



The 21st Meeting of the IASB Emerging Economies Group

Concerns about IASB's preliminary view on BCUCC DP from some China's stakeholders

China Accounting Standards Committee

May 2021



Main concerns from some China's stakeholders

According to our previous work on DP, such as translating and circulating DP, collecting opinions from China's stakeholders, holding roundtables, and conducting outreaches etc., we summarized the concerns from the stakeholders in the following aspects:

- 1. Economic substance
- 2. Information needs
- 3. Inconsistency with *Conceptual Framework*
- 4. Cost-benefit trade-offs



1. Economic substance(1/2)

■ Some stakeholders believe that:

- **To some extent, BCUCC is a kind of group restructuring or resource reallocation directed by the controlling party, rather than a purchase in substance, the economic substance of BCUCC may be different from that of BCNUCC.**
- **The existence of NCS may affect the pricing method and the transaction price of BCUCC; however, this is not a determinative factor when making judgments on the economic substance of these transactions.**
- **BCUCC in the listed companies are decided by the voting result of NCS as the controlling parties shall avoid the vote, however, considering the size and dispersion of NCS's shareholdings, the influential power of NCS on BCUCC is quite limited, and this usually wouldn't change the fact that BCUCC are mainly dominated by the controlling parties.**



1. Economic substance(2/2)

- **The concerning stakeholders give the following examples of BCUCC and consider the economic substance of the these cases is different from that of BCNUCC, and the proposed method in the DP seems not to faithfully represent their economic substance:**
 - **Case 1: Intergroup Merger and re-organization led by the ultimate controlling party**
 - **Case 2: Business re-organization between two listed companies under common control**
 - **Case 3: The ultimate controlling party injected new business into the listed company**



Case 1: Intergroup Merger and re-organization led by the ultimate controlling party (1/4)

Background

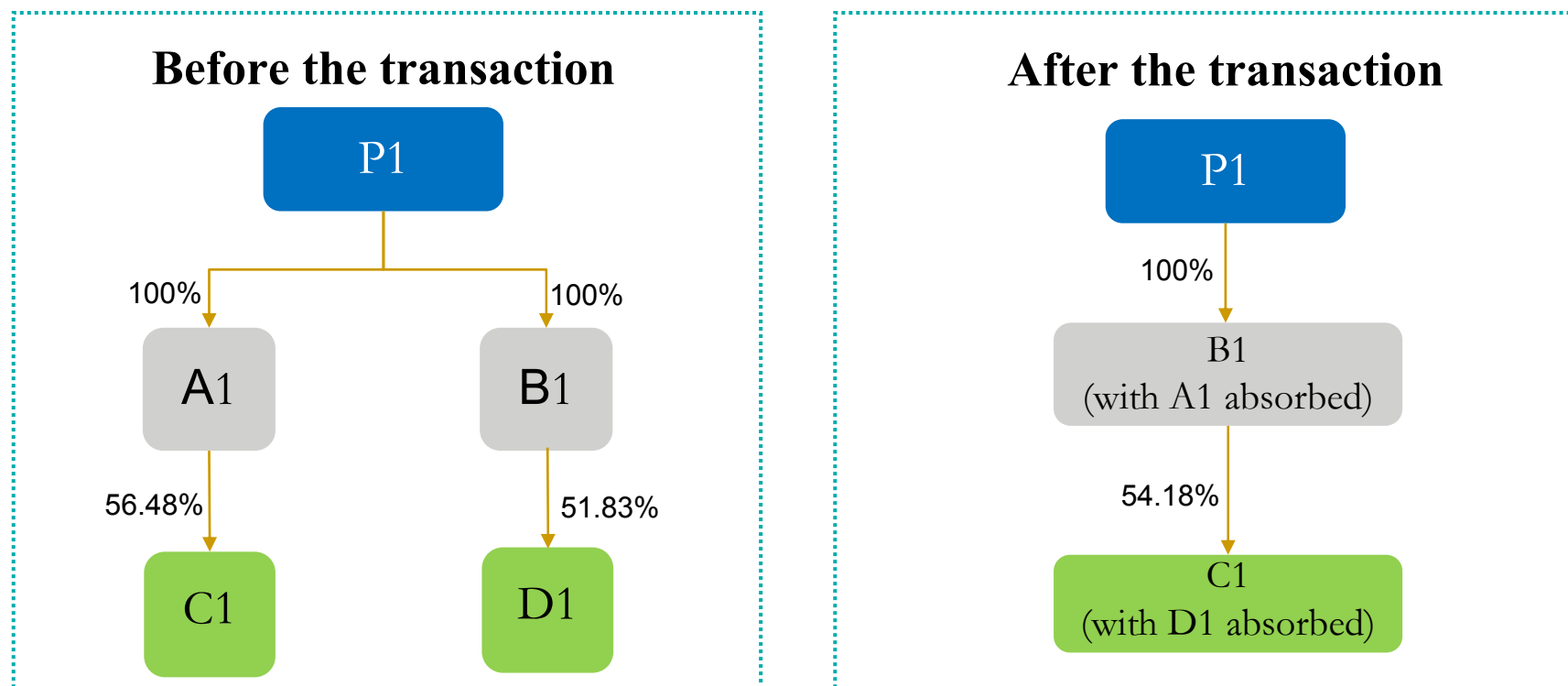
- C1 and D1 were two listed companies in an industry and both ultimately controlled by P1. In the context of rapid development of the domestic and international markets, as led by P1, the businesses of C1 and D1 were merged and re-organized, in a way of C1 merging and absorbing D1, in order to increase the scale of the new company after the merger, to improve the profitability and to promote the realization of industrial strategic objectives.
- Before the merger, C1 and D1 were close in scale, and the audited major financial information for the most recent financial period were as follows:

	C1 (in RMB millions)	D1 (in RMB millions)
Total assets	150,060.67	156,516.71
Net assets	50,416.80	49,497.43
Revenue	94,677.26	74,515.68



Case 1: Intergroup Merger and re-organization led by the ultimate controlling party (2/4)

Transaction pattern — C1 merged and absorbed D1 through shares exchange





Case 1: Intergroup Merger and re-organization led by the ultimate controlling party (3/4)

Transaction pattern — C1 merged and absorbed D1 through shares exchange

- C1 and D1 were both listed companies, with A1 and B1 as their direct controlling parities, respectively.
- A1 and B1 were both 100% controlled by P1.
- The transaction occurred in a way of shares exchange, that was, 1 share of D1 to be exchanged for 1.10 shares newly issued by C1.
- After the transaction, D1 was deregistered.
- Meanwhile, A1 was merged and absorbed into B1, and deregistered.
- After the above transactions, P1 held 100% shares of B1 (with A1 absorbed) directly, and held 54.18% shares of C1 (with D1 absorbed) indirectly, and controlled B1 and C1.



Case 1: Intergroup Merger and re-organization led by the ultimate controlling party (4/4)

The concerns raised by the stakeholders are as follows:

- **Considering C1 and D1 are close in total assets, net assets, revenue and market capitalization, if applying the acquisition method, the ultimate controlling party may be able to choose C1 to merge D1 or D1 to merge C1, which may lead to different accounting results.**
- **This case's economic substance is a kind of group restructuring or resource reallocation, which is different from that of BCNUCC.**



Case 2: Business re-organization between two listed companies under common control (1/4)

