the proposed exemption from the acquisition method.
    (a) It only takes one objection from a non-controlling shareholder to prevent an entity from using the proposed exemption. A single shareholder could raise such an objection at any time, including when the financial statements have already been prepared and are substantively ready for publication. Responding to this objection would then require significant changes to the financial statements, may require further audit effort and would delay publication.
    (b) An entity's NCS might not to object to the book value method for one BCUCC transaction, but then object to the book value method for another similar BCUCC transaction. This could result in inconsistent accounting for similar BCUCC transactions – which is a key issue that the DP is trying to resolve.

39. The above challenges would be exacerbated if the receiving entity has a large number of individual NCS that are widely dispersed, or when the composition of NCS changes regularly.

40. On the other hand, the abovementioned challenges in applying the proposed exemption from the acquisition method may mean that entities would attempt to use this exemption only when they have a small number of NCS, or when NCS are relatively sophisticated investors who are likely to understand the difference between the acquisition method and book value method – which may have been the intended outcome, and therefore may be appropriate. If that is the case, we would agree with retaining the condition for applying the exemption.

41. Should the condition for applying the exemption remain in the final standard, we recommend the standard also includes guidance to explain that attempting to apply the proposed exemption (i.e. checking with NCS that they do not object to the book value method) is most likely to be suitable in situations where the number of NCS is small and/or they are sophisticated investors, for the reasons discussed above. This could help prevent receiving entities from attempting to apply the exemption where the costs of doing so would exceed the benefits.

*Whether the proposed exception and exemption from the acquisition method should also apply to entities whose shares are publicly traded*

42. In terms of the proposed exemption from the acquisition method: As mentioned above, there are some potential issues in relation to the practical application of the proposed exemption from the acquisition method if there is a large number of NCS. These challenges would also apply, and would probably be exacerbated, for an entity whose shares are publicly traded – as a publicly traded entity is likely to have a large number of NCS. Therefore, we do not think that this exemption should be made available to entities whose shares are publicly traded.

43. In terms of the proposed exception from the acquisition method: We think it is unlikely that all of the NCS of an entity whose shares are listed will be related parties of the entity. Therefore, even if the related party exception is extended to entities whose shares are publicly traded, these entities are unlikely to qualify for this exception. We therefore do not think that this exception needs to be extended to entities whose shares are publicly traded.

[Note: We have not provided a specific response to Question 4]

**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?

***Response to Question 5:***

44. We agree with the IASB's preliminary view on how the acquisition method should be applied to a BCUCC transaction.

45. Regarding situations where the consideration paid exceeds the fair value of the net assets received:

(a) We agree that when the consideration exceeds the fair value of the net assets acquired, then it would generally not be possible to apportion this difference between goodwill and a distribution to the owners in a reliable manner.

(b) Therefore, the options are either to recognise the full amount of the difference as goodwill (as per IFRS 3), or to recognise this full amount as a distribution to the parent.

(c) We agree with the IASB that the difference should be recognised as goodwill, because a distribution from the receiving entity to the ultimate parent would probably be unlikely when the receiving entity has NCS.

46. Regarding situations where the consideration paid is lower than the fair value of the net assets received:

(a) We are aware of a view that if the economic substance of the BCUCC transaction is such that the acquisition method is considered appropriate, then the acquisition method should be applied exactly as required by IFRS 3 – including the requirements to recognise a 'bargain purchase' gain in profit or loss.

(b) However, the DP notes that in a BCUCC transaction, on the rare occasions when the receiving entity pays less than the fair value of the net assets received, the nature of the underpayment is more likely to be a contribution by the controlling party – and different from a situation where a business is acquired from an unrelated party in a 'forced sale', etc.

(c) On balance, we also agree that when the consideration paid for the BCUCC transaction is lower than the fair value of the net assets received, then the difference should be recognised as an equity contribution.

**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?

***Response to Question 6:***

47. We generally agree with the IASB's proposals to use book values as per the financial statements of the transferred entity. However, we would recommend considering an exemption from this proposal when common control is 'transitory'.

48. We are aware of a view that using the controlling party's book values is more consistent with the substance of BCUCC transactions that are accounted for at book value. That is, transactions for which the book value method is appropriate tend to be internal reorganisations of resources within the group, driven by the parent. Therefore, under this view, applying the parent's perspective when measuring the transferred entity's assets and liabilities is appropriate.

49. Nevertheless, we agree that in general, the book values per the transferred entity's financial statements should be used in applying the book value method, for the following reasons.

