

This paper provides the technical advice from EFRAG TEG to the EFRAG Board, following EFRAG TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in EFRAG Update. EFRAG positions as approved by the EFRAG Board are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

## **Business Combinations under Common Control Cover Note**

### **Objective**

- 1 The objective of the session is to discuss and approve the EFRAG comment letter on the IASB DP/2020/2 *Business Combinations under Common Control* issued by the IASB in November 2020 (the 'DP').

### **Background**

- 2 The IASB published its DP in November 2020. The DP explores possible reporting requirements for BCUCC transactions in the receiving company's financial statements to reduce diversity in practice and improve transparency of reporting for such transactions. The DP's comment period ended on 1 September 2021.
- 3 EFRAG published its draft comment letter (DCL) on the DP in February 2021. In its DCL, EFRAG broadly supported the approach proposed by the IASB and posed several questions to constituents on specific areas such as selecting a measurement method and the application of the acquisition method and a book-value method to BCUCC. A summary of EFRAG's DCL can be found in Appendix 2. EFRAG DCL's comment period ended on 30 July 2021.

### **Outreach activities on the BCUCC project**

- 4 During the consultation period, EFRAG participated in seven outreach events on the proposals included in the IASB's DP on business combinations under common control (BCUCC). The events were jointly organised with the IASB and national standard setters or professional organisations.
- 5 Appendix 1 to this cover note provides a detailed list of outreach events held on the project. For detailed feedback on the outreach events, please refer to the link in paragraph 35(b). For a more summarised version of the outreach events, refer to the link in paragraph 35(a).

### **Comment letters received**

- 6 In total, EFRAG received 14 comment letters including one draft comment letter in response to the EFRAG draft comment letter published in February 2021. The list of respondents includes nine national standard setters, two preparer organisations, one user organisation, one regulator and one anonymous.
- 7 For detailed feedback obtained from the comment letters received, please refer to the link in paragraph 35(c). For a more summarised version of the comment letters received, refer to the link in paragraph 35(a).

**Key messages from comment letters received and from outreach events held**

- 8 Regarding the summary below, unless specifically mentioned, the feedback came from both comment letters received and outreach events held.
- 9 *Scope:*
- (a) The majority of respondents from the comment letters received welcomed the DP's proposals and the IASB's efforts to address the current lack of guidance on the accounting for BCUCC.
  - (b) Also, a majority of respondents from the comment letters received welcomed the project's scope as defined in the DP. However, there were mixed views on scope from the outreach events – some supported the IASB proposals while some considered that the economic substance of the transaction should also be taken into account.
- 10 *Selecting the measurement method:*
- (a) There was general agreement that neither the acquisition method nor a book-value method should be applied to all BCUCC. Also, a majority of respondents from the comment letters received supported the IASB's decision tree and many asked to clarify the phrase "affect non-controlling shareholders". Many participants in the outreach events supported to use the existence of non-controlling shareholders (NCS) in the receiving company to determine which method to apply.
  - (b) The majority of respondents from the comment letters received agreed with the IASB proposal to require the application of the acquisition method when the receiving company's shares were traded in a public market.
  - (c) In general, there were mixed views regarding the related party exception – there was support for the IASB proposal but also others indicated that not all NCS would have the same access to information, therefore the exception should be 'permitted' rather than 'required'.
  - (d) Also, some agreed with the proposed optional exemption while some others questioned whether it was workable in practice.
  - (e) Furthermore, in general, there was agreement with the IASB proposal that the optional exemption and the related-party exception to the acquisition method should **not** apply to publicly traded companies.
- 11 *Applying the acquisition method:* Many of the respondents from the comment letters received agreed that IASB should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity. Also, there were mixed views on whether any excess fair value of the identifiable acquired assets and liabilities over the consideration paid should be recognised as a contribution to equity or as a bargain purchase gain in the statement of profit or loss (consistency with IFRS 3).
- 12 *Applying a book-value method:*
- (a) There were mixed views on whether the receiving company should measure the assets and liabilities received using the transferred company's book values or the controlling party's book values. Some respondents from the comment letters received favoured an option as it would depend on specific facts and circumstances of a transaction.
  - (b) There was general agreement regarding the IASB proposals on measuring the consideration paid. Some respondents from the comment letters received favouring consideration paid in assets to be measured at fair value.

