STAFF PAPER

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IASB® meeting

Project	**Business Combinations under Common Control**
Paper topic	Feedback on applying a book-value method

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Purpose

1. This paper summarises feedback on the International Accounting Standards Board (IASB)'s preliminary views on how to apply a book-value method to particular business combinations under common control (BCUCCs) as set out in the Discussion Paper *Business Combinations under Common Control* (Discussion Paper).
2. As explained in Agenda Paper 23, this paper does not ask the IASB for any decisions.

Structure of this paper

3. The paper includes:
   (a) background (paragraphs 4–8);
   (b) key messages (paragraph 9–10);
   (c) preliminary views and feedback summary (paragraphs 11–61);
   (d) question for the IASB;
   (e) Appendix A—Comments on other aspects of a book value method;
   (f) Appendix B—Preliminary views and rationale; and
   (g) Appendix C—Example of opportunities for accounting arbitrage.

Background

4. As explained in Agenda Paper 23B of the IASB's December 2021 meeting, applying the preliminary views, a receiving entity would use the book-value method for:

   (a) BCUCCs that do not affect non-controlling shareholders of the receiving entity; and

   (b) BCUCCs that affect non-controlling shareholders of a privately held receiving entity in particular circumstances.

5. Paragraph 4.3 of the Discussion paper acknowledges a variety of book-value methods are used in practice. In particular, the variations relate to:

   (a) measuring the assets and liabilities received—the receiving entity typically measures the assets and liabilities received using either the transferred entity's or the controlling party's book values.

   (b) providing pre-combination information—the receiving entity includes the transferred entity's assets, liabilities, income and expenses in its financial statements either:

      (i) prospectively from the date of the combination, without restating pre-combination information; or

      (ii) retrospectively from the beginning of the earliest period presented as if the receiving entity and transferred entity had always been combined, with pre-combination information restated.

6. The Discussion Paper includes the IASB's preliminary views on:

   (a) measuring assets and liabilities received;

   (b) measuring consideration paid;

   (c) reporting any difference between the consideration paid and the book value of the assets and liabilities received;

   (d) reporting transaction costs; and

   (e) providing pre-combination information.

7. Paragraph 4.5 of the Discussion Paper states:

> [Section 4 of the Discussion Paper on applying a book-value method] focuses on the key features of a book-value method. The [IASB] will consider the comments received on this Discussion Paper in deciding whether to confirm its preliminary views and develop detailed proposals on how the receiving entity should apply a book-value method. Such future detailed proposals might address, for example, how to determine the book values of the assets and liabilities received when those book values are not readily available.

8. This paper summarises key messages and provides detailed feedback summaries on each of the preliminary views. Agenda Paper 23C to this meeting includes feedback on the preliminary view on pre-combination information. Agenda Paper 23D to this meeting includes feedback on disclosure requirements for BCUCCs to which a book-value method applies. The feedback in this paper excludes feedback relating to pre-combination information and disclosure.

Key messages

9. Respondents are split in their views on how a receiving entity should measure assets and liabilities received. Many respondents agree with the preliminary view to require measuring those assets and liabilities using the transferred entity's book values. However, many others disagree and suggest using another group entity's book values[1] or allowing or requiring the use of different book values (either the transferred entity's or another group entity's book values).

10. Almost all respondents agree with the preliminary views on:

    (a) measuring consideration paid;

[1] Almost all of these respondents suggest using the controlling party's book values (consistent with the Discussion Paper, we use the term 'controlling party' to refer to both the ultimate controlling party and an intermediate controlling party). A few respondents suggest using the transferring entity's book values. For simplicity, we use the term 'another group entity' to collectively refer to all these entities.

(b) recognising within equity any difference between consideration paid and the book value of assets and liabilities received and not prescribing the component(s) of equity in which to present such difference; and

(c) recognising transaction costs as an expense in the period in which these costs are incurred, except for the costs of issuing shares or debt instruments which would be accounted for in accordance with applicable IFRS Accounting Standards.

Preliminary views and feedback summary

11. Paragraphs 13–61 below summarise the preliminary views and feedback on those preliminary views including:

(a) measuring assets and liabilities received (paragraphs 13–38);

(b) measuring consideration paid (paragraphs 39–50);

(c) reporting any difference between the consideration paid and the book value of the assets and liabilities received (paragraphs 51–56); and

(d) reporting transaction costs (paragraphs 57–61).

12. Many respondents, while acknowledging the IASB will address further detailed aspects of a book-value method in next phase of the project, highlight aspects to consider. Appendix A summarises these comments.

Measuring assets and liabilities received

Preliminary view

13. Paragraphs 4.10–4.19 of the Discussion Paper (reproduced in Appendix B) discuss whether a receiving entity should measure the assets and liabilities received using the transferred entity's book values or the controlling party's book values. The preliminary view is to require the receiving entity to use the transferred entity's book values.

Feedback

14. Respondents are split in their views:

    (a) many agree a receiving entity should use the transferred entity's book values.

