STAFF PAPER

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IASB® meeting

Project	**Business Combinations under Common Control**
Paper topic	Feedback on selecting the measurement method—user feedback
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Purpose

1. This paper summarises feedback from users of financial statements (users) on the International Accounting Standards Board (IASB)'s preliminary views about 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 is structured as follows:

   (a) preliminary views (paragraph 4–5);

   (b) key messages (paragraph 6–9);

   (c) feedback (paragraphs 10–34), including:

      (i) whether to apply only one method (paragraphs 12–17);

      (ii) BCUCCs that affect NCS (paragraphs 18–23);

      (iii) BCUCCs that do not affect NCS (paragraphs 24–33); and

      (iv) other considerations (paragraph 34).

   (d) question for the IASB;

   (e) Appendix A—Scenarios discussed with users; and

(f) Appendix B—Sources of feedback.

Preliminary views

4. The IASB's preliminary views are:

   (a) neither the acquisition method nor a book-value method should be applied to all BCUCCs;

   (b) in principle, the acquisition method should be applied if a BCUCC affects non-controlling shareholders of the receiving entity, subject to the cost-benefit trade-off and other practical considerations (NCS principle); and

   (c) a book-value method should be applied to other BCUCCs, including combinations between wholly-owned entities.

5. Appendix A of Agenda Paper 23C explains the IASB's reasons for these preliminary views and includes a visual summary of the preliminary views.

Key messages

6. Almost all users—except users from China—agree with the preliminary view that neither the acquisition method nor a book-value method should be applied to all BCUCCs. Almost all users from China disagree and say a book-value method should be applied to all BCUCCs[1].

7. All users—except users from China—agree the acquisition method should be applied to a BCUCC which affects non-controlling shareholders of the receiving entity (NCS) with shares traded in a public market (scenario 1 in Appendix A)—that is, the outcome of applying the NCS principle. Almost all users from China say a book-value method should be applied to the same scenario.

[1] Almost all users we conducted outreach with were asked about the outcome of applying the preliminary views to three specific scenarios rather than about the principles underlying the preliminary views—see paragraphs 10–11 for more information and Appendix A for the specific scenarios. Some users from China say a book-value method should be applied to all BCUCCs whilst others commented only on the three scenarios, saying a book value method should apply to those scenarios. For simplicity, we refer to all of these users as saying a book-value method should be applied to all BCUCCs.

8. Almost all users agree a book-value method should be applied to a BCUCC by a wholly-owned receiving entity in preparation for an initial public offering (IPO) (scenario 2 in Appendix A)—that is, the outcome of applying the preliminary view in paragraph 4(c).

9. Most users agree a book-value method should be applied to a BCUCC by a wholly-owned receiving entity which has bank debt or bonds traded in a public market (scenario 3 in Appendix A)—that is, the outcome of applying the preliminary view in paragraph 4(c). Some users say the acquisition method should be applied in this scenario because, similar to NCS, bondholders need information provided by the acquisition method.

Feedback[2]

10. Almost all users we conducted outreach with were asked about the outcome of applying the preliminary views to three specific scenarios rather than about the principles underlying the preliminary views. These scenarios were discussed during outreach meetings (see paragraphs B5–B6 of Appendix B) and included in the user survey (see paragraphs B7–B8 of Appendix B). Appendix A includes the scenarios.

11. We designed these three scenarios to solicit feedback relevant to the preliminary views. It may be inappropriate to interpret feedback about specific scenarios as agreeing or disagreeing with all aspects of a preliminary view or the principles underlying a preliminary view. In such cases, this paper explains the specific scenario that the feedback relates to.

Whether to apply one method

12. Almost all users—except users from China—agree with the preliminary view that neither the acquisition method nor a book-value method should be applied to all BCUCCs. A few users say the acquisition method should be applied to all three

[2] Appendix B explains the sources of feedback included in this paper.

scenarios because the acquisition method would provide more useful information—these users did not provide further detailed feedback.

13. One user representative group says in principle the acquisition method should apply to all business combinations, including BCUCCs. However, considering cost-benefit trade-offs, they say a wholly-owned receiving entity should be permitted to apply a book-value method.

14. Almost all users from China disagree with the preliminary view and say a book-value method should be applied to all BCUCCs. These users express some or all of the reasons common to all stakeholder groups which are summarised in paragraphs 17–25 of Agenda Paper 23B. Paragraphs 15–17 summarise additional feedback from a user perspective.

