

STAFF PAPER

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Project	Business Combinations under Common Control
Paper topic	Feedback on selecting the measurement method—other considerations
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Purpose

1. This paper summarises feedback on the International Accounting Standards Board (IASB)'s preliminary views about the cost-benefit trade-off and other practical considerations when selecting the measurement method to apply to a business combination under common control (BCUCC).
2. As explained in Agenda Paper 23, this paper does not ask for any decisions.

Structure of this paper

3. The paper includes:
 - (a) preliminary views (paragraphs 4–6);
 - (b) key messages (paragraphs 7–10);
 - (c) feedback (paragraphs 11–31), including:
 - (i) the optional exemption (paragraphs 13–22);
 - (ii) the related-party exception (paragraphs 23–27); and
 - (iii) publicly traded receiving entities (paragraphs 28–31).
 - (d) question for the IASB;
 - (e) Appendix A—Clarification requests; and

- (f) Appendix B—Preliminary views and rationale.

Preliminary views

4. As explained in Agenda Paper 23B, in the IASB’s preliminary view, in principle, the acquisition method should apply if a BCUCC affects non-controlling shareholders of the receiving entity (NCS), subject to the cost–benefit trade-off and other practical considerations.
5. The IASB’s preliminary views for the cost-benefit trade-off and other practical considerations are:
 - (a) if the receiving entity’s shares are traded in a public market, the receiving entity should be required to apply the acquisition method; and
 - (b) if the receiving entity’s shares are privately held:
 - (i) the receiving entity should be permitted to use a book-value method if it has informed all of its NCS that it proposes to use a book-value method and they have not objected (the optional exemption); and
 - (ii) the receiving entity should be required to use a book-value method if all of its NCS are related parties of the entity (the related-party exception).
6. Paragraphs 2.35–2.54 of the Discussion Paper explain the IASB’s reasons for these preliminary views. Appendix B summarises these reasons and includes a visual summary of the preliminary views.

Key messages

7. Many respondents agree with the optional exemption. Additionally, some respondents generally agree with the optional exemption but suggest modifying it to disregard objecting NCS if those NCS are insignificant. Some other respondents disagree with the optional exemption.
8. Many respondents, including some who agree with the optional exemption, say it may be challenging to apply in practice and / or request application guidance.

9. Many respondents agree and many others disagree with the related-party exception. Most who disagree say, similar to other NCS, some related parties (for example associates) rely on financial statements to meet their information needs.
10. Most respondents agree that the optional exemption and related-party exception should not apply to publicly traded entities—that is, a receiving entity should apply the acquisition method if its shares are traded in a public market and the BCUCC affects its NCS. Some respondents disagree, most of which say that whether an entity has publicly traded shares should not affect the method selected.

Feedback

11. Ninety-seven comment letters include feedback on the cost–benefit trade-off and other practical considerations. We also received feedback through outreach meetings with stakeholders. Our analysis summarises separately feedback on:
 - (a) the optional exemption (paragraphs 13–22);
 - (b) the related party exception (paragraphs 23–27); and
 - (c) publicly-traded receiving entities (paragraphs 28–31).
12. Many respondents asked the IASB to clarify particular terms and aspects of the preliminary views. Appendix A summarises these requests.

The optional exemption

13. Many respondents agree with the optional exemption for some or all of the reasons explained in the Discussion Paper (see paragraphs B6–B7 of Appendix B). Additionally, some generally agree with the optional exemption but suggest modifying it as explained in paragraph 16¹.
14. Respondents' views on this question in some cases relate to their views on previous questions in Agenda Paper 23B—that is, whether one method should apply to all

¹ In later paragraphs, we refer to these as respondents who mostly agree with the optional exemption.

BCUCCs and the NCS principle. Considering views expressed on those previous questions:

- (a) almost all respondents who say a book-value method should be applied to all BCUCCs and comment on the optional exemption disagree with the optional exemption;
- (b) most respondents who agree or mostly agree with the NCS principle agree or mostly agree with the optional exemption; and
- (c) of the respondents who agree that one method should not be applied to all BCUCCs but disagree with the NCS principle (see paragraph 32 of Agenda Paper 23B), many agree or mostly agree with the optional exemption but many others disagree.

15. We identified the following trends in feedback on the optional exemption by stakeholder groups:

- (a) most accountancy bodies, accounting firms, national standard-setters and users agree or mostly agree; and
- (b) many preparers and regulators agree or mostly agree but many other preparers and regulators disagree.