    (b) some disagree and suggest always using another group entity's book values. Most of these respondents suggest using a controlling party's book values. A few respondents suggest using the transferring entity's book values.

    (c) some disagree and suggest allowing or requiring the use of different book values (either the transferred entity's or another group entity's book values).

    (d) a few do not offer a view, observing instead the merits and limitations of different approaches and reporting split views within their organisation or jurisdictions.

15. Many respondents also suggest providing guidance on how to determine book values when they are not readily available—for example, if the transferred entity did not apply IFRS Accounting Standards prior to the BCUCC (see paragraphs A2–A3 of Appendix A). Feedback indicates the IASB's decision in this respect could affect the cost-benefit trade-off and therefore respondents' views on this matter.

16. The remainder of this section discusses:

    (a) trends in feedback (paragraphs 17–18);

    (b) reasons supporting either the transferred entity or another group entity's book values (paragraphs 19–34); and

    (c) reasons for allowing or requiring the use of different book values (paragraphs 35–38).

Trends in feedback

17. We identified the following trends in feedback by stakeholder group:

    (a) most accountancy bodies and regulators agree with the preliminary view;

(b) one user representative group agrees with the preliminary view[2];

(c) individuals and academics are split in their views; and

(d) most national standard-setters, preparers and accounting firms disagree.

18. We identified the following trends in feedback by region:

(a) respondents from Africa are split in their views;

(b) some respondents from Asia-Oceania agree but most disagree (including most from China and Japan);

(c) some respondents from Europe (including most from the United Kingdom) agree but most (including most from Germany) disagree;

(d) most respondents from Latin America agree;

(e) respondents from US & Canada are split in their views; and

(f) most respondents from global organisations disagree.

Reasons supporting either the transferred entity or another group entity's book values

19. Respondents in favour of using either the transferred entity or another group entity's book values did so for different reasons. We grouped the reasons in six broad categories:

(a) informational value (paragraphs 20–22);

(b) nature of a BCUCC (paragraphs 23–25);

(c) structuring opportunities (paragraphs 26–27);

(d) cost and complexity (paragraphs 28–30);

(e) consistency with practice and other requirements (paragraphs 31–33); and

(f) other reasons (paragraph 34).

[2] Other users did not provide feedback on this matter.

Informational value

20. Most respondents favouring the use of the transferred entity's book values say doing so would provide uninterrupted historical information about the transferred entity which would be useful in analysing trends and forecasting future performance.

21. However, most respondents favouring the use of another group entity's book values say doing so would provide more useful information, especially if the transferred entity had previously been acquired from an external party. This is because using another group entity's book values would provide:

    (a) more recent information than using the transferred entity's book values—see paragraph 4.11 of the Discussion Paper (reproduced in Appendix B) for more details;

    (b) useful information about additional assets and liabilities, like goodwill, and fair value adjustments resulting from the group's acquisition of the transferred entity from an external party which would not be provided if the transferred entity's book values were used.

22. One academic group suggests using the transferring entity's book values because, in its view, the book-value method is a form of carry-over accounting from the transferring entity to the receiving entity, without additional remeasurement at fair value or additional goodwill.

Nature of a BCUCC

23. Some respondents favouring the use of the transferred entity's book values say it would result in presenting the transaction from the perspective of the combining entities—the receiving entity and the transferred entity. These respondents say other group entities are not party to the combination and their perspective is irrelevant.

24. However, many respondents favouring the use of a controlling party's book values because say it better reflects the common control nature of the transaction. Although the controlling party is not one of the combining entities, the structure and financial terms of a BCUCC are often influenced, determined or approved by the controlling party. Therefore, those respondents say the controlling party is party to the transaction. A few respondents say the controlling party's common control is the main reason for using a book-value method.

25. Some of those respondents note the preliminary view to require an entity to recognise any difference between the consideration paid and the book value of the assets and liabilities received within equity (see paragraph 51). In their view, measuring the assets and liabilities received using a controlling party's book values will result in a difference that more faithfully reflects the transaction with owners acting as in their capacity as owners.

Structuring opportunities

26. Some respondents agree with the preliminary view because, as noted in paragraph 4.13(c) of the Discussion Paper (reproduced in Appendix B), using the transferred entity's book values treats assets and liabilities of the combining entities on the same basis, irrespective of how the transaction is legally structured. Using another group entity's book values could result in different outcomes depending on the transaction's structure because the assets and liabilities of one of the combining entities might be measured using updated carrying values from the other group entity. A few respondents also say using the transferred entity's book values avoids the need to identify an 'acquirer'.

27. However, many respondents favouring the use of another group entity's book values say it could prevent structuring opportunities that could arise from using the transferred entity's book values. For example, they say if a receiving entity acquires a business from a third party, it would recognise goodwill and make other fair value adjustments as required by IFRS 3 *Business Combinations*. However, by using the transferred entity's book values, the receiving entity could avoid doing so if that business were first acquired by a different group entity and then transferred to the receiving entity—the transferred entity's book values would not reflect goodwill and other fair value adjustments recognised by the group when it acquired the transferred entity. Appendix C illustrates the outcome of this scenario.