Reasons for disagreeing

15. Users who say a book-value method should be applied to all BCUCCs provide the following reasons in favour of a book-value method:

    (a) a book-value method is the prevailing practice in their jurisdiction and provides useful information, for example for trend analysis (almost all);

    (b) a book-value method improves comparability which is important to NCS (some); and

    (c) if some NCS prefer fair value information, fair value information could be disclosed in the notes to the financial statements instead of requiring the use of the acquisition method (a few).

16. Users who say a book-value method should be applied to all BCUCCs provide the following reasons why the acquisition method would not provide the most useful information:

    (a) fair values may be unreliable (a few);

    (b) a reliable book-value would be more useful than the potential relevance of fair value in the absence of an external transaction (one);

    (c) the controlling party could time the BCUCC to occur when fair values are higher or lower—for example if the transferred business's value is driven by commodity prices (one);

(d) fair value information would not be comparable with analysis previously performed under a book-value method and additional transitional costs would be incurred (a few); and

(e) the acquisition method would affect ratios and metrics:

(i) the receiving entity's price-earnings ratio would be affected which may affect its share price (one);

(ii) dividends and total shareholder return, which are most important, would be unaffected and therefore fair value information is unnecessary (one); and

(iii) the effects of acquisition accounting in subsequent periods (for example amortisation of intangible assets) would not be useful and would be reversed (one).

17. Users who say a book-value method should apply to all BCUCCs also provide other reasons for their view:

(a) capital markets regulations in China require listed entities to provide shareholders fair value information and therefore users in that jurisdiction, including NCS, do not need to rely on general purpose financial statements to meet their information needs (some);

(b) some capital markets regulations are based on earnings[3], therefore a book-value method is better for entities (one); and

(c) analysts' models use many financial and non-financial inputs—analysts could work with either fair value or book-value information (one).

BCUCCs that affect NCS

18. Both comment letters from user representative groups agree with the NCS principle.

19. As explained in paragraphs 10–11, almost all users we conducted outreach with were asked about specific scenarios. Scenario 1 (reproduced in Appendix A) illustrates a

[3] For example, regulations that an entity must delist from an exchange if it generates a net loss over a specified period. In such cases, the controlling party may transfer a profitable business to an unprofitable listed business so that the combined business is profitable. Applying the acquisition method, there may be increased amortisation expense from intangible assets which would reduce net profit of the combined business.

BCUCC which affects NCS. The IASB's preliminary view would result in the receiving entity applying the acquisition method. All users—except users from China—agree the acquisition method should be applied to this scenario. This includes users located outside China who analyse entities in China.

20. These users express some or all of the reasons common to all stakeholder groups which are summarised in paragraph 27 of Agenda Paper 23B. Paragraphs 22–23 summarise additional feedback from a user perspective.

21. Almost all users from China say a book-value method should be applied to scenario 1 for the reasons explained in paragraphs 14–17.

Reasons for agreeing

22. Users who agree with the acquisition method being applied to scenario 1 provide the following reasons:

    (a) from NCS' perspective, there has been an acquisition and NCS need the same information regardless of whether the transaction is a BCUCC or a business combination between unrelated parties (many);

    (b) applying the acquisition method would not protect NCS from disadvantageous pricing but would provide transparency in measuring subsequent performance and may deter disadvantageous pricing (some);

    (c) although applying the acquisition method would be more costly, by raising external capital the receiving entity has accountability to NCS to provide such information (one user representative group); and

    (d) information provided by the acquisition method would be useful to assess stewardship and calculate return on invested capital—purchase price allocation adjustments can be reversed to derive book-value information for trend analysis and to calculate the return on capital employed (one).

23. One user, who agreed the acquisition method should be applied in scenario 1, said a book-value method would be easier to understand if the transferred entity was listed before the combination (so the transferred entity's book-value information would already be available to users and information provided by the receiving entity would

use a similar basis if a book-value method were applied). This user said his view applied to all business combinations and was not specific to BCUCCs.

BCUCCs that do not affect NCS

24. Both comment letters from user representative groups agree with the preliminary view that a book-value method should be applied to BCUCCs that do not affect NCS, including combinations between wholly-owned entities.

25. As explained in paragraphs 10–11 almost all users we conducted outreach with were asked about specific scenarios (reproduced in Appendix A).