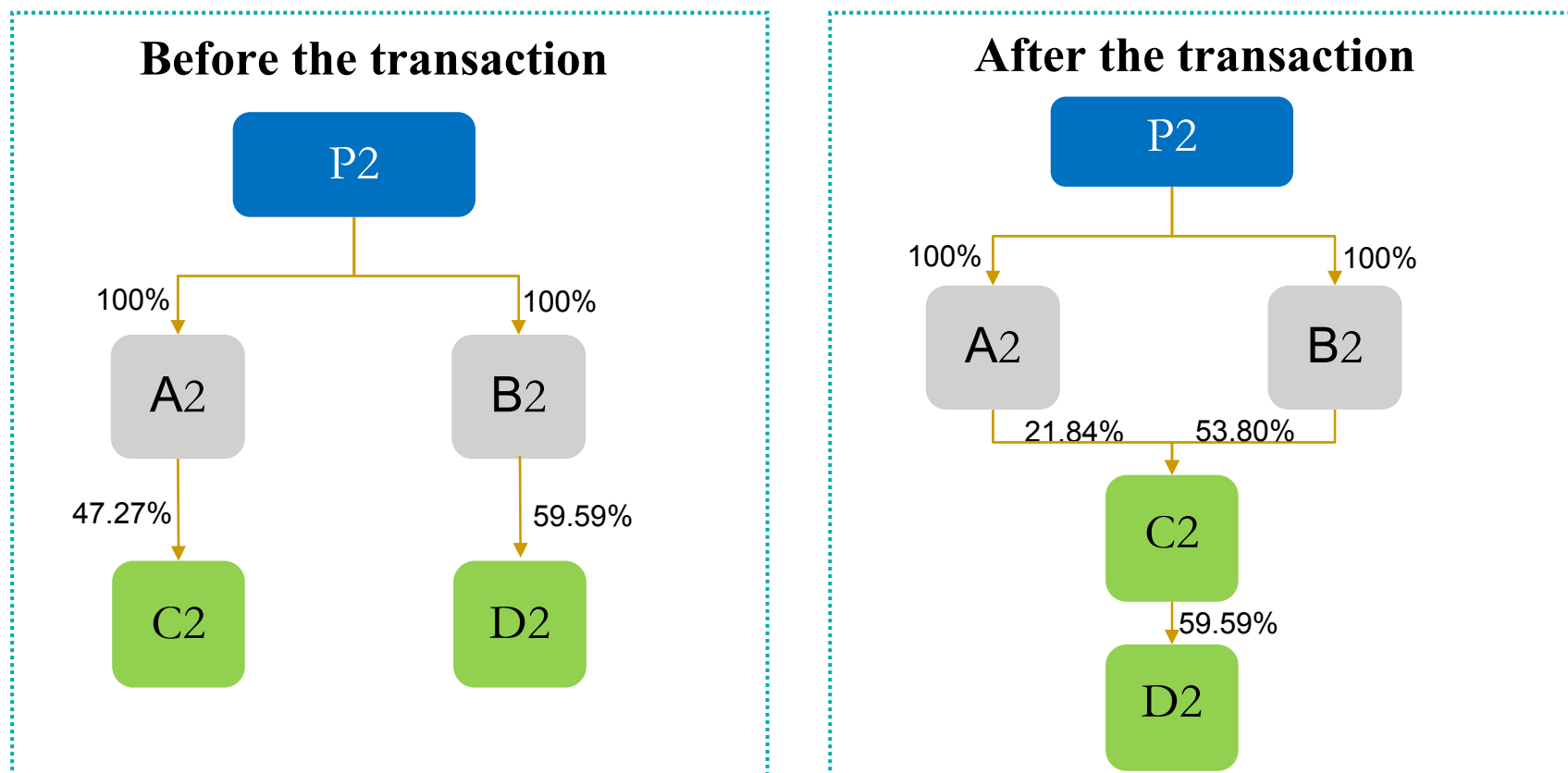
Background

- **The ultimate controlling party re-organized the business of two listed companies that it controlled, in order to integrate their real estate business, to realize the business complements of C2 and D2, and to enhance the synergies.**
- **C2 was principally engaged in residential property development, property leasing and property management, and D2 was principally engaged in developing and operating the commercial property, urban complex brand management and committed to becoming the leader of the urban complex industry.**



Case 2: Business re-organization between two listed companies under common control (2/4)

Transaction pattern — C2 issued shares to obtain D2





Case 2: Business re-organization between two listed companies under common control (3/4)

Transaction pattern — C2 issued shares to obtain D2

- C2 and D2 were both listed companies and ultimately controlled by P2.
- A2 and B2, 100% subsidiaries of P2, were intermediate holding companies of C2 and D2, respectively.
- C2 issued new shares to B2 to obtain 59.59% shares of D2 (that is 9,133M ordinary shares) and then obtained control of D2.
- After the transaction, P2 held 75.64% shares of C2 indirectly through A2 and B2, and controlled C2.



Case 2: Business re-organization between two listed companies under common control (4/4)

The concerns raised by the stakeholders are as follows:

- **In this case, if C2 and D2 were not ultimately controlled by the same party, C2 would not conduct the BCNUCC transaction to obtain D2, otherwise, A2 would lose control in C2 after the transaction.**
- **The case's economic substance is a kind of group restructuring or resource reallocation, which is different from that of BCNUCC.**



Case 3: The ultimate controlling party injected new business into the listed company (1/4)