    (a) As the DP notes, the *Conceptual Framework for Financial Reporting* focuses on information about transactions and events from the perspective of the entity that prepares the financial statements—in this case, the receiving entity. The DP says that "from that perspective, the book values recorded by the controlling party, arguably, have no relation to the combination between the receiving entity and transferred entity". This argument supports the use of book values as per the transferred entity's financial statements, rather than as per the controlling party's financial statements.

    (b) We also agree with the IASB that one of the key features of the book value method is that the same information is provided to potential shareholders about the combining entities, regardless of how the transaction is structured. Using the controlling party's book values to measure the assets and liabilities of the transferred entities is not consistent with this feature. It would mean that the assets and liabilities of *one* of the

combining entities would be measured at 'updated' values – so the values in the consolidated balance sheet would depend on how the transaction is structured, i.e. which entity is the 'receiving entity' and which is the 'transferred entity'. Thus, using book values as per the controlling party's financial statements would not provide the same information to potential shareholders about the combining entities regardless of how the transaction is structured.

(c) We acknowledge that the book values per the controlling party's financial statements could be more current than those in the transferred entity's own financial statements. However, it could be argued that if the use of current values is important, then fair value information would be even more useful than the book values in the parents' financial statements – and fair value is consistent with the acquisition method, rather than the book value method.

50. However, we recommend considering an exemption from using the transferred entity's book values in situations where the transferring entity recently acquired the transferred entity from an external party, i.e. where common control is 'transitory'. For example, suppose parent P has subsidiaries A and B. The parent directs its subsidiary A to purchase Entity C from a party outside the group, and soon afterwards directs A to transfer Entity C to subsidiary B. In this situation, the BCUCC transaction seems to be an additional step in the acquisition of C from the external party. Therefore, it would seem appropriate for B to recognise C's assets and liabilities using the amounts recognised in the financial statements of the group's controlling party (P) – which would be based on the fair values of these assets and liabilities as at the date when the group acquired C from the external party – rather than using the book values in C's own financial statements.

51. Providing the exemption suggested above would require the IASB to consider guidance on determining when common control is transitory. For instance, in the example above, would common control be considered transitory only if A transferred C to B before a specific time period has passed? Or would common control be considered transitory in any situation where the transferred business was brought into the group with the intention to conduct a BCUCC?

52. We also recommend considering whether, in situations where the transferred entity does not prepare financial statements under IFRS Standards, the receiving entity should be allowed to recognise the transferred entity's assets and liabilities using book values as per the controlling party's financial statements. If the IASB decides not to allow this, we recommend providing guidance on how to apply the book value method in these situations.

[Note: We have not provided a specific response to Questions 7, 8 and 9].

**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?

***Response to Question 10:***

53. We acknowledge that, as the DP notes, restating comparatives as if the receiving entity had always controlled the transferred entity would involve preparing financial statements for a 'hypothetical' group that did not exist in practice.

54. However, we recommend that the IASB consider providing an option for entities to disclose restated pre-combination information in the notes to the financial statements, for the following reasons.

    (a) We think that restated pre-combination information could be useful to users of financial statements, especially in IPO situations. Two thirds of participants at our virtual outreach event thought that pre-combination information about the transferred entity should be included in the notes to the financial statements.

    (b) We have received comments that restating pre-combination information under the book value method would be appropriate, given that the transaction would generally represent an internal reorganisation of existing subsidiaries by the parent entity – which is different to the acquisition of a new business into the group.

    (c) Furthermore, we are aware that in some jurisdictions, there are concerns about the proposal not to restate pre-combination information because this information may be required by regulators when an entity undertakes an IPO. Our understanding is that this would not necessarily cause an issue in New Zealand, nevertheless constituent support suggests such information to be useful.

55. If there is an option to include restated pre-combination information in the notes to the financial statements, entities would be able to use such disclosure for compliance with regulations around IPOs, or if the benefits to users from providing this pre-combination information in the notes would outweigh the costs of providing it.

56. We also think that the IASB may need to further consider situations where the BCUCC transaction involves setting up an intermediate parent (sometimes referred to as 'newco'), which obtains control over the existing subsidiaries – for example, in preparation for a spin-off or an IPO. It could be argued that is some such cases, the newly created company is merely a continuation of the subsidiaries that it acquired – and a continuation of the existing group structure. On this basis, it could be argued that in this situation comparatives should be restated, i.e. the pre-combination information of the acquired subsidiaries should be included

in the financial statements of the newly created intermediate parent to reflect their substantive continuation in a new form.

