



Accounting Standards Board

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1 May 2012

Dear Françoise

EFRAG Discussion Paper: 'Accounting for Business Combinations under Common Control'

I am enclosing the Accounting Standards Board's response to the Discussion Paper 'Accounting for Business Combinations under Common Control' (BCUCC). The ASB's response to the Discussion Paper's invitation to comment is set out in the Appendix to this letter.

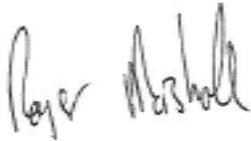
The ASB is of the view that BCUCC are a diverse set of transactions and the application of IFRS 3 'Business Combinations' can only be supported when the accounting outcome results in decision-useful information. The ASB considers there are circumstances when the predecessor basis of accounting provides decision-useful and cost effective information. It does not consider this should be restricted to circumstances when an analogy with IFRS 3 breaks down.

The ASB does not support the approach taken in developing the Discussion Paper. The principles in IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' have been followed to identify how to apply current IFRS. In its opinion applying the hierarchy in IAS 8 restricts the search for possible solutions to those within current IFRS literature. A well balanced Discussion Paper should identify the issues, research user needs and provide 'thought-leadership' by recommending alternative solutions, not restrict itself to current IFRS.

The ASB considers the proposals in this paper require further development to identify user needs and provide greater explanation of predecessor basis of accounting.

Should you have any questions regarding this letter please do not hesitate to contact Michelle or myself.

Yours sincerely

A handwritten signature in black ink that reads "Roger Marshall". The signature is written in a cursive style.

Roger Marshall

Chairman

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Response to the EFRAG Discussion Paper: Accounting for Business Combinations under Common Control

1.1 Question

Do you think that the concerns have been accurately described in relation to the issues arising from accounting for BCUCC transactions? If not, please could you suggest other significant concerns that have not been addressed?

1.1 Response

No. The ASB suggest that in addition to the concerns identified in the DP further evaluation of the implications to non-controlling interests should be undertaken. A BCUCC will often involve the transfer of value from one entity to another and could thereby affect the value of a non-controlling interest. It is important that the information provided by the financial statements enables non-controlling interests to evaluate this change.

1.2 Question

In your experience, what approaches are typically applied by preparers in practice for BCUCC and what justification is provided to support their application of these approaches?

1.2 Response

UK and Republic of Ireland accounting standards (local GAAP) include Financial Reporting Standard 6 'Acquisition and Mergers' (FRS 6) which addresses group reconstructions. A group reconstruction may be accounted for using merger accounting, even though there is no merger, providing merger accounting is permitted by company law and the ultimate shareholders remain the same, and the rights of each shareholder, relative to others, are unchanged.

A group reconstruction is defined in FRS 6 as any of the following arrangements:

- (i) the transfer of a shareholding in a subsidiary undertaking from one group company to another;**
- (ii) the addition of a new parent to a group;**

- (iii) the transfer of shares in one or more subsidiary undertakings of a group to a new company that is not a group company but whose shareholders are the same as those of the group's parent; and
- (iv) the combination into a group of two or more companies that before the combination had the same shareholders.

We consider that UK and Republic of Ireland entities that prepare financial statements in accordance with EU-adopted IFRS will apply the hierarchy in IAS 8, which will lead them to FRS 6. We note, however, that there are circumstances in the UK where company law may prohibit the use of book value, these circumstances relate to where this is a transfer at undervalue.

2.1 Question

Are there any issues not included in the scope of the DP that, in your view, need to be addressed in developing an approach to account for BCUCC in the consolidated financial statements of the transferee?

2.1 Response

Yes. The ASB considers it would have been helpful to define a BCUCC or to identify arrangements within the definition and then identify possible solutions. The discussion paper does not define a BCUCC in the same manner as FRS 6 and consequently a greater number of transactions may fall within the scope of the DP. This makes the task of identifying possible solutions for recognition and measurement of a BCUCC transaction more difficult.

2.2 Question

Do you believe that there are any specific issues to be addressed in the initial recognition and measurement of BCUCC in the separate and individual financial statements? If so please explain what those issues are and how they should be addressed.

2.2 Response

Yes. As noted above the ASB consider greater consideration of non-controlling interest is required. This is especially true where the individual financial statements are used to calculate profits available for distribution to shareholders; the effect of the BCUCC on distributable profits should be addressed.

