STAFF PAPER

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IASB® meeting

Project	Business Combinations under Common Control
Paper topic	Feedback on pre-combination information
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Purpose

1. This paper summarises feedback on the International Accounting Standards Board (IASB)'s preliminary views on whether and how a receiving entity that applies a book-value method to a business combination under common control (BCUCC) provides pre-combination information about the transferred entity.

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 4–5);

   (b) key messages (paragraphs 6–9);

   (c) feedback (paragraphs 10–25);

   (d) question for the IASB; and

   (e) Appendix A—Preliminary views and rationale.

Preliminary views

4. The IASB's preliminary view is that a receiving entity should:
   (a) include in its financial statements the assets, liabilities, income and expenses of the transferred entity prospectively from the combination date, without restating pre-combination information.[1]
   (b) not be required to disclose pre-combination information.
5. Appendix A to this paper summarises the IASB's reasons for these preliminary views.

Key messages

6. Many respondents agree with the preliminary view to not restate pre-combination information because, in their view, restating pre-combination information would be complex and costly and these costs would outweigh any benefits of doing so.
7. Many respondents, including most accounting firms and regulators, disagree because:
   (a) in some jurisdictions, restated pre-combination information is required by capital market regulations in specific situations and, therefore, providing it in the financial statements won't result in significant additional costs; and
   (b) restated pre-combination information could meet user information needs for trend analysis, especially for a BCUCC in which a new entity (with no historical information) is set up to acquire the transferred entity.
8. Respondents who disagree suggest allowing (or requiring) a receiving entity to restate pre-combination information either in specific circumstances or for all BCUCCs.
9. Respondents' views are also split on whether the IASB should require a receiving entity to disclose pre-combination information in the notes to the financial statements. Many respondents agree with the preliminary view to not require a receiving entity to disclose pre-combination information. However, many respondents suggest requiring

[1] For simplicity, we describe this accounting treatment as 'not restating pre-combination information'. References to 'restating pre-combination information' refer to a situation in which a receiving entity would restate pre-combination information to include the transferred entity's assets, liabilities, income and expenses before the combination date.

a receiving entity to disclose either limited or a complete set of pre-combination information for all or some specific types of BCUCCs.

Feedback

10. Our summary presents separately feedback from users (paragraphs 11–15) and other stakeholders (paragraphs 16–25).

User feedback

11. Some users agree with the preliminary views that a receiving entity should not restate, and should not be required to disclose, pre-combination information because:
    (a) calculating pre-combination information could be subjective;
    (b) pre-combination information may not be useful for trend analysis (for example, it would exclude synergies resulting from the BCUCC); and
    (c) some users do not find restated pre-combination information useful—one user says the disclosures suggested in the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment* (IFRS 3 Discussion Paper) would be more useful (for example information about the subsequent performance of business combinations).
12. Most users disagree with the preliminary views, of which:
    (a) some suggest requiring a receiving entity to restate pre-combination information;
    (b) some agree with not restating pre-combination information but suggest requiring a receiving entity to disclose pre-combination information; and
    (c) some say pre-combination information is useful but do not express a preference between requiring a receiving entity to restate or disclose pre-combination information.
13. Users who say a receiving entity should restate pre-combination information express the following reasons:

(a) providing pre-combination information only in the notes to financial statements could increase the risk of user mistakes (for example, many users' models begin with information from primary financial statements and users might not realise adjustments are required); and

(b) restating will ensure users receive information about all material items.

14. Users who agree with not restating pre-combination information but say a receiving entity should be required to disclose pre-combination information say restating pre-combination information could cause confusion. One of these users says restating pre-combination information could provide useful information, however, doing so could make it difficult to track the underlying businesses, particularly if there are other significant transactions. This user suggests that if a receiving entity restates pre-combination information, it should disclose a line-by-line reconciliation to previously reported amounts.

15. When asked whether a receiving entity should disclose pre-combination information for specific line items and whether a receiving entity can aggregate pre-combination information disclosed, users say:

(a) aggregation of pre-combination information for some line items would be acceptable, however, they would want some specific items to be disclosed separately such as pensions, research and development expenditure and metrics that affect key management personnel remuneration (a few users); and

(b) a receiving entity should not aggregate any line items when disclosing pre-combination information (one user).

Feedback from other stakeholders

16. We have separately analysed respondents' comments related to:

(a) restating pre-combination information (paragraphs 17–22); and

(b) disclosing pre-combination information (paragraphs 23–25).

Restating pre-combination information

17. Respondents' views are split. Respondents commonly say regulations in some jurisdictions require a receiving entity to restate pre-combination information for at least some BCUCCs. For example, respondents say in some jurisdictions a receiving entity is required to restate pre-combination information for a BCUCC undertaken in preparation of an initial public offering (IPO) or for internal group restructurings accounted for applying a book-value method.

