UKEB UK Endorsement Board

Dr. Andreas Barckow
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26 August 2021

Dear Dr. Barckow

## Invitation to Comment: Discussion Paper DP/2020/2 *Business Combinations Under Common Control.*

The UK Endorsement Board (UKEB) is responsible for endorsement and adoption of IFRS for use in the UK and therefore is the UK's National Standard Setter for IFRS. The UKEB also leads the UK's engagement with the IFRS Foundation (Foundation) on the development of new standards, amendments and interpretations. This letter is intended to contribute to the Foundation's due process. The views expressed by the UKEB in this letter are separate from, and will not necessarily affect the conclusions in, any endorsement and adoption assessment on new or amended International Accounting Standards undertaken by the UKEB.

We welcome the opportunity to contribute to the debate on accounting for Business Combinations Under Common Control (BCUCC). Our main points on the IASB's Discussion Paper (DP) are outlined below. For detailed responses to the questions in the DP please see the Appendix to this letter.

Overall, we support the proposals in the DP. They provide users of financial statements with information on BCUCC, a significant step forward from the minimal information required today. In particular, the proposals in the DP will lead to improvements over current financial reporting as follows:

1. Measurement and disclosure requirements in the DP will reduce diversity in accounting practice, improve transparency and lead to greater comparability between financial statements.

2. The proportionate approach, whereby the book value method is required in situations where non-controlling shareholders are not affected, will reduce complexity and cost for preparers.

In our detailed responses to the consultation questions in the appendix to this letter, we recommend that:

1. entities that qualify for the book value method should have an option to use the acquisition method: and

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2. when considering the valuations to use for the book value method, the values recorded by the parent or “seller” company should also be permitted if they provide more relevant information.

Furthermore, while we support in principle the non-controlling shareholder exemption from using acquisition accounting, we recognise that there may be practical issues with its application such as those experienced when the UK trialled a similar negative consent requirement for the reduced disclosure framework in Financial Reporting Standard FRS101. In practice, therefore, it is possible that companies may not have a real option to avoid using acquisition accounting in these circumstances.

If you have any questions about this response please contact the project team at BCUCC@endorsement-board.uk

Yours sincerely

Pauline Wallace
Chair
UK Endorsement Board

Appendix: Questions on DP/2020/2 *Business Combinations Under Common Control.*

# Appendix: Questions on DP/2020/2 *Business Combinations Under Common Control*

| Question 1: Project Scope |
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| 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:<br>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<br>b) is conditional on a sale of the combining companies to an external party, such as in an initial public offering.<br>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? |

A1 We support the scope suggested in the DP including in the situations noted above. We note the scope is slightly wider than that currently captured by IFRS 3 *Business Combinations* due to the inclusion of items such as "group restructurings". However, this is appropriate as (i) it fits the spirit of the proposals to provide users with information on intra-group company transactions and (ii) the slight difference in scope is likely to have little practical effect.

| Question 2: Selecting the Measurement Method |
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| Paragraphs 2.15–2.34 discuss the Board's preliminary views that:<br>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?<br>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?<br>c) a book-value method should be applied to all other business combinations under common control, including all combinations between wholly owned companies.<br>Do you agree? Why or why not? If you disagree, in your view, when should a book-value method be applied and why? |

A2 We agree that not all BCUCC have the same characteristics, and therefore will not require the same accounting solution. While this topic only generated a limited response from UK stakeholders, those who did engage provided mixed feedback on the question of the best way to reflect this in accounting standards. From that feedback it appears that the book value method is the most commonly used for BCUCC. Some have used fair values and agree with the proposals to do so where non-controlling shareholders are affected. Others prefer to continue to use book value in all instances. Stakeholders reported a wide range of reasons for BCUCC transactions, including legal, regulatory and tax issues and are concerned that an overly rigid approach may compromise the ability to faithfully reflect the circumstances of the BCUCC.

A3 On balance, recognising the need to provide consistent information on BCUCC, we agree with the proposals in the DP. We agree that where BCUCC transactions have characteristics similar to those captured by IFRS 3 *Business Combinations* and affect non-controlling shareholders it is reasonable that the requirements of IFRS 3 be used. We welcome the DP proposal to use book value method, which is appropriate and proportionate for transactions which are internal to the group and where users do not need to rely solely on general purpose financial statements for information on the transaction. However we recommend that those who qualify for the book value method should have an option to use the acquisition method where this is considered to provide more relevant information.

| Question 3: Selecting the Measurement Method |
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| 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.<br>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?<br>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?<br>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? |

A4 Where a company's shares are traded in a public market there are likely to be a large number of non-controlling shareholders who rely heavily on general purpose financial statements for decision making. In those instances, we support the use of the acquisition method, which requires more disclosure. To ensure a principles based approach and consistency of application we think the phrase "shares traded in a public market" will require further definition, and suggest the phrase "equity instruments traded in a public market" be used instead.