Background

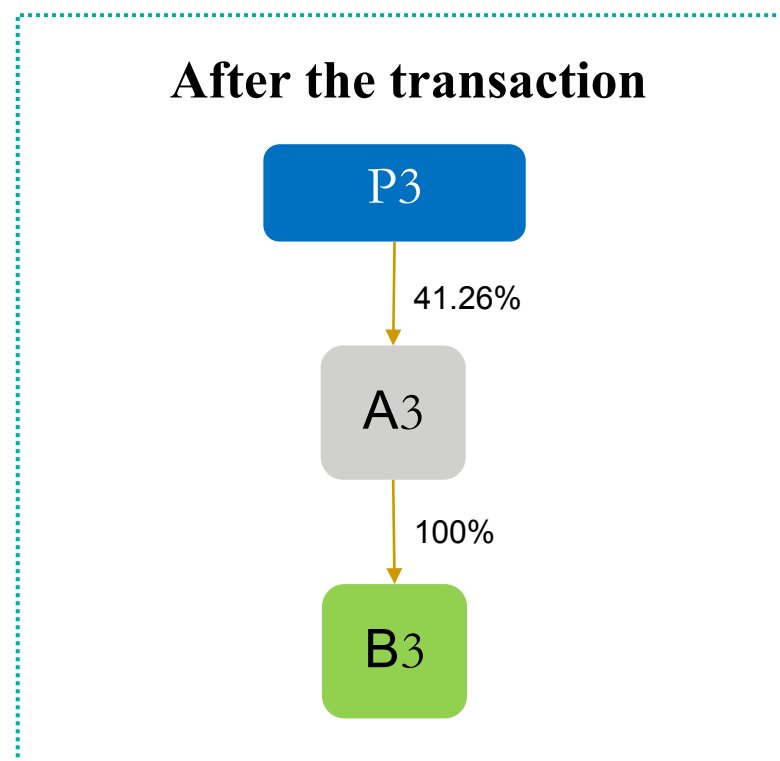
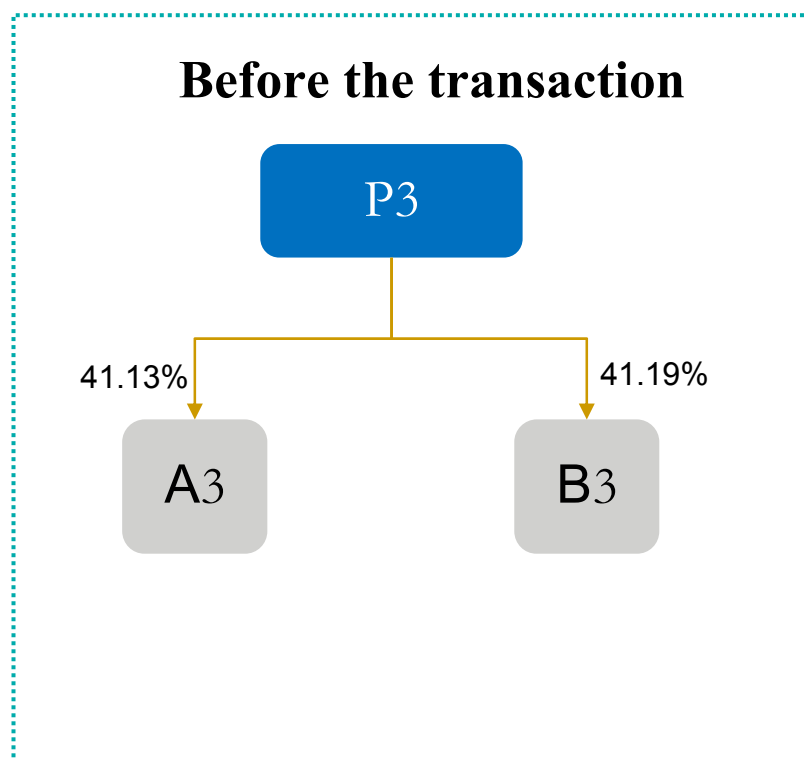
- Listed company A3 was mainly engaged in chemical industry and had poor profitability and faced the risk of listing suspension or delisting, the ultimate controlling party injected B3 and its new business in new-energy automobile into A3.
- Before the transaction, the book value and evaluated value of the net assets of A3 and B3 for the most recent financial period were as follows:

Net Assets	A3 (in RMB millions)	B3 (in RMB millions)
Book value	73.08	16,462.79
Evaluated value	187.09	28,849.55



Case 3: The ultimate controlling party injected new business into the listed company (2/4)

- Transaction pattern — A3 issued shares to obtain B3





Case 3: The ultimate controlling party injected new business into the listed company (3/4)