Suggested modifications

16. As stated in paragraph 13, some respondents generally agree with the optional exemption but suggest modifying it as follows:

- (a) some of these suggest modifying the optional exemption to disregard objecting NCS if those NCS are insignificant². Some of these respondents say if objecting NCS are insignificant then the costs of applying the acquisition method would outweigh the benefits and a single insignificant shareholder would have too much power.
- (b) one preparer says shareholder agreements often specify the relative rights of different shareholders to decide accounting policies—it suggests the

² We use the term ‘insignificant’ for simplicity—however, these respondents suggest various thresholds, including for example only considering ‘significant’ objections, disregarding ‘insignificant’ / ‘de minimis’ objections or ‘substantially all’ / a ‘majority’ of NCS not objecting.

optional exemption not apply if it would contradict prevailing legal agreements. For example, if the shareholder agreement gives the controlling party the right to decide accounting policies then the receiving entity should be able to apply a book-value method without applying the optional exemption and being required to inform NCS.

Disagreements with the optional exemption

17. Some respondents disagree with the optional exemption. Paragraph 18 summarises their reasons and paragraphs 19–21 summarise their alternative suggestions.

Reasons for disagreeing

18. Respondents who disagree give the following reasons:
- (a) most disagree with the concept of allowing NCS to decide accounting policies, some of which say accounting policies should be determined by management—one regulator says shareholders are described in the *Conceptual Framework for Financial Reporting (Conceptual Framework)* as users of the financial statements and should therefore receive, and not be involved in preparing, financial statements;
 - (b) many say the optional exemption would be challenging to apply;
 - (c) some say similar conditions in IFRS Standards³ are used only in connection with presentation and disclosure requirements, for example whether to present consolidated financial statements, whereas the optional exemption would affect measurement in the current and subsequent reporting periods;
 - (d) some say the costs of applying the optional exemption (for example providing NCS with both book-value and fair-value information to allow NCS to make an informed decision) would outweigh the benefits;
 - (e) some say the optional exemption would reduce comparability between entities that apply the optional exemption and those that do not;

³ See paragraph 4 of IFRS 10 *Consolidated Financial Statements* and paragraph 17 of IAS 28 *Investments in Associates and Joint Ventures*.

- (f) a few say similar conditions in IFRS Standards are not widely used and should therefore not be assumed to be well understood or workable;
- (g) a few say the optional exemption would expose the receiving entity to legal risks; and
- (h) one regulator says in their jurisdiction NCS cannot, by law, veto an accounting policy.

Alternative suggestions

19. Some of the respondents who disagree with the optional exemption say privately held receiving entities should apply a book-value method to all BCUCCs because:
 - (a) measuring the assets and liabilities received at fair value when applying the acquisition method would involve significant uncertainty for privately held entities (a few respondents);
 - (b) the effect on NCS is limited when the receiving entity is privately held (one preparer representative group); and
 - (c) comparability between privately held receiving entities would improve (a few respondents).

20. Some of the respondents who disagree with the optional exemption say privately held receiving entities should have a choice between applying the acquisition method or a book-value method. In particular:
 - (a) many of these respondents say receiving entities should have a choice between applying the acquisition method or a book-value method to all BCUCCs that affect NCS for the reasons explained in paragraphs 37–39 of Agenda Paper 23B; and
 - (b) a few of these respondents say the receiving entity should have a choice except for specific situations—for example, one says the receiving entity should apply the acquisition method if unrelated affected NCS have a significant interest.

21. A few of the respondents who disagree with the optional exemption suggest removing the optional exemption but do not suggest an alternative approach to balance the benefits and costs for privately held entities.

Other feedback

22. Many respondents, including some who agree with the optional exemption, say it may be challenging to apply and / or request application guidance. Appendix A summarises specific requests.

The related-party exception

23. Many respondents agree with the related-party exception. Most of the respondents who agree with the related-party exception express some or all of the reasons explained in the Discussion Paper (see Appendix B). Additionally, some respondents generally agree with the related-party exception but suggest modifying it as discussed below.