18. Many respondents agree with the IASB's preliminary view that a receiving entity should not restate pre-combination information for reasons considered by the IASB (see Appendix A). Those respondents also say:

    (a) not restating pre-combination information aligns with IFRS 3 which requires an acquirer to include information about an acquiree only from the acquisition date (a few respondents); and

    (b) there would generally be no non-controlling shareholders or potential shareholders using pre-combination information—unless a receiving entity enters into a BCUCC in preparation for, or conditional upon, an IPO (one respondent).

19. Many respondents, including most accounting firms and regulators, disagree with the preliminary view. These respondents say:

    (a) in at least some circumstances restated pre-combination information is useful (for example, to provide historical information and assess eligibility for a listing) and that is why some jurisdictions require restated pre-combination information (many respondents).

    (b) prohibiting a receiving entity from restating pre-combination information would result in:

        (i) financial statements excluding useful information (some respondents). For example, the Hong Kong Institute of Certified Public Accountants says:

            this would impair the quality and completeness of information presented under IFRS [Accounting Standards] because under such an approach, useful information for investors and other users to make informed economic decisions would only be presented outside IFRS financial statements.

(ii) entities incurring the cost of preparing separate information for regulatory purposes and that separate information not complying with IFRS Accounting Standards (some respondents); and

(iii) a need to determine the acquisition date and accounting acquirer which could be challenging and could lead to additional audit cost (some respondents).

(c) restating pre-combination information would:

(i) result in the same information being provided, regardless of how a BCUCC is structured. Not restating pre-combination information would result in users receiving different information depending on how a BCUCC is structured (see paragraph 4.59 of the Discussion Paper—reproduced in Appendix A) (many respondents).

(ii) not generally result in significant additional costs. This is because regulators might already require entities to (a) provide restated pre-combination information and (b) subject this information to some level of assurance (many respondents).

(iii) be consistent with the logic underpinning a book-value method because it would present financial information as if the companies had always been combined. Given that a BCUCC to which a book value method applies would generally be an internal reorganisation, restating pre-combination information would better reflect continuation of the existing business and ensure historical information is provided (some respondents).

(iv) provide information that may be useful in analysing trends (many respondents).

20. A few accounting firms say allowing a receiving entity to disclose pre-combination information would not achieve the same objective as restating pre-combination information. Whether and what information entities disclose could vary and the information disclosed might not be sufficient.

Alternative suggestions

21. The respondents who disagree provide the following alternative suggestions:

    (a) most of these respondents suggest allowing a receiving entity an option to restate pre-combination information. One respondent says a receiving entity should apply the option consistently to all BCUCCs while other respondents do not specify whether the option should be applied consistently to all BCUCCs or separately for each BCUCC. Some of these respondents also suggest a receiving entity disclose the reason for the chosen option.

    (b) some respondents suggest requiring a receiving entity to restate pre-combination information in some circumstances, such as a group restructuring in preparation of an IPO, and allowing a receiving entity the option to restate pre-combination information in other circumstances.

    (c) some respondents suggest requiring a receiving entity to restate pre-combination information but allowing the receiving entity to not restate pre-combination information if doing so would be impracticable or inconsistent with legal requirements.

    (d) a few respondents suggest requiring a receiving entity to always restate pre-combination information because, in their view, doing so would be the most cost-beneficial.

22. One respondent says a receiving entity should restate pre-combination information from the later of (a) the earliest date presented or (b) the date the receiving and transferred entities first came under common control.

Disclosing pre-combination information

23. Many respondents agree with the preliminary view to not require a receiving entity to disclose pre-combination information for reasons considered by the IASB (see Appendix A). Some of these respondents say the IASB should *not prohibit* a receiving entity from disclosing pre-combination information because pre-combination information could be useful for trend analysis and, as stated earlier, may be required in some jurisdictions for specific types of BCUCCs.

24. Some respondents suggest requiring a receiving entity to disclose a complete set of pre-combination information:
    (a) if the IASB confirms its preliminary view to not allow a receiving entity to restate pre-combination information;
    (b) if a BCUCC is undertaken in preparation for an IPO;
    (c) if creating a new holding entity for internal group restructurings; or
    (d) for all BCUCCs.
25. Some respondents say the IASB should require a receiving entity to disclose limited pre-combination information. This would not lead to excessive costs while still providing information that would be useful in understanding the effects of a BCUCC and for trend analysis. One national standard-setter suggests requiring such disclosure only for material BCUCCs. Suggestions of pre-combination information a receiving entity would disclose include:
    (a) revenue and profit or loss of the combined entity for the current reporting period, as if the BCUCC had occurred at the beginning of the reporting period (similar to that required by paragraph B64(q)(ii) of IFRS 3); and
    (b) total current and non-current assets, total current and non-current liabilities, revenues and net income of the combined entity.

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 deliberations?

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

Appendix A—Preliminary views and rationale

A1. This appendix reproduces excerpts from the Discussion Paper explaining the IASB's rationale for the preliminary views set out in paragraph 4 of this paper.