- (c) There was agreement regarding the IASB proposals on (i) recognising within equity any difference between the consideration paid and the book value of the assets and liabilities received and (ii) transaction costs.
- (d) There were mixed views on whether the receiving entity should provide information on about the transferred company prospectively without restating pre-combination or retrospectively by restating pre-combination information. Many respondents from the comment letters received were in favour of an option in this regard for cost/benefit reasons.
- (e) *Disclosures*: There was general support of the disclosures proposed by the IASB.

#### **Key changes from the EFRAG draft comment letter**

13 Based on the feedback received during the EFRAG consultation process on the BCUCC project and the EFRAG TEG discussion on 16 September 2021, below are the main changes introduced to the EFRAG DCL.

#### 14 *Scope*

- (a) EFRAG proposes that the scope of the project be extended to include transfers of equity investments in subsidiaries under common control in the separate financial statements of the receiving entity;
- (b) EFRAG suggests to clarify the notion of ‘transitory control’ and consider whether BCUCC followed by an external sale with loss of control shall be captured by the scope of the project;
- (c) EFRAG suggests to clarify whether certain types of transactions are captured by the scope of the project.

#### 15 *Selecting the measurement method*

- (a) EFRAG acknowledges that a better starting point for selecting the measurement method for BCUCC transactions would be the economic substance of the transaction as it would capture the underlying drivers for such transactions. However, due to practical considerations, EFRAG accepts the IASB’s decision tree as a reasonable proxy to operationalize this approach;
- (b) EFRAG recommends the IASB to further consider the interests of other stakeholders, like lenders and other creditors, when determining the measurement method;
- (c) EFRAG suggests the IASB to clarify and provide guidance on the criterion ‘affect non-controlling shareholders’ and on identifying the receiving company to ensure appropriate application of the proposals;
- (d) EFRAG considers that the related-party exception should be optional rather than required;
- (e) EFRAG recommends the IASB to provide further guidance on the practical application of the optional exemption and the related-party exception when there are different levels of receiving companies with NCS.

#### 16 *Applying the acquisition method*

- (a) EFRAG suggests the IASB to further explore the two approaches to recognise any excess fair value of the identifiable net assets over the consideration paid as a contribution to equity (as proposed in the DP) or as a bargain purchase gain in the statement of profit or loss (in line with IFRS 3 requirements) in order to provide relevant information to users of financial statements.

17 *Applying a book-value method*

- (a) EFRAG considers that both the use of the carrying amounts in the consolidated financial statements of the transferred company's controlling party and use of the carrying amounts in the financial statements of the transferred company can provide decision-useful information for users. EFRAG further suggests that the accounting policy choice should be applied on a transaction by transaction basis and be supported by additional disclosures explaining that choice;
- (b) The EFRAG [TEG] members expressed mixed views with respect to the pre-combination information to be provided under the book-value method. Therefore, there is a majority and minority view included in the EFRAG draft FCL. Majority of EFRAG [TEG] members support the IASB proposal to include in the receiving company's financial statements the acquired net assets of the transferred company prospectively from the combination date. While, minority of EFRAG [TEG] members suggest an accounting policy choice and support for retrospective application until the beginning of the reporting period if the receiving entity chooses this option. In their view, the benefits provided by the presentation of retrospective information would outweigh the costs and some jurisdiction already require to restate comparatives.