Suggested modifications

24. Some respondents generally agree with the preliminary view but suggest modifying it as follows:
- (a) some suggest extending it such that a receiving entity would apply a book-value method if affected unrelated NCS are insignificant. These respondents say unrelated NCS that are insignificant should not be allowed to determine the measurement method for the reasons explained in paragraph 29(a) of Agenda Paper 23B.
 - (b) a few suggest limiting the related-party exception to situations in which related parties are (a) ultimately controlled by the controlling party (one preparer representative group), or (b) wholly-owned by the controlling party (one national standard-setter). These respondents say, similar to other NCS, other related parties may need to rely on the receiving entity's financial statements to meet their information needs as explained in paragraph 26(a).
 - (c) one accountancy body suggests extending the related-party exception to situations in which all affected NCS are related parties of the receiving entity and / or the controlling party.

Disagreements with the related-party exception

25. Many respondents disagree with the related-party exception. Paragraph 26 summarises their reasons and paragraph 27 summarises their alternate suggestions.

Reasons for disagreeing

26. Respondents who disagree with the related-party exception give the following reasons:
- (a) most say, similar to other NCS, some related parties (for example associates) need to rely on financial statements to meet their information needs;
 - (b) some say removing the related-party exception would reduce costs, for example, costs to identify related parties at the date of a BCUCC;
 - (c) one accounting firm says it is unnecessary to prohibit the application of the acquisition method to such a BCUCC because, in their view, the acquisition method should, in principle, apply to all BCUCCs; and
 - (d) one national standard-setter says the *Conceptual Framework* specifies accounting treatments should be determined from the reporting entity’s perspective and not from the perspective of particular groups of investors (such as NCS).

Alternative suggestions

27. Of the respondents that disagree:
- (a) some say the related-party exception should be removed. They say the optional exemption should be available even if all NCS are related parties. Most of these respondents say related parties should be able to object to the use of a book-value method. One accountancy body says all NCS (regardless of whether they are related parties) should be treated equally.
 - (b) some say privately held receiving entities should have a choice between applying the acquisition method or a book-value method to BCUCCs that affect NCS as explained in paragraphs 37–39 of Agenda Paper 23B.
 - (c) some do not suggest an alternative approach to balance the benefits and costs for privately held entities.

Publicly traded receiving entities

28. Most respondents agree with the preliminary view that the optional exemption and related-party exception should not apply to publicly traded receiving entities—that is, the acquisition method should be required if the receiving entity’s shares are traded in a public market and the BCUCC affects NCS.
29. Most of the respondents who agree express some or all of the reasons explained in the Discussion Paper (see Appendix B).

Suggested modifications

30. Some respondents generally agree with the preliminary view but suggest modifying it as follows:
 - (a) some of these respondents suggest extending it—that is, requiring the acquisition method to be applied—to situations in which any of the receiving entity’s instruments are traded in a public market for the reasons explained in paragraph 44 of Agenda Paper 23B. One national standard-setter also suggests requiring a receiving entity to apply the acquisition method if the receiving entity expects to list in a public market soon after the BCUCC.
 - (b) a few respondents suggest not requiring publicly traded listed entities to apply the acquisition method to ‘hive-up’ transactions if such transactions are in scope of the project. For an explanation of hive-up transactions see paragraph 20(a)(iii) of Agenda Paper 23A.

Disagreements with publicly traded receiving companies

31. Some respondents disagree with the preliminary view and suggest removing the requirement to use the acquisition method if the receiving entity’s shares are traded in a public market and the BCUCC affects NCS. These respondents give the following reasons:
 - (a) most say whether an entity has publicly traded shares should not affect the method selected—this includes some respondents who conceptually disagree with having different requirements for publicly traded entities

from privately held entities and others who say NCS' information needs are unaffected by whether shares are publicly traded;

- (b) some say the preliminary view will reduce comparability between privately held and publicly traded entities;
- (c) some disagree with the principle of applying the acquisition method to BCUCCs that affect NCS for the reasons explained in paragraphs 31–32 of Agenda Paper 23B;
- (d) one national standard-setter says the optional exemption should be available to listed entities but says in practice it would be rare for a listed entity to receive no objections from NCS; and
- (e) one user says by taking capital from NCS, the receiving entity has accountability to NCS to provide fair value information, regardless of whether its shares are publicly traded.

Question for the IASB

Does the IASB have any questions or comments on the feedback discussed in this paper? Specifically:

- (a) is there any feedback that is unclear?
- (b) are there any points you think the IASB did not consider in developing the Discussion Paper but should consider in the re-deliberations?
- (c) are there any points you would like staff to research further for the re-deliberations?

Appendix A—Clarification requests

A1. The table below summarises requests to clarify specific terminology or aspects of the IASB’s preliminary views on selecting the method.