Cost and complexity

28. Many respondents favour using the transferred entity's book values because, in their view, doing so would be the least complex and costly option, particularly if the transferred entity prepares financial statements applying IFRS Accounting Standards. Some respondents say using the transferred entity's book-values could be the only

available option because other group entities may not prepare financial statements applying IFRS Accounting Standards.

29. However, most respondents in favour of using another group entity's book values say, in their view, doing so would be the least complex and costly option. In particular:

(a) many of those respondents say using the transferred entity's book values is likely to require a different set of consolidation adjustments to be prepared for the receiving entity which might need to be reversed when preparing a controlling party's consolidated financial statements, thereby increasing costs.

(b) many respondents say the transferred entity may have no statutory or other requirements to prepare financial statements applying IFRS Accounting Standards. In these circumstances, respondents say mandating the use of the transferred entity's book values could require preparing the transferred entity's financial statements (which might also require applying IFRS 1 *First-time Adoption of International Financial Reporting Standards*). In their view, the costs of doing so could exceed the benefits. One national standard-setter also says a controlling party's book values are more likely to be available and audited.

30. A few respondents suggest a 'waterfall approach' which would require a receiving entity to use available book values in financial statements prepared applying IFRS Accounting Standards at the highest level of common control within the group. If these book values are not available or would not be available without incurring undue cost or effort (for example, if consolidated financial information is not prepared at the highest level of common control), then the receiving entity should go one level down in the group structure until the required information is available—depending on the facts and circumstances, this could be at the level of the transferred entity.

Consistency with practice and other requirements

31. Some respondents favouring the use of another group entity's book values say the preliminary view would result in differences from US GAAP which requires measuring assets and liabilities received at the parent entity's carrying amount.

32. A few respondents say using the transferred entity's book values would be inconsistent with existing practice. For example, one national standard-setter from Asia says doing so would be inconsistent with local guidelines on merger accounting which require a receiving entity to use a controlling party's book values.

33. One preparer also says using the transferred entity's book values would be inconsistent with paragraph 13 of IAS 27 *Separate Financial Statements* which requires an entity to measure equity investments transferred in particular group reorganisations using the cost recognised in the original parent's financial statements.

Other reasons

34. Other reasons include:

(a) some respondents acknowledge using another group entity's book values may provide a more recent valuation[3]. However, they say this valuation would not necessarily result in better information unless the date of that recent valuation is relatively close to the date of the BCUCC. One respondent also says providing fair value information is more consistent with the acquisition method and not a book-value method.

(b) a few respondents from Asia say using the transferred entity's book values (which exclude fair value adjustments resulting from an acquisition of the transferred entity by the group) would improve comparability between combining entities that were subject to BCUCCs and entities that had grown organically.

Reasons for allowing or requiring the use of different book values

35. Some respondents suggest allowing or requiring a receiving entity to use different book values (either the transferred entity's book values or another group entity's book values) of which:

(a) some say a receiving entity should have an accounting policy choice (either on a transaction-by-transaction basis or on a consistent basis to all BCUCCs);

[3] See paragraph 21 of this paper and paragraph 4.11 of the Discussion Paper (reproduced in Appendix B)

(b) a few suggest which book values to use should be based on the circumstances of each BCUCC (for example using the waterfall approach explained in paragraph 30); and

(c) most do not specify the circumstances in which a receiving entity should be allowed or required to use the transferred entity or another group entity's book values.

36. Respondents supporting this approach comment on the merits and limitations of using either the transferred entity's book values or another group entity's book values (similar to those discussed in paragraphs 19–34) and say each method could provide relevant information depending on the situation. These respondents say:

(a) prescribing one method risks confusing users with inconsistent information about the same transaction being presented to the market. For example, if a controlling party spins off a business to a new holding entity, that new holding entity's financial statements would use the transferred entity's book values. However, those values might be inconsistent with information the controlling party discloses about the transferred entity as a discontinued operation. These respondents suggest allowing a receiving entity to use the book values that best align with other information presented by the group.

(b) consistent with the discussion in paragraph 4.17 of the Discussion Paper (reproduced in Appendix B), the costs of using either the transferred entity's book values or another group entity's book values could differ depending on facts and circumstances. These respondents suggest allowing a receiving entity to use the least costly method.

(c) the IASB should not prescribe a method because of the differing nature and rationale of BCUCCs to which a book-value method would apply. These respondents suggest allowing a receiving entity to use the most appropriate book values for a BCUCC depending on the facts and circumstances.

(d) allowing a receiving entity a choice of which book values to use would have limited effect on comparability because a book-value method would apply in limited circumstances.