A5 On balance we support the optional non-controlling shareholder exemption from using the acquisition method. We acknowledge that following a BCUCC the non-controlling shareholders have the right to relevant information about the transaction, and that use of the acquisition method can provide this. However we also recognise the need for a pragmatic approach to allow the use of the book value method for private companies in circumstances where the non-controlling shareholders may be few in number, close to the activities of the company and may not be reliant on general purpose financial statements.

A6 We note there may be practical issues in applying the proposed exemption. For example when the negative consent requirement was trialled in the UK for certain companies using the reduced disclosure framework under UK GAAP[1], it proved unworkable due to the cost and logistics of obtaining shareholder consent and providing an opportunity for them to object. Furthermore, there is some concern from investors that any objection to the use of a book-value method has a fundamental impact on the

[1] Refer FRS 101 *Reduced Disclosure Framework*, Basis for Conclusions paragraphs 25-26 for further information.

accounting for that business combination in all future sets of financial statements. It seems inappropriate for the accounting for a business combination to be dictated by the action of the non-controlling shareholder base at a particular point in time. The proposals do not consider the information needs of potential future shareholders.

A7 However we recognise that companies are not required to use the exemption, and that the default position is to use acquisition accounting for such transactions. Those wishing to pursue use of the book value method can assess the cost-benefit based on the circumstances of their transaction and the nature of their shareholder group. This appears to strike a reasonable balance between protecting the information needs of non-controlling shareholders in private companies and providing a pragmatic solution in circumstances where the application of the exemption is straightforward.

A8 We agree a related party exemption should be made available as related parties are less likely to rely on general purpose financial statements to meet their information needs, making the use of the book value method appropriate. We recommend this is achieved using the same process as that proposed for the non-controlling shareholder exemption. This provides protection to related parties who need to rely on general purpose financial statements for information on the transaction. It provides the further advantage of streamlining the number of decision points in the decision tree at DP Diagram IN.2 .

| Question 4: Selecting the Measurement Method |
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| 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? |

A9 We agree that the optional non-controlling shareholder exemption should not be available to publicly traded companies. We consider this exemption to be a pragmatic approach, in circumstances where the non-controlling shareholders are few in number, close to the activities of the company and not dependent on general purpose financial statements to meet their information needs. As publicly traded companies are likely to have a large number of shareholders who rely on general purpose financial statements for decision making the optional exemption is not appropriate for these circumstances. There would also be practical barriers to this approach, such as the large number of shareholders to contact, and the frequency with which shareholders change.

| Question 5: Applying the Acquisition Method |
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| 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 |

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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?

A10 During our recent stakeholder survey we asked participants whether consideration paid in excess of the fair value of the assets and liabilities acquired should be treated as goodwill. Although we only received a limited number of responses on this topic they expressed different views. Some favoured this approach while others felt that treating this as goodwill would cause confusion, reduce the understandability of financial statements and set an unwelcome precedent of recognising internally generated goodwill.

A11 Having considered these views, on balance we agree with the IASB that if consideration paid is greater than the fair value of the assets and liabilities acquired it should be treated as goodwill. As this is a common control transaction it would be inappropriate to record the difference in the statement of profit and loss. Recording this as goodwill seems preferable to recording the difference as a distribution from equity as goodwill is consistent with the IFRS 3 treatment users are familiar with, and the ongoing requirement to periodically test goodwill for impairment may provide useful information to users on the appropriateness of the transaction price set by management. As it is only applied in cases where non-controlling shareholders are affected it is likely to reflect the substance of the transaction. In arriving at this conclusion we considered whether the amount recognised as goodwill should be further disaggregated to separate goodwill (transaction synergies) from other distributions as illustrated at Diagram 3.12 of the DP, but concluded that this was impracticable. Should the opportunity arise we would encourage IASB to confirm this analysis via field testing.

A12 Our support for this approach is predicated on IASB resolving the issues currently associated with goodwill which were raised in the UKEB Secretariat's recent response to discussion paper DP/2020/1 *Business Combinations – Disclosures, Goodwill and Impairment.*

A13 We agree with IASB's position that, if consideration is less than the fair value of the assets and liabilities acquired, the resulting gain should be treated as a contribution to equity rather than recorded in profit and loss. We acknowledge the difference in treatment to that applied to arm's length transactions under IFRS 3. However, in a transaction under common control, the parent company is likely to have been involved in setting the purchase price, making the equity solution the appropriate reflection of that control. By ensuring that the statement of profit and loss remains unaffected by shortfalls in the purchase price this most closely reflects the substance of the transaction and reduces the likelihood of structuring opportunities within the Group.

| Question 6: Applying a Book Value Method |
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| 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.<br><br>Do you agree with the Board's preliminary view? Why or why not? If you disagree, what approach do you suggest and why? |

A14 We agree in principle that, when the book value method is used, the receiving company should measure the assets and liabilities received using the transferred company book values. This is the least complex and most cost-effective approach to accounting for such transactions. It also ensures that trend analysis of the assets and liabilities is not interrupted by the transaction for users who track this information. However UK stakeholders made compelling arguments that valuations in the parent or "seller" company should also be permitted in circumstances where this is considered to provide more relevant information, and we recommend the proposals be expanded to include this.