As noted in our response to question 1.1 we also consider that the role of the non-controlling interest needs to be further explored. A BCUCC which, for example, transfers an asset from one group entity to another, changes the cash flows of the individual entities concerned and therefore has the potential to alter the value of the non-controlling interests and the profits available for distribution. Therefore special consideration needs to be given to BCUCC that alter the value of non-controlling interests.

2.3 Question

Are there any specific issues you think need to be addressed when considering what information about a BCUCC should be disclosed in the notes to the financial statements of the transferee?

2.3 Response

Yes. It is difficult to answer this question when recognition and measurement requirements are not proposed in the DP. We suggest that the disclosure requirements in IAS 8 'Related Party' transactions should be considered. In addition the disclosure requirements in IFRS 3 that relate to the narrative description of the transaction and the potential implications on future cash flows are relevant, specifically the disclosure objective in paragraph 59 of IFRS 3.

3.1 Question

Do you agree that an important step is to understand the information needs of users in the financial reporting of a BCUCC transaction? If not, how else would you set out an approach that satisfies the objective of financial reporting?

3.1 Response

Yes. We agree that it is important to understand the needs of users when developing a proposal in a DP. We also consider a DP must provide 'thought-leadership' by evaluation of the identified needs and considering the implication to financial statements. A well balanced DP needs to identify the issue, evaluate the needs of users and set out alternative solutions as a minimum. In developing alternative solutions it is necessary to balance the cost of providing information with the benefit to users of financial statements. Therefore understanding the needs of users' is a key step in developing the DP but is only one step in developing a DP.

3.2 Question

It is noted above that the analysis in this DP is taken from the perspective of the transferee (entity perspective) as opposed to the perspective of the owners (proprietary perspective). Do you agree that, to be consistent with existing IFRS, the entity perspective should be dominant when considering BCUCC? If not, why not?

3.2 Response

We agree that the entity perspective is consistent with current IFRS, although we acknowledge the IASB has not explicitly stated it applies the entity perspective.

We consider a DP should evaluate accounting options to find an optimal solution. We do not believe a DP should restrict its analysis to current IFRS.

As the aim of the project is to influence IFRS it is important to evaluate findings and possible solutions in relation to the current IFRS framework but current IFRS should not restrict the search for and evaluation of possible solutions.

3.3 Question

Do you agree with applying the 'logic' of the IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' hierarchy in developing an approach to accounting for BCUCC transactions? If not, what alternative would you propose and how would you reconcile that approach with existing IFRS?

3.3 Response

No. We do not agree with applying the logic in IAS 8. We are concerned that the DP attempts to apply current IFRS to the problem rather than find an optimal solution, building from the conceptual framework would be preferable.

3.4 Question

Do you agree that if and when an analogy to IFRS 3 is considered to apply, it is appropriate to assume that fair value at initial recognition provides information that is more decision-useful than values based on previously recognized amounts or any other measurement attribute? If not, please explain why?

3.4 Response

No. If an analogy is applied to IFRS 3 then fair value must provide decision useful information. However, IFRS provides decision useful information by requiring the use of fair values to most assets and liabilities acquired contrasted with the consideration transferred for the acquisition (at fair value) to obtain a value for goodwill. A BCUCC is a transaction between related parties; it is not evident therefore the consideration transferred (if consideration is transferred) is at fair value. Consequently, a strict analogy is not always possible and therefore it is not always appropriate to assume that fair value at initial recognition provides decision useful information.

We also question whether users would find fair values helpful for BCUCC, many argue there has been no external transaction and therefore this is not so much a fair value exercise but a revaluation of existing assets and liabilities. For example, consider a BCUCC transaction where the economic rationale for the transaction is to maximise tax positions; although a legal transaction occurs no changes are made to the operating procedures of the entities we question if a user obtains decision useful information from revaluing the transferor's assets to fair value where transferee's remain at book value.

3.5 Question

Do you agree that if the analogy to IFRS 3 does not apply, defining an appropriate measurement attribute should be guided by an analysis of the information needs of users? If not, why not?

3.5 Response

Yes. We agree if an analogy to IFRS 3 does not apply then user information needs should be considered. In addition to evaluating users' needs the cost of preparation versus the benefit to users (including the reliability of the information provided) needs to be considered.

4.1 Question

Do you agree with the main features of a BCUCC identified above? If not, what other features would you highlight?