37. Some respondents say a receiving entity should disclose its rationale for the selected method.

38. However, one accountancy body says allowing a choice of which book values to use would not reduce diversity in accounting for BCUCCs—one of the project's objectives.

Measuring consideration paid

Preliminary views

39. As stated in paragraphs 4.20–4.21 of the Discussion Paper, the consideration paid in a BCUCC can take various forms. Research had indicated that consideration is often paid in cash or in the receiving entity's own shares, but sometimes in non-cash assets or by incurring or assuming liabilities. Research also indicated that when a book-value method is applied, consideration paid is measured either at fair value or at book value or, in the case of the consideration paid in own shares, at their par or nominal value.

40. In the IASB's preliminary view:
    (a) it should not prescribe how the receiving entity measures consideration paid in own shares because as explained in paragraphs 4.26–4.28 of the Discussion Paper:
        (i) measuring consideration paid in own shares at either their par, nominal or fair value would affect only amounts reported for particular components of equity; and
        (ii) the reporting of components within equity and the measurement of issued shares for the purpose of that reporting are often affected by national requirements and regulations, and are generally not prescribed in IFRS Accounting Standards.
    (b) the receiving entity should measure consideration paid in assets at the receiving entity's book values of those assets at the combination date for reasons explained in paragraphs 4.29–4.36 of the Discussion Paper. In particular, the IASB's view was that the benefits of measuring such consideration at the fair value of the assets may not outweigh the costs of

doing so. The IASB observed that measuring fair values could be costly and could involve significant measurement uncertainty; and

(c) the receiving entity should measure consideration paid by incurring or assuming liabilities at the amount determined on the initial recognition of the liability at the combination date applying IFRS Accounting Standards for the reasons explained in paragraphs 4.37–4.42 of the Discussion Paper. In particular, the IASB did not identify convincing reasons to require measuring such consideration at fair value.

Feedback

Consideration paid in own shares

41. Almost all respondents agree with the preliminary view for reasons considered by the IASB. They also say the cost of measuring the fair value of shares is likely to outweigh the benefits.

42. A few respondents, although agreeing with the preliminary view, say measuring consideration paid in own shares at the shares' par or nominal value and not at fair value could result in additional costs and complexity if the receiving entity were to adopt a different basis when measuring an investment in a subsidiary in its separate financial statements (for example, fair value).

43. A few respondents disagree with the preliminary view:

(a) one national standard-setter and a preparer group suggest measuring consideration paid in own shares at the book value of assets and liabilities received. The preparer group says this would be consistent with requirements in other IFRS Accounting Standards, such as paragraph 10 of IFRS 2 *Share-based Payments*[4];

(b) one regulator and an accountancy body suggest measuring consideration paid in own shares at their par value or nominal value to reduce diversity and enhance consistency and comparability;

[4] Paragraph 10 of IFRS 2 requires an entity to measure goods and services received, and the corresponding equity increase, in an equity-settled share-based transaction, at the fair value of those goods and services, unless that fair value cannot be estimated reliably.

(c) one accounting firm says allowing measurement of consideration paid in own shares at fair value would be inconsistent with the logic underpinning a book-value method.

Consideration paid in assets

44. Most respondents agree with the preliminary view for reasons considered by the IASB (see paragraph 40(b)). In their view, measuring such consideration at book value would:

(a) be consistent with the logic of a model that focuses on book values;

(b) appropriately avoid recognising any gain or loss on assets transferred as consideration. One respondent says paying consideration in the form of assets is not the same as selling the asset at fair value and using the cash proceeds received as consideration (see also paragraph 45(b) below).

45. Some respondents disagree with the preliminary view. They say:

(a) the benefit of measuring such consideration at fair value may outweigh its cost; and

(b) measuring consideration paid in assets at the receiving entity's book values may lead to a risk of accounting arbitrage. For example, they say it would be inappropriate to have different accounting outcomes between the following circumstances:

(i) transferring an asset as consideration in a BCUCC; and

(ii) selling an asset at fair value and using the cash proceeds received as consideration for the BCUCC.

46. A few respondents suggest allowing a receiving entity the option to measure consideration paid in assets using either the assets' book values or fair values. One academic group says using book values is inferior and using fair values would better reflect the change in value during the period the receiving entity held the asset.

47. Some respondents say the IASB should consider any possible inconsistency with derecognition requirements in other IFRS Accounting Standards including for example IAS 16 *Property, Plant and Equipment*[5].

Consideration paid by incurring or assuming liabilities

48. Almost all respondents agree with the preliminary view for the reasons considered by the IASB (see paragraph 40(c)). Some say the preliminary view is cost-effective and using existing requirements will improve consistency. A few respondents also say the preliminary view would result in the most useful information about liabilities incurred or assumed in a BCUCC.

49. The Securities and Exchange Commission of Brazil disagrees with the preliminary view and says the preliminary view would not reduce diversity, suggesting:

> …consideration paid for incurring or assuming liabilities should be measured at either the incurred cost of the liability issued or the transferred cost of the liability assumed.