Feedback topic	Details (if specified)
1. Meaning of ‘receiving company’	<p>Respondents ask:</p> <p>(a) whether ‘receiving company’ means ‘the acquirer’ as defined in IFRS 3 <i>Business Combinations</i>, or whether the ‘receiving company’ would be determined based on the BCUCC’s legal form?</p> <p>(b) if receiving company means the acquirer as defined in IFRS 3, respondents:</p> <ul style="list-style-type: none"> (i) suggest providing guidance on identifying the acquirer in situations involving a new entity; (ii) say it may be unclear or difficult to identify the acquirer in some situations, for example in a ‘merger of equals’ or to determine whether a reverse acquisition exists; and (iii) suggest that a solution would be to conclude reverse acquisitions do not exist in BCUCCs. <p>(c) if the receiving company is determined based on legal form, respondents ask whether the acquirer is the same as the ‘legal acquirer’ used in paragraph B19 of IFRS 3⁴?</p>
2. Meaning of ‘shares’	<p>Respondents ask whether:</p> <p>(a) only financial instruments classified as equity in IAS 32 <i>Financial Instruments: Presentation</i> should be regarded as shares.</p>

⁴ Paragraph B19 of IFRS 3 says the legal acquirer is the entity that issues securities.

Feedback topic	Details (if specified)
	<p>(b) specific financial instruments should be considered as shares including, for example:</p> <ul style="list-style-type: none"> (i) convertible instruments and preference shares; (ii) warrants and options including NCI puts; and (iii) share-based payment arrangements. <p>(c) the IASB has considered implications of the Financial Instruments with Characteristics of Equity (FICE) project; and</p>
<p>3. Meaning of ‘non-controlling shareholder’</p>	<p>Respondents ask:</p> <p>(a) about the difference between ‘non-controlling interest’ referenced in IFRS Standards and ‘non-controlling shareholders’ referenced in the Discussion Paper?</p> <p>(b) whether NCS includes holders of instruments with potential ownership interest or only holders of instruments with present ownership interest?</p> <p>(c) when there is more than one receiving entity (for example when there is an intermediate parent between the reporting entity and the ultimate controlling party—see paragraphs B.14–B.15 of the Discussion Paper), respondents ask whether non-controlling shareholders refers to only the reporting entity’s NCS or if it refers to non-controlling shareholders of any of the receiving entities?</p> <ul style="list-style-type: none"> (i) if NCS refers to NCS of only the reporting entity, respondents ask whether the different receiving entities could have different accounting outcomes for the same BCUCC?
<p>4. Meaning of ‘affects’ non-</p>	<p>Respondents suggest clarifying the meaning of ‘affects’. They ask whether NCS are affected:</p>

Feedback topic	Details (if specified)
controlling shareholders	<p>(a) whenever the receiving entity has NCS—that is, whether the existence of NCS suffices to conclude NCS are affected.</p> <p>(b) if there is a demerger in which the same NCS have the same ownership interests before and after the combination.</p> <p>(c) if a receiving entity and a transferring entity have the same NCS holding the same relative ownership interests in the transferred entity before and after the combination.</p> <p>(d) if NCS are introduced as part of the BCUCC.</p>
5. Meaning of ‘traded’ in a ‘public market’	<p>Respondents ask:</p> <p>(a) whether unregulated / over-the-counter markets are public markets?</p> <p>(b) whether the receiving entity’s shares are traded if the shares are listed on a public market? If not, what differentiates shares that are traded?</p> <p>(c) whether shares with restrictions on transferability that are listed in a public market can be considered as traded?</p> <p>(d) for consistency with other IFRS Standards⁵, whether references to ‘traded’ are intended to include:</p> <ul style="list-style-type: none"> (i) publicly traded debt or other instruments? (ii) shares that will be traded shortly after a BCUCC (for example, a BCUCC conditional on an initial public offering)?

⁵ The Discussion Paper says a similar condition is already used in IFRS Standards to determine which information must be provided in some specified cases. For example in paragraph 4(a) of IFRS 10 *Consolidated Financial Statements*, a similar condition applies to both debt and equity instruments and also to entities in the process of filing financial statements with the relevant regulatory organisation for the purpose of issuing instruments in a public market.