57. In addition, we note that the proposal not to restate pre-combination information implies that the receiving entity should present pre-combination information with respect to *its own operations*, but that it should not restate this information to include the transferred entity. This proposal seems to be underpinned by an assumption that it would always be possible to identify a 'receiving entity' and a 'transferred entity'. However, there could be BCUCC transactions where it is not clear which entity is the 'receiving entity' and which is the 'transferred entity'. This could be the case in a legal amalgamation, where two entities become a single legal entity, and in other 'merger of equals' situations. In such cases, it could be difficult to determine which entity's pre-combination information should be presented in the primary financial statements. We recommend that the IASB considers whether to require pre-combination information to be restated in such situations, or otherwise provides guidance on how to determine which entity is the receiving entity.

58. We also consider the IASB should clarify <u>*how*</u> the *transferred entity's equity reserves of other comprehensive income* (OCI) – such as revaluation reserves relating to property, plant and equipment (PP&E), and cash flow hedge accounting reserves – should be treated at the combination date. The DP proposes that under the book value method, the receiving entity should recognise the transferred entity's assets, liabilities, revenue and expenses from the combination date – but does not mention how the transferred entity's existing reserves of OCI should be treated. This may imply that the receiving entity does not recognise the transferred entity's OCI reserves as at the combination date, which could have consequences in the receiving entity's post-BCUCC financial statements. For example, if the receiving entity does not recognise the transferred entity's PP&E revaluation reserve as at the date of the BCUCC, a subsequent reduction in the fair value of the transferred entity's PP&E will have to be recognised as an impairment in profit or loss, rather than a reduction in the revaluation reserve through OCI. Also, if the receiving entity does not recognise the transferred entity's cash flow hedge reserve as at the date of the BCUCC, does this mean that hedge accounting needs to start anew?

59. It would also be useful to provide guidance on the treatment of OCI reserves when the transferred entity's accounting policies in relation to hedge accounting, revaluation of property, plant and equipment or other items relating to OCI reserves are not aligned with those of the receiving entity.

60. In addition, we recommend that the IASB considers the impact of the proposal not to restate pre-combination information on 'carve-out' or 'combination' accounts, which are provided to potential investors ahead of an IPO, where a BCUCC transaction is contingent on the success of the IPO. We understand that entities usually prepare such accounts by restating pre-combination information using the combining entities' book values, as if these combined entities were always combined – because this information is useful to investors. We also understand that entities prefer to refer to IFRS Standards as much as possible when preparing such statements, as this enhances the usefulness of the information in the carve-out or combination financial statements. If restatement of pre-combination information is not

allowed under IFRS Standards, entities that prepare combination or carve-out accounts would need to reconsider how they can provide pre-combination information to investors in a useful manner. They could still include restated pre-combination information in the combination or carve-out accounts, and provide a reconciliation to IFRS-compliant (non-restated) information. However, from the perspective of investors, this could increase the complexity of the information in the carve-out or combination accounts.

**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?

**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?

***Response to Questions 11 and 12:***

61. In relation to Question 12(b), which proposes that the IASB should not require the disclosure of pre-combination information: As noted in our response to Question 10, we recommend

that the IASB consider providing an option for entities to disclose pre-combination information in the notes to the financial statements.

62. In relation to disclosure requirements for BCUCC transactions in general, we agree in principle that when the acquisition method applies, disclosure requirements should be similar to those required for business combinations between unrelated parties – whereas when the book value method applies, some of these disclosures should not be required.

63. However, as noted in our response to the IASB's DP *Business Combinations – Disclosures, Goodwill and Impairment*, we have expressed concerns about the proposed disclosures on the subsequent performance of acquisitions and expected synergies. These concerns also apply to BCUCC transactions.

64. As noted in our comment letter on *Business Combinations – Disclosures, Goodwill and Impairment*, we do not agree that the proposed disclosures on the subsequent performance of acquisitions and expected synergies should be included in the financial statements, for the following reasons.

    (a) We are concerned that the subjective nature of the disclosures on the subsequent performance of acquisitions may lead to ineffective disclosures in the financial statements, and these disclosures may be challenging to audit. Furthermore, disclosures about synergies may be based on information that lacks accuracy and completeness.

    (b) 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.

    (c) There is a risk that the proposed disclosures would be provided in such a generic way so as not to be useful to investors (for example, due to concerns about commercial sensitivity).

    (d) 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.