Other comments

50. Some respondents suggest:

    (a) considering situations in which consideration paid in a BCUCC might take a different form such as an exchange of two businesses—that is, the receiving entity transfers an existing business as consideration for the transferred entity (one national standard-setter and a regional group representing standard-setters).

    (b) providing additional guidance when the receiving entity pays no consideration. In particular, these respondents suggest clarifying whether, for accounting purposes, such consideration should be measured at nil, the book value of the net assets received or another basis (one national standard-setter and a regional group representing standard-setters).

[5] IAS 16 requires determining the amount of consideration included in the gain or loss arising from derecognising an item of property, plant and equipment applying the requirements for determining the transaction price in IFRS 15 *Revenue from Contracts with Customers*.

(c) a few respondents suggest providing further guidance on contingent consideration. For example, they suggest clarifying whether a receiving entity would apply IFRS 3, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or IFRS 9 *Financial Instruments* to account for contingent consideration.

Reporting difference between consideration paid and net assets received

Preliminary views

51. The IASB's preliminary view is to:

(a) require a receiving entity to recognise within equity any difference between consideration paid and the book value of assets and liabilities received; and

(b) not prescribe in which component(s) of equity the receiving entity should present that difference—this is because the reporting of components within a reporting entity's equity are often affected by national requirements and regulations, and are generally not prescribed in IFRS Accounting Standards.

52. Paragraphs 4.44–4.59 of the Discussion Paper explain the IASB's rationale for this preliminary view. In particular, the IASB observed:

(a) entities typically recognise this difference within equity.

(b) economically, not all of the difference necessarily constitutes a contribution to, or distribution from, equity, nor does all of it necessarily represent income or an expense. However, requiring an entity to segregate that difference into components could be costly and complex.

Feedback

Recognising difference within equity

53. Almost all respondents agree with the preliminary view for the reasons considered by the IASB. They also say the preliminary view avoids recognising an arbitrary gain or loss and is consistent with:

(a) prevailing accounting practice;

(b) IAS 1 *Presentation of Financial Statements* which requires reporting transactions with owners acting in their capacity as owners in the statement of changes in equity; and

(c) the fact that a BCUCC to which a book-value method applies might not be priced at arm's length.

Prescribing the component(s) of equity

54. Almost all respondents agree with the preliminary view to not prescribe in which component(s) of equity a receiving entity presents any difference between consideration paid and the book value of the assets and liabilities received for reasons considered by the IASB. A few respondents also say the preliminary view:

(a) is consistent with other IFRS Accounting Standards for transactions that affect equity;

(b) would allow a receiving entity to apply judgement based on the facts and circumstances.

55. Two respondents from Europe—a preparer and an accountancy body—agree the IASB should not prescribe the component in which an entity should present the difference but say they expect a receiving entity to present the difference in a specific component (retained earnings and a separate reserve, respectively).

56. A few respondents did not agree with the preliminary view and say specifying the component of equity within which to present any difference would prevent diversity.

Reporting transaction costs

Preliminary view

57. The IASB's preliminary view is that a receiving entity 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 applicable IFRS Accounting Standards.

58. In reaching this preliminary view, the IASB observed:

(a) applying IFRS 3, transaction costs are recognised as expenses in the period in which they are incurred, with an exception for the costs of issuing shares or debt instruments, which are accounted for applying the applicable IFRS Accounting Standards[6]. This is because transaction costs are not part of the exchange between the buyer and the seller of the business but are separate transactions in which a buyer pays for services received.

(b) entities apply a similar approach in practice.

Feedback

59. Almost all respondents agree with the preliminary view for reasons considered by the IASB.

60. However, a few respondents disagree with the preliminary view. Most of these respondents say BCUCCs accounted for using a book-value method might be different from other business combinations and, therefore, the IASB's conclusion in paragraph BC366 of IFRS 3—that acquisition-related costs are not part of the exchange—may not apply to such BCUCCs. These respondents suggest capitalising these costs, consistently with requirements for other costs incurred to acquire an asset.

61. One regional group representing standard-setters from Latin America says the preliminary view is inconsistent with the fact that a BCUCC accounted for using a book-value method is a transaction with owners acting as in their capacity as owners. This respondent says IFRS Accounting Standards require recognising costs arising from transaction with owners acting as in their capacity as owners in equity and the preliminary view could result in similar costs being accounted for differently.

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?

[6] IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments*.

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

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

Appendix A—Comments on other aspects of a book-value method

A1. Many respondents, while acknowledging the IASB will address further detailed aspects of a book-value method in next phase of the project, highlight particular aspects to consider which are summarised below.

How to determine book values when information is not readily available

A2. Many respondents suggest providing further guidance on how to determine the book values of assets and liabilities received when those book values are not readily available—such as when the transferred entity did not prepare financial statements applying IFRS Accounting Standards. For example:

(a) some respondents suggest clarifying whether—and if so how—the transferred entity would be required to prepare a full set of financial statements applying IFRS Accounting Standards solely for the purpose of providing financial information to the receiving entity or whether it would be sufficient to provide information prepared, for example, for inclusion in consolidation reporting packages.