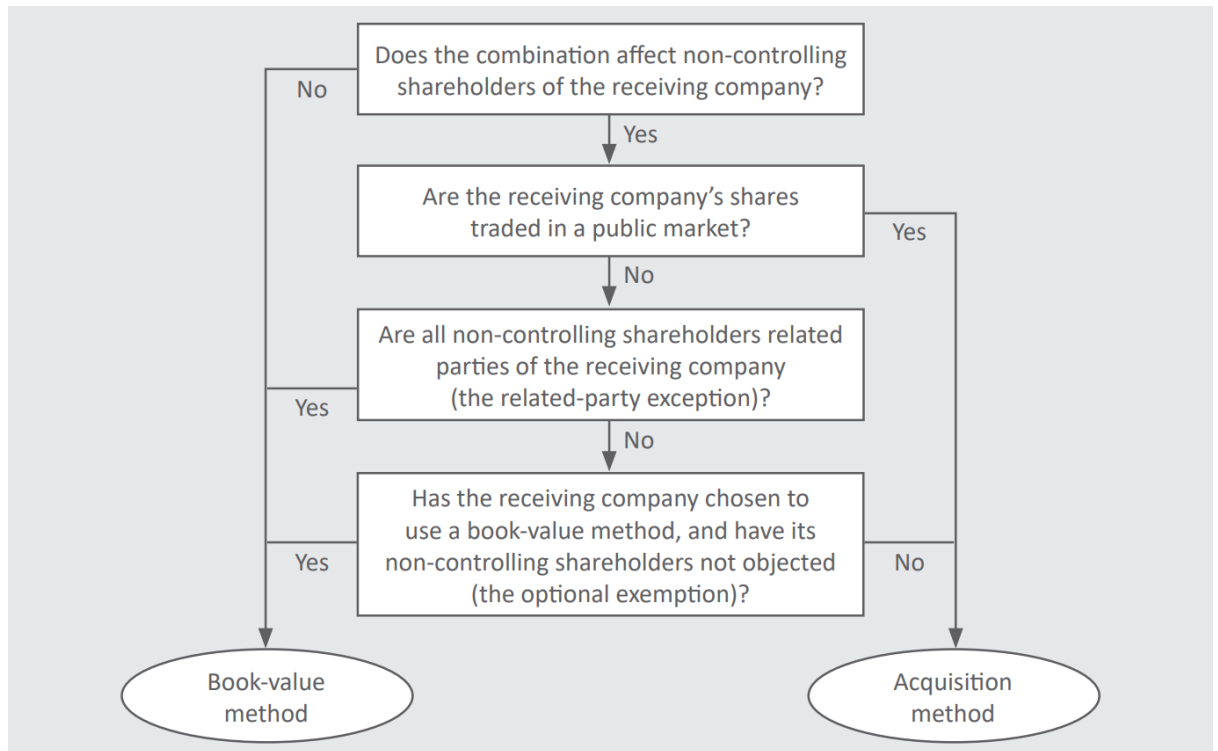
Feedback topic	Details (if specified)
	<p>(e) whether the receiving entity’s shares are traded if its parent’s shares (and not the receiving entity’s shares themselves) are traded?</p> <p>Respondents also suggest considering the effect of any clarification on IFRS 8 <i>Operating Segments</i>, IFRS 10 <i>Consolidated Financial Statements</i> and IAS 33 <i>Earnings per Share</i> because they use similar terminology.</p>
<p>6. Optional exemption—application questions</p>	<p>Respondents ask:</p> <p>(a) whether all NCS have the right to object or only specific NCS (for example, only those with a present ownership interest or only unrelated parties)?</p> <p>(b) if a NCS does not reply, would that be considered an objection?</p> <p>(c) whether the optional exemption would be applied on a transaction-by-transaction basis?</p> <p style="padding-left: 40px;">(i) if yes, could NCS provide approval to use a book-value method for all BCUCCs or would they have to be notified separately for every transaction?</p> <p style="padding-left: 40px;">(ii) if the receiving entity chooses not to apply the optional exemption to one BCUCC, whether the acquisition method should then be retrospectively applied to previous BCUCCs?</p> <p>(d) when a receiving entity should communicate its intention to use a book-value method?</p> <p>(e) whether NCS can be given a limited time frame within which they can object?</p> <p style="padding-left: 40px;">(i) if yes, how long that time frame should be?</p> <p style="padding-left: 40px;">(ii) if not, whether an objection received after the financial statements were published would</p>