4.1 Response

No. We do not agree with the list provided. We do not understand what is unique about the purpose of the transaction to BCUCC. In addition we note the list does not include the fact that a BCUCC is a related party transaction.

4.2 Question

It is noted above that BCUCC can be substantially different in nature from business combinations between unrelated parties. Do you agree that a BCUCC can be different to a business combination under IFRS 3? If so, describe examples you have encountered in practice that verifies this. If not, please explain why?

4.2 Response

Yes. We agree that a BCUCC can be different to an unrelated business combination under IFRS 3.

The most significant difference is the transaction between related parties and therefore is not necessarily an arm's-length transaction. We do not agree the purpose of the transaction is particularly different, for example, it might be argued all business combinations are undertaken to enhance shareholder value.

We note particularly the process for undertaking the transaction is likely to be significantly different. In an arm's length transaction a detailed due diligence process with a careful exchange of information is likely to take place. A BCUCC is unlikely to have the same restrictions around the flow of information and unlikely to be subject to due diligence and investigation. It might be argued that the transferee in a BCUCC 'knows more about the target' than in an arm's length transaction and therefore there is less risk to the transaction.

We also consider that where the BCUCC does not involve non-controlling interest whilst future cash flows might be improved by synergies the only additional risk to the ultimate parent is risk from arising from the BCUCC transaction itself.

4.3 Question

Do you agree with the analysis that has been performed in relation to the information needs of users? If not, why not?

4.3 Response

No. We do not agree with the analysis for the following reasons:

- (i) Paragraphs 36 and 37 suggest that a BCUCC lacks economic substance and may not change future cash flows; without economic substance there is no justification to undertake the BCUCC and management would therefore not expend resources on the transaction.**
- (ii) The scope of the DP is defined as consolidated financial statements and therefore this analysis should focus on decision useful information in those financial statements. We are therefore surprised that the DP concludes that the consolidated financial statements are not used. We note that IFRS 10 and the European Accounting Directives provide exemptions from consolidation that are designed to avoid the need for 'sub-groups' to prepare consolidated financial statements. We therefore consider that where consolidated financial statements are required there is a distinct group of users, for example a Regulator may require consolidated financial statements for a related entities operating in a particular jurisdiction.**
- (iii) We do not consider it is always true the transferee is never responsible for achieving a fair price. This is because directors have fiduciary duties and secondly directors are likely to be responsible for future cash flows post the BCUCC and therefore are likely to have an interest in the price of the business acquired.**

4.4 Question

Do you think that with BCUCC it may be difficult in some circumstances to identify an acquirer (View A) or do you believe that an acquirer can always be identified (View B)?

4.4 Response

We support view A that it might be difficult to identify an acquirer in all circumstances.

4.5 Question

If you believe that an acquirer can always be identified in a BCUCC, do you think that an analogy to IFRS 3 is not valid because the ultimate parent entity can direct the identification of an acquirer so that the accounting outcome is not a faithful representation of the underlying BCUCC transaction?

4.5 Response

Not applicable.

4.6 Question

Do you agree with the analysis above that under IFRS 10 'control' should be assessed from the perspective of the reporting entity and not from that of the ultimate parent entity? If not, why not?

4.6 Response

Yes. We agree that control should be assessed from the perspective of the reporting entity and not from that of the parent entity. We consider that the boundaries of the entity must be from the perspective of the reporting entity, even when the entity is itself part of a larger reporting entity.

4.7 Question

Do you agree that the definition of a 'business' in IFRS 3 raises no particular issues for BCUCC? If not, why not?

4.7 Response

Yes. We agree that the IFRS 3 definition of a business raises no particular issues.

4.8 Question

Do you think the absence of a market-based transaction can have consequences when applying the recognition principle in IFRS 3 because of a lack of measurement reliability? If so, do you agree with the analysis? If not, why not?

4.8 Response

Yes. We agree that the absence of a market based transaction complicates the application of the recognition principle in IFRS 3, specifically regarding identifying the consideration for the BCUCC.

4.9 Question

Do you think it is appropriate to apply the measurement principle in IFRS 3 to BCUCC when the analogy to IFRS 3 is valid? If not, why not?

4.9 Response

No. As noted above we consider that the absence of a market-based transaction complicates the application of the measurement principle in IFRS 3, especially in relation to consideration. Therefore we do not think it is always appropriate to apply the measurement principle on IFRS 3.