26. Scenario 2 (see Appendix A) illustrates a BCUCC by a wholly owned receiving entity in preparation for an IPO. The IASB's preliminary view would result in the receiving entity applying a book-value method. Almost all users agree a book-value method should be applied in this scenario. A few of these users would prefer applying a 'fresh start' method[4] in this scenario but they acknowledge that method is rarely used and say they would prefer a book-value method rather than the acquisition method. A few other users would prefer applying the acquisition method in this scenario.

27. Scenario 3 (see appendix A) illustrates a BCUCC by a wholly-owned receiving entity which has bank debt and bonds traded in a public market. The IASB's preliminary view would result in the receiving entity applying a book-value method. Most users agree a book-value method should be applied to this scenario. Some users say the acquisition method should be applied because, similar to NCS, bondholders need information provided by the acquisition method.

28. Users express some or all of the reasons for agreeing or disagreeing common to all stakeholder groups which are summarised in paragraphs 41–43 of Agenda Paper 23B. Paragraphs 29–33 summarise additional feedback from a user perspective.

Reasons for agreeing

29. In addition to the feedback from users who say a book-value method should be applied to all BCUCCs (see paragraphs 14–17), users who say a book-value method should be applied to scenarios 2 and 3 provide the following reasons:

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[4] A 'fresh start' method measures all of the combining entities' assets and liabilities, including the receiving entity's own assets and liabilities, at fair value.

(a) a book-value method would provide consistent book-value information for the combined group regardless of the BCUCC structure (some);

(b) if the acquisition method were allowed, entities could try to manipulate the fair values—some users were concerned that asset values could be overstated and one user was concerned that asset values could be understated to reduce future depreciation expenses;

(c) as a potential investor in an initial public offering, they assess the value of the entire group and are not interested in a BCUCC that happened before they invested (a few); and

(d) they could work with either fresh-start fair value information or book-value information—their model uses many financial and non-financial inputs, and they would get comfort from the IPO registration process (one).

Reasons for disagreeing

30. The few users who say the acquisition method should be applied to scenario 2 say fair value information about the transferred entity would be more useful than book-value information even though the receiving entity's information would be at book value.

31. Users who say the acquisition method should be applied to scenario 3 provide the following reasons why fair value information would be useful:

(a) although lenders and other creditors' interests are typically limited to receiving payments of principal and interest, the equity in a business is the buffer available to repay the debt and accordingly fair value information is relevant when evaluating credit risk (a few);

(b) book-value information may be sufficient for simple investment-grade debt, but fair value information is necessary to assess recoverability of distressed or subordinated debt (some);

(c) if the difference between fair values and book values is significant enough to affect an equity analyst's decision, then it could also affect a debt analyst's decision, for example by affecting ratios such as gearing (one); and

(d) listed debtholders sometimes receive less information outside financial statements than listed equityholders (capital markets regulations often require particular market communications if equity is listed) and therefore rely on financial statements to meet their information needs (one).

32. Most of the users referred to in paragraph 31 differentiated holders of publicly traded instruments from privately held instruments—some said although private debtholders (for example banks) might need information similar to a public debtholder, private debtholders can typically obtain information from the receiving entity and do not rely on financial statements to meet their information needs.

33. Users who say the acquisition method should be applied to scenario 3 provide the following additional feedback:

(a) when comparing entities on the debt market to make an investment decision, it would be useful if entities with listed debt apply the acquisition method to all BCUCCs rather than only to BCUCCs that affect NCS (one); and

(b) one user says fair value information disclosed in the notes would be sufficient but another says applying the acquisition method would provide better information to evaluate future performance than disclosing fair value information in the notes.

Other considerations

34. Users provided limited feedback on the cost-benefit trade-off and other practical considerations[5] when selecting the measurement method:

(a) some users disagree with differentiating the accounting treatment depending on whether a receiving entity's shares are publicly traded. One of these users 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.

[5] Agenda Paper 23C explains the cost-benefit trade-off and other practical considerations.

(b) one user agrees with the optional exemption. In their experience, a significant NCS represented on a privately held entity's board would often not need fair value information. However, other NCS (for example without board representation) may need the information provided by the acquisition method, and the optional exemption would allow such NCS to receive the information if they need it.

(c) one user suggests setting a threshold for the percentage of shares held by NCS in privately held receiving entities below which a book-value method would apply and above which the acquisition method would apply.

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?