Feedback topic	Details (if specified)
	<p style="text-align: center;">mean that using a book-value method was an error?</p> <p style="text-align: center;">(iii) respondents note an objection could delay the publication of the financial statements.</p> <p>(f) how a receiving entity should communicate its intention to use a book-value method?</p> <p style="text-align: center;">(i) would a general meeting be required?</p> <p style="text-align: center;">(ii) could disclosing the accounting policy in the financial statements suffice?</p> <p style="text-align: center;">(iii) what information about a BCUCC should NCS receive?</p> <p style="text-align: center;">(iv) what if the receiving entity is unable to contact some NCS?</p> <p style="text-align: center;">(v) how should the process be documented?</p> <p>(g) when there is more than one receiving entity (see paragraphs B.14–B.15 of the Discussion Paper and point 3(c) above), whether an objection from NCS in one receiving entity could affect the measurement method for another receiving entity?</p>
<p>7. Optional exemption and related-party exception—criteria</p>	<p>Respondents ask:</p> <p>(a) whether the criteria should be assessed at the date of the BCUCC or at the end of the reporting period?</p> <p>(b) whether the criteria can or should be re-assessed in future, for example if the receiving entity lists?</p> <p>(c) whether the exception and exemption would apply if NCS are affected at the combination date but the receiving entity becomes wholly-owned by reporting date / before the financial statements are published?</p>

Feedback topic	Details (if specified)
8. Transition requirements	Respondents ask whether the accounting method would be applied retrospectively—that is, to past BCUCCs and say the costs of retrospective application may exceed the benefits.

Appendix B—Preliminary views and rationale

B1. This diagram, extracted from paragraph 2.55 of the Discussion Paper, summarises the IASB’s preliminary views on which method to apply to BCUCCs.



The cost–benefit trade-off and other practical considerations

- B2. Having reached the preliminary view that, in principle, the acquisition method should be applied to business combinations under common control that affect non-controlling shareholders of the receiving entity, the IASB considered whether that method should be applied to all or only to some such combinations.
- B3. When NCS have only a ‘small’ ownership interest in the receiving entity, or are its related parties, some stakeholders suggested the costs of applying the acquisition method may not justify the benefits. Some stakeholders also expressed concerns about opportunities for accounting arbitrage.
- B4. The IASB rejected setting a quantitative threshold for NCS ownership, below which the acquisition method should not be applied, because a quantitative threshold would be arbitrary, lack conceptual basis and could give rise to further concerns about opportunities for accounting arbitrage.

- B5. In reaching its preliminary view that the acquisition method should be applied to a BCUCC if the receiving entity's shares are traded in a public market the IASB considered:
- (a) listing requirements or capital markets regulations for public trading in many jurisdictions typically prevent the listing of shares when the ownership interest of NCS is insignificant;
 - (b) this condition would be objective and easy to apply, and would not create opportunities for accounting arbitrage; and
 - (c) a similar condition is already used in IFRS Standards to determine which information should be provided in some specified cases.
- B6. The IASB considered that for privately held entities, the benefits of information provided by the acquisition method may not outweigh the costs of providing that information.
- B7. In reaching its preliminary view that a privately held receiving entity should be permitted to use a book-value method if it has informed all of its NCS that it proposes to use a book-value method and they have not objected (the optional exemption) the IASB considered:
- (a) NCS could require the use of the acquisition method so they receive fair value information when that information is important to them;
 - (b) NCS would not be required to take action unless they object to the use of a book-value method; and
 - (c) a similar condition is already used in IFRS Standards—the IASB therefore expects the condition to be workable in practice, especially for a small number of concentrated and stable shareholdings in a privately held entity.
- B8. In reaching its preliminary view that the receiving entity should be required to use a book-value method if all of its NCS are related parties of the receiving entity, as defined in IAS 24 *Related Party Disclosures* (the related-party exception) the IASB considered:
- (a) the receiving entity's related parties might not need to rely on its general purpose financial statements to meet their information needs (in which case

the benefits of applying the acquisition method might not justify the costs);
and

- (b) requiring a book-value method in those cases would prevent opportunities to structure a combination by issuing shares to related parties for the sole purpose of qualifying for the acquisition method.

B9. In reaching its preliminary view that the optional exemption and related party exception should not be available for / apply to publicly traded receiving entities the IASB considered:

- (a) the optional exemption might be more difficult to apply—such entities often have many shareholders holding a significant ownership interest and frequent changes in ownership; and
- (b) listing requirements or capital markets regulations for public trading in many jurisdictions typically limit how many shares of a publicly traded entity can be held by related parties and accordingly the IASB expected it to be unusual for all NCS to be related parties in such situations. Therefore, extending the related-party exception to publicly traded entities may have little practical effect.