We consider that in some circumstances the measurement principle in IFRS 3, for example if an ultimate parent entity acquires a subsidiary on day 1 and then on day 2 reorganises the group, this would provide evidence of a market based transaction and the principle in IFRS 3 could be applied. However, we consider there may be circumstances, such as group reorganisations as defined in FRS 6, where user needs do not require the application of the measurement principle in IFRS 3.

As already highlighted we consider further research is required as to whether fair value provides the most cost benefit information for all BCUCC, even where the principles in IFRS 3 can be applied.

5.1 Question

Do you believe that the transaction price should be referenced against the fair value of the business acquired and bifurcated (when the transaction price exceeds the fair value of the business acquired) if the transaction price does not reflect a proxy for fair value? This ensures the BCUCC transaction reflects two transactions: a) a contribution from (distribution to) the ultimate parent entity, and b) a business combination.

5.1 Response

No. We are not of the view that applying IFRS 3 is necessarily the correct solution for all BCUCC, consequently we do not consider bifurcation of the transaction is always required.

5.2 Question

Do you believe that goodwill and/or identifiable intangible assets should not be recognised in the balance sheet of the acquirer on the basis that they cannot be reliably measured?

5.2 Response

No. We consider that if the transaction price is reference to a market based transaction and thereby at fair value or the consideration can be reliably measured we see no justification for not recognising goodwill and/or intangible assets when it is required by IFRS 3. However, if the consideration is not reference to a market based transaction then we would agree that where goodwill is the residual asset it may not be representationally faithful.

5.3 Question

Do you believe that where the consideration transferred is lower than the fair value of the net assets acquired, the difference should reflect a contribution from the ultimate parent entity or recognised as income?

5.3 Response

We consider whether there is a bargain purchase or a parent entity contribution is a matter of circumstance. We consider that a parent entity contribution is a transaction with equity holders and should not be recognised as income.

5.4 Question

Do you think that the BCUCC should be viewed as a 'transfer' of a business rather than an acquisition of a business when the analogy to IFRS 3 can never be applied?

5.4 Response

No. We consider there is no justification for viewing a BCUCC as a 'transfer' rather than an 'acquisition'. We do not see the application of predecessor accounting should necessarily be restricted to circumstances when IFRS 3 cannot be applied. We believe predecessor accounting can provide the appropriate

accounting and that it does not need to be justified on the grounds that an acquirer cannot be identified.

We agree with the DP that 'fresh start' accounting may be difficult to justify on cost benefit grounds and question whether it would really provide more useful information to users than predecessor accounting. If it is agreed that the transaction is between related parties and can be undertaken at predecessor values with adequate disclosures we question what additional information is gained from the use of 'fresh start' accounting.

5.5 Question

Do you believe that all the arguments and views presented are valid when it is not appropriate to apply an analogy to IFRS 3?

5.5 Response

Yes. We agree the accounting under a predecessor basis of accounting might be more appropriate than applying acquisition accounting and therefore support the view in paragraph 50 of chapter 5.

5.6 Question

Do you agree that the approaches outlined in Appendix 3 are unlikely to result in decision-useful information? If not, why not?

5.6 Response

Appendix three tries to identify how to determine whether to apply IFRS 3. We agree that no single approach can be applied to all BCUCC and therefore support view 3. We suggest that in a further development of the DP approaches outlined in Appendix 3 might be considered further, to provide guidance on selecting the appropriate accounting.

5.7 Question

Do you believe that the diversity in the information needs of users when compared to a business combination and the cost constraint in financial reporting provide justification to consider whether or not the recognition and measurement principle in IFRS 3 are appropriate when accounting for BCUCC?

5.7 Response

Yes. We agree that the diversity in the information needs of users and the diversity of transactions that fall within the scope of a BCUCC provide justification to consider whether the principles in IFRS 3 should be applied.

5.8 Question

Do you believe that all the arguments presented in relation to view three are valid or are there others that you would consider?

5.8 Response

Yes. We are content with the analysis of position supporting the three views. Our only comment would be that we do not consider the costs and benefits of applying the principles in IFRS 3 have been adequately investigated. As noted earlier whilst we do not disagree with many of the conclusions raised we think the approach to the DP of applying IAS 8 may have restricted the outcome of the DP.