**EFRAG TEG discussion and advice to the EFRAG Board**

- 18 At its meeting on 16 September 2021, EFRAG TEG reviewed the feedback received in response to EFRAG's draft comment letter, considered feedback from outreach events held and considered the final comment letter to be recommended to the EFRAG Board. Below are main points that arose from the EFRAG TEG discussion.
- 19 In general, the draft final comment letter recommended by EFRAG TEG to the EFRAG Board expresses a cautious support for the proposed approach how to report business combinations under common control by the receiving entity and makes a few suggestions for the IASB to consider when deciding how to apply the acquisition method and a book-value method to such transactions.
- 20 Further details on the main points discussed are elaborated below.

*Project scope*

- 21 EFRAG TEG continued to agree with the scope as proposed by the IASB but suggested that the scope should be expanded to include also reporting for equity investments in subsidiaries under common control in the separate financial statements of the receiving entity. All other common control transactions could be considered in a future comprehensive project.
- 22 EFRAG TEG also suggested to include in an Appendix to the final comment letter a list of transactions where further clarification was required whether they were in scope of the project.

*Selecting the measurement method*

- 23 EFRAG TEG agreed to indicate that conceptually the starting point for selecting a measurement method for BCUCC should be to assess the economic substance of the transaction.
- 24 However, due to practical challenges to define what economic substance is, EFRAG supports the IASB's proposed decision tree as a reasonable proxy to operationalise the concept of the BCUCC project. As a result, EFRAG TEG agreed to express a cautious support for the proposed approach.

*Practical consideration when selecting the measurement method*

- 25 EFRAG TEG agreed to remove EFRAG's suggested decision tree based on constituents' feedback and to recommend the IASB to consider the interests of other stakeholders, like lenders and other creditors, when determining the measurement method.
- 26 Furthermore, EFRAG TEG members suggested to explain better the need to provide additional guidance on the application of the related-party exception when there were different levels of receiving companies with non-controlling shareholders.

*Applying the acquisition method*

- 27 EFRAG TEG supported the changes made. That is, indicating that EFRAG's consultation and outreach resulted in mixed views regarding the treatment of consideration paid being lower than the identifiable assets and liabilities acquired – some supporting recognition in equity while others supported consistency with IFRS 3, i.e., recognition in profit or loss. Therefore, the IASB should explore these two approaches.

*Applying a book-value method*

- 28 Regarding *Question 6* on measurement of assets and liabilities received:
- (a) EFRAG TEG members supported having an accounting policy choice to measure the assets and liabilities received by the receiving company either:
    - (i) at the carrying amounts included in the financial statements of the transferred company (as suggested by the DP); or
    - (ii) at carrying amounts included in the consolidated financial statements of the transferred company's controlling party.
  - (b) EFRAG TEG agreed that the accounting policy choice should be applied on a transaction-by-transaction basis and be supported by additional disclosures explaining that choice.
  - (c) Also, EFRAG TEG suggested to include the possibility to use the intermediate book values of potential sub-holding within the group to capture the latest IFRS amounts within the group.
- 29 EFRAG TEG agreed with the drafting regarding *Questions 7 to 9* of the DP.
- 30 Regarding *Question 10* on pre-combination information, EFRAG TEG members agreed to present a mixed view:
- (a) a majority view - supporting the IASB proposals for prospective application of the DP's requirement based on cost/benefit consideration and the feedback received during the consultation process; and
  - (b) a minority view - supporting an accounting policy choice and support for retrospective application from the beginning of the reporting period if the receiving entity chooses this option.

*Disclosures – Questions 11 and 12*

- 31 EFRAG TEG supported keeping the text as it was published in the DCL.

*EFRAG TEG advice to the EFRAG Board*

- 32 Based on the above changes which have been incorporated in the draft final comment letter, the EFRAG TEG advises the EFRAG Board to approve the comment letter on the DP.

**Question for EFRAG Board**

- 33 Does EFRAG Board approve the comment letter on the DP?