(b) one national standard-setter suggests providing guidance on how a transferred entity that is an unincorporated business would prepare financial statements if it has not previously done so.

A3. Respondents also ask whether a transferred entity that has not previously prepared and presented financial statements applying IFRS Accounting Standards would be required to apply IFRS 1. Respondents say:

(a) applying the exemption in paragraph D16(a) of IFRS 1 for a subsidiary that becomes a first-time adopter later than its parent would result in a similar outcome to that of requiring the use of another group entity's book values[7];

[7] Paragraph D16(a) of IFRS 1 allows a subsidiary to measure its assets and liabilities at the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary.

(b) exercising the exemptions to use the fair value as deemed cost in paragraphs D5-D8 of IFRS 1 could result in an outcome similar to that of applying the acquisition method of accounting to the relevant assets; and

(c) a few respondents suggest considering practical expedients to reduce costs, for example by allowing a receiving entity that has not previously prepared financial statements applying IFRS Accounting Standards to consider the date of the BCUCC as the date of transition to IFRSs when applying IFRS 1 (if the transferred entity is required to apply IFRS 1), and therefore avoiding the need to prepare comparative information.

Other aspects

A4. Respondents also suggest clarifying:

(a) *history of assets and liabilities and treatment of equity reserves:* many respondents suggest clarifying whether applying the book value method would result in the initial recognition of assets and liabilities (while using existing book values) or whether the assets and liabilities would retain any associated history. For example, respondents ask whether a receiving entity:

(i) would, subsequent to a BCUCC, be able to reverse impairment charges recognised before the BCUCC (one accountancy body and a national standard setter);

(ii) could reassess the classification of financial instruments received and lease contracts transferred (a few respondents); and

(iii) would be required to reset reserves and reclassify any balances to profit or loss (for example, foreign currency translation reserves or hedging reserves) or whether such reserves should be maintained (some respondents).

(b) *differing accounting policies:* a few respondents suggest clarifying how to determine book values in situations in which accounting policies between the receiving entity and the transferred entity differ before the BCUCC.

(c) *pre-existing relationships:* one accountancy body and two accounting firms say the combining entities may have pre-existing relationships or other arrangements before a BCUCC. IFRS 3 requires the acquirer to identify and separately account for such relationships or other arrangements. Those respondents suggest providing similar guidance for BCUCCs.

(d) *recognising deferred tax:* one accounting firm suggests clarifying that:

(i) a BCUCC is not a business combination within the meaning of paragraphs15(b)(i) and 24(a) of IAS 12 *Income Taxes* and, therefore, a deferred tax asset or liability is not recognised for temporary differences arising from a BCUCC; and

(ii) any tax consequences arising from a BCUCC (for example, due to a change in tax base) will be recognised in profit and loss (rather than, for example, in equity).

(e) *measuring non-controlling interest:* one national standard-setter suggests clarifying the measurement of any non-controlling interest in the transferred entity.

(f) *business combinations achieved in stages:* one national standard-setter suggests considering how the book-value method would interact with other IFRS Accounting Standards, such as IAS 28 *Investments in Associates and Joint Ventures* when a receiving entity obtains control of a joint venture or an associate in a BCUCC (and is therefore required to discontinue applying IAS 28).

(g) *Alignment with the Conceptual Framework:* EFRAG says:

> Finally, EFRAG suggests that the IASB either further aligns the book-value method with the measurement bases under the *Conceptual Framework* or explains the conceptual differences if there is a departure from the *Conceptual Framework*. EFRAG acknowledges that a departure from the *Conceptual Framework* is possible, however, it is important to explain the conceptual differences between a transaction under common control (BCUCC) and acquisition of an asset under IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*.

Appendix B—Preliminary views and rationale

B1. The following excerpts from the Discussion Paper explain the rationale for the IASB's preliminary views on how to apply a book-value method:

> 4.10 The [IASB] considered whether the receiving company should measure the assets and liabilities received at the transferred company's book values or at the controlling party's book values.[8] Those book values would typically be identical if the controlling party has controlled the transferred company since the creation of that company. However, those book values could differ if, for example, the transferred company had previously been acquired from an external party (that is, a party outside the group), especially if that external acquisition was recent.
>
> 4.11 A difference between the transferred company's book values and the controlling party's book values is illustrated in the example in Diagram 4.1. In that example, Company P controls and wholly owns companies A, B and C. In the past, Company A acquired Company C from an external party. Applying the acquisition method, the assets and liabilities of Company C were measured at fair value at the acquisition date both by Company A, the immediate acquirer, and by Company P, the controlling party. Subsequently, Company C is transferred from Company A to Company B.[9] At the time of this business combination under common control, the book value of Company C's assets and liabilities in its financial statements is CU250,[10] and the book value of those assets and liabilities in both Company A's and Company P's consolidated financial