- **Transaction pattern — A3 issued shares to obtain B3**
 - **A3 was a listed company, B3 was a non-listed company, and A3 and B3 were both ultimately controlled by P3.**
 - **A3 issued new shares to the original shareholders of B3 to obtain 100% shares in B3, and controlled B3.**
 - **After the transaction, P3 held 41.26% shares of A3 directly and indirectly and controlled A3 (for simplicity, the illustration did not demonstrate the shares that P3 indirectly held through other intermediate subsidiaries).**
 - **The scale of B3 was far larger than A3, and the principal business of A3 changed from chemical to new-energy automobile.**



Case 3: The ultimate controlling party injected new business into the listed company (4/4)

The concerns raised by the stakeholders are as follows:

- On the combination date, the book value of B3 in P3's consolidated financial statements was RMB16.19 billion, and the evaluated value of B3 and the consideration was RMB28.85 billion. If the acquisition method was applied and A3 was identified as the receiving entity, it would put in too much performance pressure to management and incur considerable costs to prepare the financial statements.
- As A3 and B3 were under common control before and after the transaction, it was unclear if the requirements of reverse acquisition covered by IFRS 3 could be applied and it is concerned if the accounting for reverse acquisition could faithfully represent the economic substance of the transaction.
- The case's economic substance is a kind of group restructuring or resource reallocation, which is different from that of BCNUCC.



2. Information needs (1/2)

- **Some stakeholders believe that:**
 - **The controlling parties are also important users of financial statements, and it may not be reasonable not to seek to address the controlling parties' information needs in BCUCC project.**
 - **When the controlling parties prepare the consolidated financial statements or make decisions on BCUCC transaction, although they have access to information related to the transaction, they still heavily rely on the information provided by the general-purpose financial statements.**
 - **Subject to the factors, such as capital market regulatory rules or corporate governance regulations etc., the transactional information the controlling parties can obtain may be restricted. In most circumstances, the relevant information obtained by the controlling parties may be neither more sufficient nor more timely than NCS.**



2. Information needs (2/2)

- **Some stakeholders believe that:**
 - **To some extent, the information in the financial statements is only a reference for NCS, and the DP did not explain clearly why NCS need the information provided by the acquisition method.**
 - **As BCUCC in listed companies are decided by the voting result of NCS when the controlling parties avoid the vote, NCS would have already obtained information about BCUCC in the voting process.**
 - **In China, NCS do not show a strong preference for accounting information provided by the acquisition method.**
 - **Financial statements are not the only source of information for NCS and it can also obtain information through disclosures required by regulators, due diligence reports, investor questions and answers, etc.**



3. Inconsistency with Conceptual Framework

- Some stakeholders believe that the DP proposes different accounting treatments depending on whether a transaction affects NCS or not, whereas the *Conceptual Framework for Financial Reporting* states that accounting treatments should be determined from the perspective of the reporting entity, rather than from the perspective of NCS or particular groups of investors.
 - Paragraph 3.8 of *Conceptual Framework for Financial Reporting* states that *Financial statements provide information about transactions and other events viewed from the perspective of the reporting entity as a whole, not from the perspective of any particular group of the entity's existing or potential investors, lenders or other creditors.*



4. Cost-benefit trade-offs (1/2)

- **Some stakeholders believe that:**
 - **The book value method is simple and easy to apply in practice. Since 2007, China has been using the book value method, and the implementation is generally good, basically meeting the information needs of NCS, lenders and other creditors, controlling parties and other information users.**
 - **The valuation and subsequent measurement of goodwill brought by the acquisition method involve a lot of judgments and estimates, which may have a negative impact on the financial performance of entities and the stability of the capital market, and will aggravate the difficulty of accounting treatment and increase the cost of the preparation and use of accounting information.**



4. Cost-benefit trade-offs (2/2)

- **Acquisition method will incur large costs to prepare the financial statement for the receiving entity and its controlling party:**
 - ✓ **The receiving entity needs to do a purchase price allocation (PPA) on the combination date, and review the PPA and perform goodwill impairment test after the combination date.**
 - ✓ **The controlling party shall eliminate or adjust the information under acquisition method, which incurs high preparation costs and it requires the receiving entity to have frequent communication with its controlling party at great cost.**
 - ✓ **It has been required to apply book value method for all BCUCC in China since 2007. If acquisition method is required to be adopted and retrospective adjustment is required, there will be great cost or even impractical.**



Thanks!