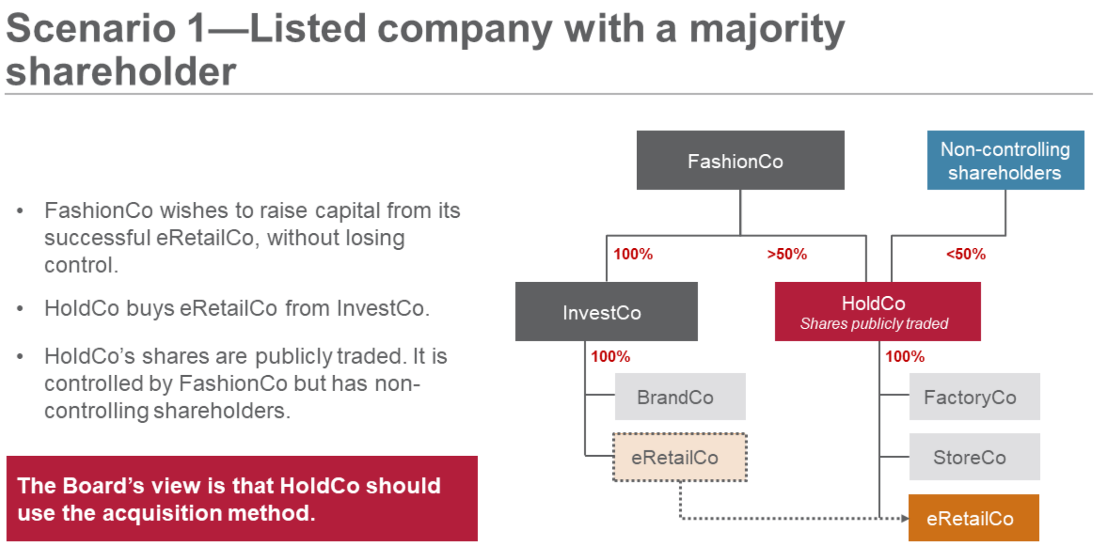
(b) are there any points you think the IASB did not consider in developing the Discussion Paper but should consider in the re-deliberations?

(c) are there any points you would like staff to research further for the re-deliberations?

Appendix A—Scenarios discussed with users

Scenario 1

A1. Applying the IASB's preliminary views, Holdco (the receiving entity) would apply the acquisition method to scenario 1 because Holdco's NCS are affected and its shares are publicly traded. We asked users whether the acquisition method would provide useful information to Holdco's NCS.



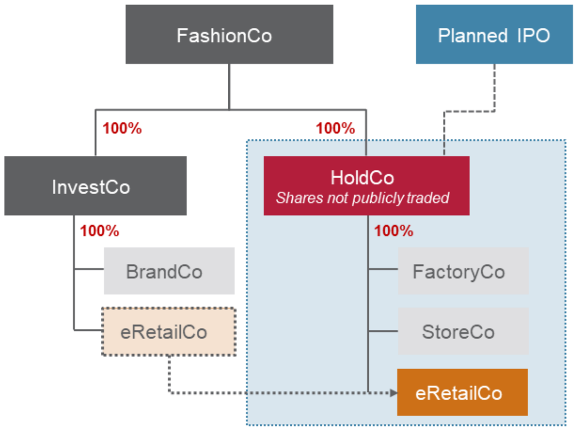
Scenario 2

A2. Applying the IASB's preliminary views, Holdco (the receiving entity) would apply a book-value method to scenario 2 because Holdco does not have any affected NCS. We asked users whether a book-value method would provide useful information to HoldCo's potential shareholders.

Scenario 2—Preparing for an IPO

- FashionCo is preparing for an IPO of its retail business, and decides to move eRetailCo into the HoldCo group.
- HoldCo buys eRetailCo from InvestCo.
- Prior to the anticipated IPO, HoldCo is wholly owned by FashionCo.

The Board's view is that HoldCo should use a book-value method.



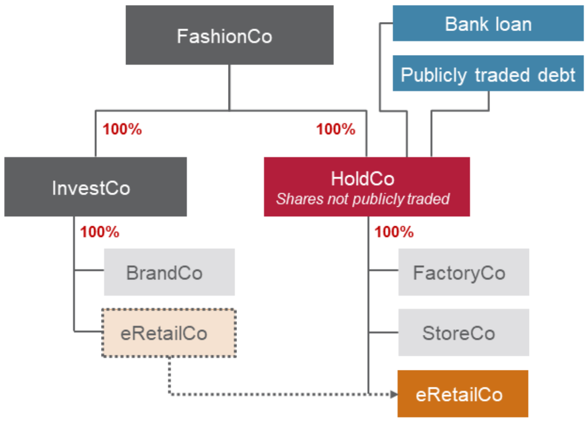
Scenario 3

A3. Applying the IASB's preliminary views, HoldCo (the receiving entity) would apply a book-value method to scenario 3 because Holdco does not have any affected NCS. We asked users whether a book-value method would provide useful information to HoldCo's debt holders (that is, holders of the bank loan and publicly-traded debt).