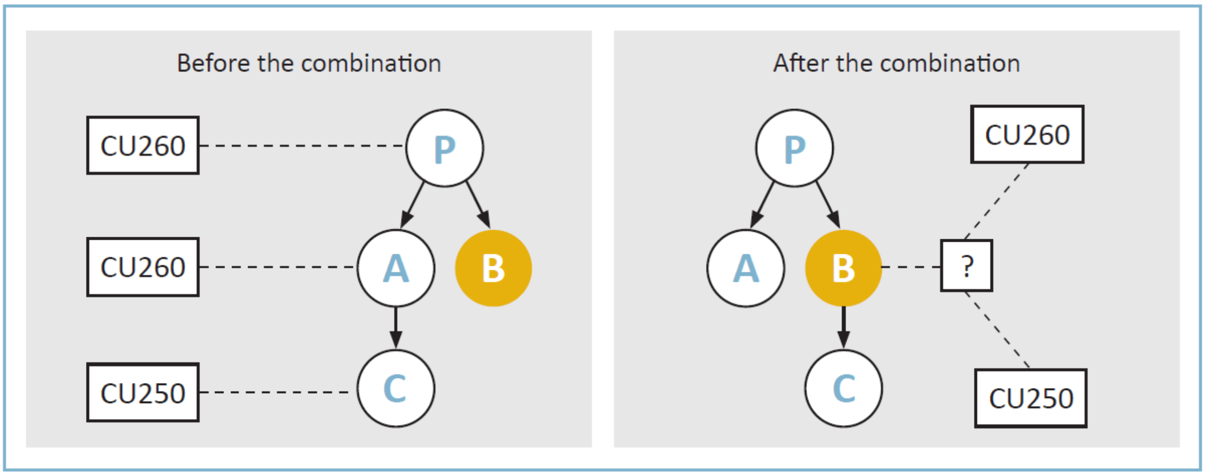
[8] Regardless of the approach used, the book values of the assets and liabilities received might need to be adjusted to align them with the receiving company's accounting policies.

[9] In describing business combinations under common control, IFRS 3 requires that common control is not transitory. As discussed in paragraph 1.16, the IASB has not yet considered whether to retain the notion of 'transitory control' and whether to clarify its meaning.

[10] In this Discussion Paper, monetary amounts are denominated in 'currency units' (CU).

statements is CU260.[11] The latter book value reflects a more recent valuation of Company C's assets and liabilities that was performed at the time when Company A acquired that company from the external party.

Diagram 4.1—Book values in a business combination under common control



4.12 In the example in Diagram 4.1, using the controlling party's book values to measure the assets and liabilities received in the business combination under common control would:

a. provide information based on a more recent valuation of the assets and liabilities of Company C, the transferred company. However, the controlling party's book values would typically not reflect the fair value of those assets and liabilities at the date of the business combination under common control, especially if the prior external acquisition occurred a long time ago.

b. be, arguably, inconsistent with the *Conceptual Framework for Financial Reporting* (Conceptual Framework) which focuses on information about transactions and events from the perspective of the company that prepares the financial statements—in this

[11] The amounts of CU250 and CU260 are both aggregate net amounts that comprise: (a) the total book value of the assets; minus (b) the total book value of the liabilities.

case, the receiving company.[12] From that perspective, the book values recorded by the controlling party, arguably, have no relation to the combination between Company B, the receiving company, and Company C, the transferred company, because the controlling party is not a party to that combination.

c. treat the assets and liabilities of the combining companies, Company B and Company C, on a different basis. That is, following the combination, the assets and liabilities of Company B, the receiving company, would continue to be measured at the book values reported by that company whereas the assets and liabilities of Company C, the transferred company, would be measured at the book values reported by the controlling party. Such an approach means that different information would be provided about the assets and liabilities of the combining companies, depending on how the combination is structured (that is, depending on whether Company C is transferred to Company B or vice versa).

4.13 In contrast, using the transferred company's book values to measure the assets and liabilities received in the business combination under common control would:

a. provide uninterrupted historical information about Company C, the transferred company, that is useful in analysing trends;

b. present the combination from the perspective of the combining companies, Company B and Company C, rather than from the perspective of the controlling party; and

c. treat the assets and liabilities of the combining companies, Company B and Company C, on the same basis. That is, following the combination, each

[12] Paragraph 3.8 of the *Conceptual Framework*.

company's assets and liabilities would continue to be measured at the book values previously reported by that company. Such an approach would provide similar information about the assets and liabilities of the combining companies, irrespective of how the combination is structured (that is, irrespective of whether Company C is transferred to Company B or vice versa).

