UKEB UK Endorsement Board

Mr. Hans Hoogervorst
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[Date]

Dear Mr Hoogervorst

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

Following the UK's exit from the European Union, the Department for Business, Energy and Industrial Strategy (BEIS) has set up the UK Endorsement Board (UKEB) to fulfil statutory functions of influencing the development and subsequent adoption of International Accounting Standards for use in the UK. This letter forms part of those influencing activities and is intended to contribute to the International Accounting Standards Board's (IASB) 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 appendix 1.

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.

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

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Yours sincerely

Pauline Wallace
Chair
UK Endorsement Board

Appendix 1 Questions on DP/2020/2 *Business Combinations Under Common Control.*

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Appendix 1: Questions on DP/2020/2 *Business Combinations Under Common Control*

Question 1: Project Scope
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?

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) a Business Combination and a BCUCC are unlikely to happen simultaneously so the slight difference in scope is likely to have little practical effect.

Question 2: Selecting the Measurement Method
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?

A2 We agree that not all BCUCC have the same characteristics, and therefore will not require the same accounting solution. However, our initial outreach to stakeholders resulted in mixed feedback on the question of the best way to reflect this in accounting standards. From that feedback it is clear 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 drivers associated with BCUCC including legal, regulatory and tax drivers 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

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UKEB UK Endorsement Board

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.

Question 3: Selecting the Measurement Method
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?

A4 At a principles level, more information should be provided when there are external users who will rely on that information for decision making, whereas a book value approach is likely to be more appropriate on cost-benefit grounds in instances where the users are less likely to be dependent on general purpose financial statements, such as those internal to the company or Group, related parties, or users who can command their own information.

A5 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.

A6 We support the optional non-controlling shareholder exemption from using the acquisition method. We support IASB in trying to find a pragmatic approach to allow use of the book value method for private companies in circumstances where the non-controlling shareholders may be fewer in number, close to the activities of the company, and may not be reliant on general purpose financial statements.

A7 We agree a related party exemption should be made available as related parties are unlikely to rely on general purpose financial statements to meet their information needs, making the use of the book value method appropriate. However we recommend this is achieved using the same process as that proposed for the non-controlling shareholder exemption. This allows related parties to object if they deem it necessary. It provides

DRAFT FOR COMMENT

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
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?

A8 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 fewer 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.

A9 We feel that the related party exemption could be made available to publicly traded companies as related parties are unlikely to rely on general purpose financial statements for their information needs. However this is unlikely to be significant to the UK market as publicly traded companies where the non-controlling shareholders are all related parties are uncommon, so in practice such an exemption may seldom be used.

Question 5: Applying the Acquisition Method
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?

A10 We agree with the IASB that if consideration paid is greater than the fair value of the assets and liabilities acquired, goodwill, rather than a distribution from equity, is

DRAFT FOR COMMENT

created. We acknowledge the arguments for considering this a distribution from equity, which were favoured by some UK stakeholders in our recent stakeholder survey. Some stakeholders identified concerns that goodwill created in a BCUCC would have elements of an internal intangible asset, provide structuring opportunities and impede the understandability of financial statements. On balance we support the goodwill approach, which is consistent with IFRS 3.The acquisition method is only applied in cases where non-controlling shareholders are affected, so recognising goodwill is likely to reflect the economic substance of the transaction in such cases. However 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.* 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 this was impracticable.

A11 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 treatment further reduces the likelihood of structuring opportunities within the Group.

Question 6: Applying a Book Value Method
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?

A12 We agree in principle that, when the book value method is used, the receiving company should measure the assets and liabilities received using the transferring 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. The alternative to this approach, using the valuations used by a parent or other group company, would be difficult to justify as that company is unconnected to the transaction.

A13 However we have already heard from, and concur with, stakeholders who recommend that further consideration should be given to the practical implications of this approach. For example, would the receiving company treat such transactions at a point of initial recognition under the conceptual framework? How would reserves of the transferring company such as FVOCI or hedging reserves be treated? Paragraph 4.17 of the DP implies that transferring entities, which do not apply IFRS standards, would need to use IFRS accounting to use book value method. We agree IFRS should be used, but this should be explicitly stated. We recommend that the IASB develops further guidance and

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examples to assist in developing a greater understanding as to how the book value method would be applied in practice.

Question 7: Applying a Book Value Method
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?

A14 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.

A15 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
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?

A16 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.

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A17 For the reasons described in A14 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
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?

A18 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
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?

A19 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.

A20 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 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, would be required in such cases.

Question 11: Disclosure Requirements
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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A21 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
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?

A22 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.

A23 We agree that the disclosure of pre-combination information should not be required. Pre-combination values are likely 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

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