Scenario 3—Internal restructuring

- FashionCo decides to adopt a new organisational structure, with all retail companies held by HoldCo.
- HoldCo buys eRetailCo from InvestCo.
- HoldCo has no non-controlling shareholders but has outstanding debt.

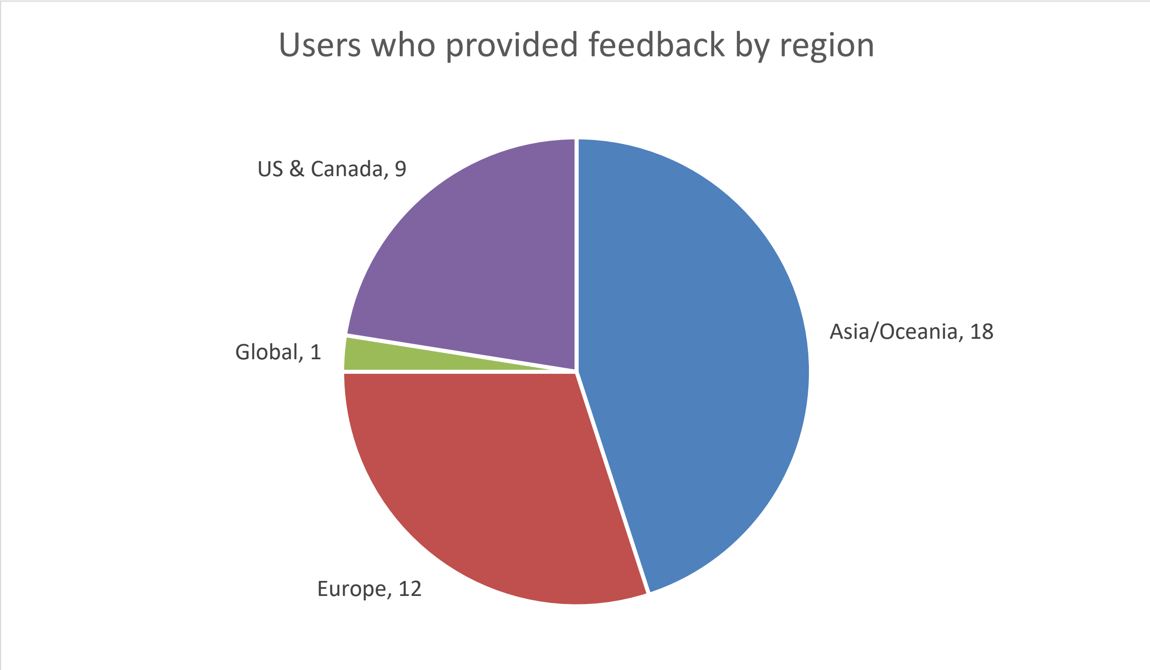
The Board's view is that HoldCo should use a book-value method.



Appendix B—Sources of feedback

B1. The analysis in this paper includes user feedback from comment letters, outreach meetings and a user survey.

B2. This pie chart illustrates the breakdown of user feedback by location:



Comment letters

B3. The IASB received two comment letters from user representative groups.

B4. Some national standard-setters also provided feedback from users within their jurisdictions in their comment letters.

Outreach meetings

B5. Between November 2020 and September 2021, the staff participated in 17 meetings with users and user representative groups to discuss the preliminary views included in the Discussion Paper *Business Combinations under Common Control*. These meetings included:

(a) one meeting with the Capital Markets Advisory Committee (CMAC);

(b) three meetings with national standard-setter user advisory groups;

(c) one meeting with user representative groups; and

(d) 12 other meetings, during which we met 22 individual users.

B6. The staff also observed additional meetings with national standard-setter user advisory groups.

User survey

B7. To seek feedback from a range of users, we sent a survey to individual users. Nine users responded, and most of these also attended meetings to further discuss their views.

B8. The survey included three specific scenarios (see Appendix A) and also asked whether pre-combination information would be useful when applying a book-value method. We will provide feedback on pre-combination information at a future meeting.