4.14 The [IASB] considers that using the transferred company's book values, rather than the controlling party's book values, would be more consistent with the [IASB]'s reasons for requiring or permitting a book-value method in specified circumstances. Specifically, as discussed in paragraphs 2.24–2.27 and illustrated in Diagrams 2.3 and 2.4, using a book-value method for business combinations under common control that do not affect non-controlling shareholders would:

a. provide useful information to potential shareholders of the combining companies because the information produced by that method does not depend on how the combination is legally structured; and

b. avoid the difficulties that would arise if the acquisition method was applied because a book-value method does not rely on identifying the 'acquirer' in order to provide useful information.

4.15 Extending this logic to how a book-value method should be applied suggests that the assets and liabilities of each combining company should be treated on the same basis. That is, each company's assets and liabilities should continue to be measured at the book values previously reported by that company—instead of using different approaches for measuring the assets and liabilities of the combining companies depending on how the combination is legally structured.

4.16 The [IASB] also considered the other arguments summarised in paragraphs 4.12–4.13 for using the transferred company's book values or the controlling party's book values. The [IASB] acknowledged that, in principle, both information about more recent valuations (discussed in paragraph 4.12(a)) and uninterrupted historical information for analysing trends (discussed in paragraph 4.13 (a)) could be useful to users of financial statements. However, the [IASB]'s view is that from a conceptual standpoint, using the transferred company's book values is more appropriate than using the controlling party's book values because the controlling party is not a party to the combination of the receiving company with the transferred company.

4.17 From a practical perspective, the [IASB] noted that whether the transferred company's book values or the controlling party's book values are less costly to use would depend on the facts and circumstances of each combination. For example, one factor that would affect the costs of applying a book-value method is whether the transferred company or the controlling party has prepared its financial statements applying IFRS [Accounting] Standards.

4.18 On the basis of the above analysis, the [IASB] has reached the preliminary view that using the transferred company's book values would be likely to provide the most useful information to users of the receiving company's financial statements at a cost justified by the benefits of that information.

Appendix C—Example of opportunities for accounting arbitrage

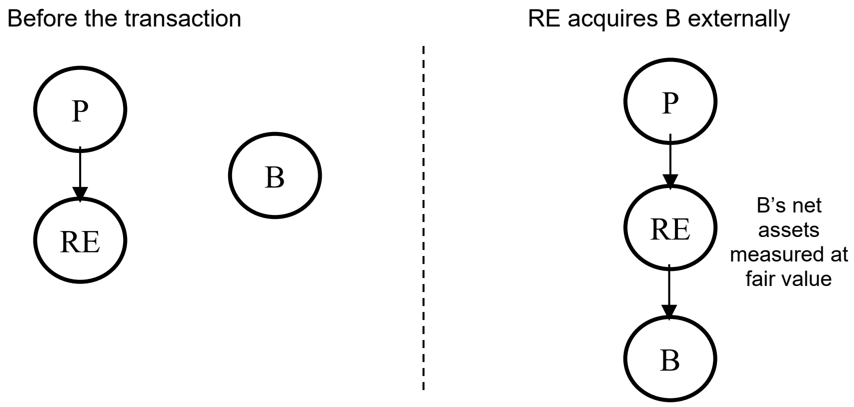
C1. Respondents provide examples of BCUCCs that could create opportunities for accounting arbitrage. Figure 1 illustrates one of these opportunities[13].

Figure 1

Controlling party P directs receiving entity RE (a wholly-owned subsidiary that has no non-controlling shareholders) to acquire business B which is controlled by an unrelated external party.

Option A

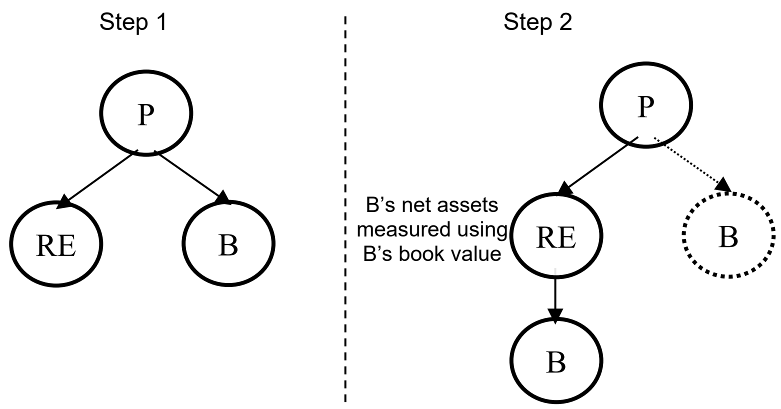
RE acquires B directly from the external party and measures assets and liabilities received at fair values applying IFRS 3 (and recognises any goodwill).



Option B

Step1: P acquires B from the external party. P measures assets and liabilities received at fair values applying IFRS 3 (and recognises any goodwill).

Step 2: P transfers B to RE (a BCUCC). Because RE has no NCS, RE applies a book-value method and uses Entity B's book values (which do not reflect fair value adjustments or goodwill recognised by P).



[13] Paragraph 17(a) of Agenda Paper 23A of the Board's December 2021 meeting also describes this situation.