Restating pre-combination information

A2. Paragraphs 4.57–4.62 of the Discussion Paper state:

> 4.57 As discussed in paragraph 4.3 [of the Discussion Paper], in some cases when applying a book-value method, companies combine the assets, liabilities, income and expenses of the transferred company retrospectively. In other words, the receiving company's financial statements are prepared as if the combining companies had always been combined, with pre-combination information restated to include the transferred company's assets, liabilities, income and expenses from the beginning of the earliest period presented. In other cases, companies combine those items prospectively, that is, from the date of the combination, as is required for business combinations covered by IFRS 3. The prospective approach does not require the receiving company to restate pre-combination information.
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> 4.58 As discussed in paragraphs 4.14–4.15 [of the Discussion Paper], in developing its preliminary views on how a book-value method should be applied, the [IASB] considered the reasons for its preliminary view on when a book-value method should be applied to business combinations under common control. Specifically, as discussed in paragraphs 2.24–2.27 [of the Discussion Paper] and illustrated in Diagrams 2.3 and 2.4 [of the Discussion Paper], 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.

4.59 Extending this logic to how a book-value method should be applied in relation to pre-combination information suggests that pre-combination information should be prepared in a way that does not depend on how the combination is legally structured. That is, the receiving company should combine the transferred company's assets, liabilities, income and expenses retrospectively, so the receiving company's financial statements are prepared as if the combining companies had always been combined. Such an approach would result in the same information being provided, regardless of how the combination is legally structured. Also, such an approach would be similar to the concept of combined financial statements discussed in the *Conceptual Framework*, which implies a retrospective approach.[36]

4.60 However, in discussing this issue, many users of financial statements and other stakeholders did not agree with using a retrospective approach in the primary financial statements. As explained in paragraph 4.9(b)(ii) [of the Discussion Paper], although they agreed that pre-combination information for all combining companies could be useful, they expressed a view that such a retrospective approach would provide a picture of a group in a period when that group did not exist. Some stakeholders call such information 'pro forma' (or hypothetical) information and consider it inappropriate to include such information in primary financial statements. Some stakeholders also expressed concerns that preparing such information may involve significant judgement and uncertainty. Finally, some stakeholders pointed out that historical information about each

[36] Paragraph 3.12 of the *Conceptual Framework*.

of the combining companies would typically be required by capital market regulations if the combination is undertaken in preparation for an initial public offering.

4.61 From a practical perspective, the [IASB] noted that the retrospective approach would be more costly to apply than a prospective approach. Furthermore, the two approaches would provide different information only in the financial statements for the period in which the combination occurs (including when presenting comparative information) and in the financial statements for the following period (only when presenting comparative information). The differences between the approaches would not cause differences in the financial statements for later periods.

4.62 After considering the stakeholder input and analysis summarised in paragraphs 4.57–4.61, the [IASB] has reached the view that the benefits of information provided by a retrospective approach may be limited and may not outweigh the costs of providing that information. Accordingly, the [IASB] has reached the preliminary view that the receiving company should combine the transferred company's assets, liabilities, income and expenses prospectively from the combination date. (However, that preliminary view would not preclude requiring the receiving company to disclose pre-combination information in the notes to its financial statements. That issue is discussed in paragraphs 5.23–5.25 [of the Discussion Paper].)

Disclosing pre-combination information

A3. Paragraphs 5.23–5.25 of the Discussion Paper state:

5.23 In particular, the [IASB] considered whether it should require disclosure of pre-combination information. Section 4 [of the Discussion Paper] explains that the [IASB] reached the preliminary view that the assets, liabilities, income and expenses of the transferred company should be combined with those of the receiving company prospectively, from the combination date, without restating pre-combination information. However, that preliminary view would not preclude requiring the receiving company to disclose pre-combination information in the notes to its financial statements.

5.24 For example, the [IASB] could require a complete set of pre-combination information for all the combining companies, such as a full or condensed set of combined financial statements. Alternatively, the [IASB] could require limited pre-combination information, such as the revenue and profit or loss of the combined company for the current reporting period, as if the combination had occurred at the beginning of the reporting period (as required by paragraph B64(q)(ii) of IFRS 3). (The IFRS 3 Discussion Paper discusses possible improvements to this requirement, such as adding a requirement to disclose cash flows from operating activities.)

5.25 In considering whether it should require disclosure of pre-combination information, the [IASB] noted feedback from users of financial statements that such information could be useful, for example, in performing trend analysis. However, some stakeholders (including preparers of financial statements) argued that this information is costly to prepare, for example, when it would be necessary to align accounting policies of the combining companies retrospectively rather than prospectively. On balance, in the [IASB]'s view, the benefits of the disclosure of pre-combination information in the circumstances when a book-value method is applied would not outweigh the costs of doing so. Accordingly, the [IASB] has reached the preliminary view that it should not require the disclosure of pre-combination information.