A15 With regards to applying the book value method we have heard from, and concur with, stakeholders who recommend that further consideration should be given to the practical implications of this approach. For example, paragraph 4.17 of the DP implies that transferred entities, which do not apply IFRS standards, would need to first convert to IFRS accounting to use book value method but there is no explicit requirement to do so. We agree IFRS should be used and recommend that this is explicitly required. We recommend that the IASB develops further guidance and examples to assist in developing a greater understanding as to how the book value method would be applied in practice. We would be happy to discuss the detailed feedback we received on practical guidance with IASB staff if this would be useful.

| Question 7: Applying a Book Value Method |
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| Paragraphs 4.20–4.43 discuss the Board's preliminary views that:<br><br>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<br><br>b) when applying that method, the receiving company should measure the consideration paid as follows:<br><br>(i) consideration paid in assets—at the receiving company's book values of those assets at the combination date; and<br><br>(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.<br><br>Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why? |

A16 We agree that IASB should not prescribe how the receiving company should measure the consideration paid in its own shares when applying a book value method. This approach is consistent with other IFRS standards. Measurement of issued shares and the reporting of components of equity are more likely to be determined by national requirements and regulations, and so are generally not prescribed in IFRS standards.

A17 We agree with IASB's recommended approach for measuring consideration paid in assets and liabilities. The book value method approach of using the receiving company book values at the combination date is consistent with its aims to provide a cost-effective approach to accounting for BCUCC transactions. In the case of liabilities being created or assumed by the transaction a number of accounting standards already deal with the recognition and measurement of liabilities. There is no reason to create further requirements that are specific for BCUCC.

| Question 8 Applying a Book Value Method |
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| Paragraphs 4.44–4.50 discuss the Board's preliminary views that:<br>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<br>b) the Board should not prescribe in which component, or components, of equity the receiving company should present that difference.<br>Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why? |

A18 We agree that when applying the book value method any difference between consideration and the book value of the assets and liabilities acquired should be recognised in equity. Our stakeholders tell us that this is a common method used in practice today. The simplicity of this approach and the use of readily available information makes it a cost-effective solution to accounting for BCUCC. The most significant benefit of the proposals in the DP is to develop consistency of practice. A simple and low cost approach, that can be easily applied by all companies adopting the book value method, is consistent with that goal.

A19 For the reasons described in A16 above, we agree that IASB should not prescribe the components of equity where any difference between the consideration paid and the book value of the assets and liabilities received should be presented.

| Question 9: Applying a Book Value Method |
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| 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.<br>Do you agree with the Board's preliminary view? Why or why not? If you disagree, what approach do you suggest and why? |

A20 We agree that, when applying the book value method, the receiving company should recognise the transaction costs in the period in which they are incurred. This is consistent with the requirements of IFRS3. We agree that costs of issuing shares and debt instruments should be an exception to this and should be accounted for in accordance with existing IFRS standards.

| Question 10: Applying a Book Value Method |
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| 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. |

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

A21 We agree with the prospective approach to application. Retrospective application would be more complex and costly, which is not necessary for transactions that qualify for the book value approach.

A22 However, we think that management should have the option to choose retrospective application in certain cases. For example BCUCC undertaken in preparation for a financing transaction or regulated activity may require multiple year restated IFRS information to be made available, and it is reasonable that the financial statements are able to reflect this. Suitable disclosure, including that restatement had taken place, should be required in such cases.

| Question 11: Disclosure Requirements |
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| 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.<br><br>Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why? |

A23 We agree that the disclosure requirements of IFRS 3 *Business Combinations* should apply when the acquisition method is used. Where BCUCC have similar characteristics to a business combination under IFRS3 it is reasonable that users would have similar information needs, and would expect disclosures consistent with those of IFRS 3. We agree with IASB that application guidance will be useful to ensure consistency of application, which supports the objective of BCUCC being reported in a more consistent manner than today.

| Question 12: Disclosure Requirements |
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| 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.<br><br>Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why? |

A24 We agree with the IASB's proposals. Requiring only a subset of the IFRS 3 *Business Combinations* disclosures when the book value method is used is a proportionate response.

A25 We agree that the disclosure of pre-combination information should not be required. Pre-combination values are likely to be the same as the transferred values under the book value method, so further disclosure is unlikely to provide benefit to users which outweighs the cost to preparers.