**Agenda Papers**

- 34 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 06-02A – draft final comment letter – compared to the draft comment letter;
  - (b) Agenda paper 06-02B – draft final comment letter – clean version; and
  - (c) Agenda paper 06-03 – IASB snapshot on the BCUCC DP – for background information.
- 35 In addition to the above papers, if you would like to read the detailed documents which formed the basis of EFRAG TEG's discussion and position on 16 September, below are the links:
- (a) [Key messages from outreach and comment letters received including the EFRAG Secretariat's recommendations to EFRAG TEG](#);
  - (b) [Summary of outreach events](#); and
  - (c) [Comment letter analysis](#).

## **Appendix 1: Outreach events held on the BCUCC project**

No	Participant	Description	Outreach event	Date
1	Accounting Standards Committee of Germany (ASCG)	National Standard Setter	Public webinar	7 June 2021
2	Italian Standard Setter - Organismo Italiano di Contabilità (OIC)	National Standard Setter	Public webinar	14 June 2021
3	EFRAG CFSS/TEG	National Standard Setter	Public webinar	16 June 2021
4	Business Europe	Professional organisation	Closed consultation	22 June 2021
5	Accountancy Europe	Professional organisation	Closed consultation	29 June 2021
6	Portuguese Standard Setter - Comissão de Normalização Contabilística (CNC)	National Standard Setter	Public webinar	8 July 2021
7	French Standard Setter - Autorité des Normes Comptables (ANC)	National Standard Setter	Closed consultation	26 July 2021

## **Appendix 2: Summary of EFRAG’s draft comment letter**

### **Scope of the project**

- 1 EFRAG supported the proposed scope of the DP to include all transfers of businesses under common control. However, EFRAG considered that the IASB should better define 'group restructurings' without labelling them BCUCC when they do not meet the description of a business combination in IFRS 3 *Business Combinations*. EFRAG also suggested that the IASB considers common control transactions in a future project, including the effects on the separate financial statements.

### **Selecting the measurement method**

- 2 EFRAG agreed that a single measurement method is not appropriate for all BCUCC. EFRAG also supported the application of the acquisition method to BCUCC that affect the non-controlling shareholders of the receiving company (with limited exceptions). However, EFRAG proposed a few modifications to the IASB’s decision tree on when to apply each method. EFRAG consulted constituents on two possible modifications:
  - (a) Reversing Step 1 and Step 2 of the IASB’s diagram; and
  - (b) Expanding the scope of entities included in the proposed new Step 1 (three different options).
- 3 EFRAG cautioned that selecting the measurement method relies on the definition of a ‘public market,’ which includes both regulated and unregulated markets. EFRAG suggested that the IASB clarifies the meaning of the term ‘traded’.
- 4 EFRAG supported the optional exemption and the related-party exception to the acquisition method for privately-held entities with non-controlling shareholders. However, EFRAG consulted constituents on whether the related-party exception should be optional rather than required.

### **Applying the acquisition method and a book-value method**

- 5 EFRAG generally agreed with the IASB’s proposals on how to apply the acquisition method. EFRAG agreed that the IASB should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity but rather recognise any difference between the fair value of consideration paid and the fair value of identifiable acquired assets and liabilities entirely as goodwill.
- 6 However, EFRAG consulted constituents on whether to recognise a contribution to equity when the consideration paid is lower than the net identifiable assets in the business combination by considering the following:
  - (a) Alternative 1 - support the rationale for the IASB proposals to recognise the difference in equity as a contribution to equity; or
  - (b) Alternative 2 - support consistency with the requirements in IFRS 3 and recognise the difference as a gain in profit or loss.
- 7 EFRAG also generally agreed with the IASB’s proposals on how to apply a book-value method. However, EFRAG consulted constituents on:
  - (a) measurement of assets and liabilities received: whether the carrying amounts in the consolidated financial statements of the transferor or the carrying amounts in the financial statements of the transferred company provide more relevant information for users;



- (b) pre-combination information: whether prospective reporting of the BCUCC is in conflict with current practice or with current reporting requirements in some jurisdictions.

**Disclosure requirements**

- 8 EFRAG supported the proposed disclosure requirements for BCUCC accounted for under both the acquisition method and a book-value method.