EFRAG
European Financial Reporting Advisory Group

IASB DP/2020/2 Business Combinations under Common Control

Feedback to respondents – EFRAG Final Comment Letter

November 2021

This Feedback Statement has been compiled by the EFRAG Secretariat to summarise the main comments received by EFRAG on its draft comment letter and explain how those comments were considered by EFRAG during its technical discussions leading to the publication of its final comment letter. The content of this Feedback Statement does not constitute any form of advice or opinion and does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG.

Summary of contents

Introduction

Objective of this feedback statement

EFRAG published its final comment letter on the Discussion Paper DP/2020/2 *Business Combinations under Common Control* ('the DP') on 8 October 2021. This feedback statement summarises the main comments received by EFRAG on its draft comment letter and explains how those comments were considered by EFRAG during its technical discussions leading to the publication of EFRAG's final comment letter. The feedback statement focuses on topics where EFRAG's final position was different from the majority of comment letters received and different from EFRAG's draft comment letter.

Background to the ED

The IASB published its DP in November 2020. The DP includes proposals on how to account for all transfers of business under common control reported by the receiving company.

The objective of the project was to explore possible reporting requirements for business combinations under common control ('BCUCC') in the receiving company's financial statements to reduce diversity in practice and improve transparency of reporting for such transactions which would result in more relevant and comparable information provided to users of financial statements.

The IASB DP was open for comments until 1 September 2021. Further details about the IASB's project are available on the IASB website.

EFRAG's draft comment letter

EFRAG published a draft comment letter on the proposals on 09 February 2021. The draft comment letter ('DCL') was open for comments until 30 July 2021.

In its DCL, 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.

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 ('NCS') 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 by considering three different options.

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'.

EFRAG supported the optional exemption and the related-party exception to the acquisition method for privately-held entities with NCS. However, EFRAG consulted constituents on whether the related-party exception should be optional rather than required.

EFRAG generally agreed with the IASB's proposals on how to apply the acquisition method to BCUCC. 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.

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.

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.

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

Outreach activities

Following the publication of its DCL, EFRAG organised seven outreach events on the proposals included in the IASB DP on BCUCC. The events were jointly organised with the IASB and national standard setters or professional organisations. In total, EFRAG participated in the following outreach activities:

- ASCG outreach event on the IASB's Discussion Paper DP/2020/2 *Business Combinations under Common Control* – joint webinar with the ASCG and the IASB on 7 June 2021. The feedback statement can be accessed here.
- *Business Combinations under Common Control – Italian perspective* - joint webinar with the OIC and the IASB on 14 June 2021. The feedback statement can be accessed here.
- EFRAG TEG – EFRAG CFSS meeting – public meeting with representatives of European standard setters on 16 June 2021.
- Closed consultation with Business Europe on 22 June 2021.
- Closed consultation with Accountancy Europe on 29 June 2021.
- *Business Combinations under Common Control: Perspectives from Portugal* - joint webinar with the CNC and the IASB on 8 July 2021. The feedback statement can be accessed here.
- Closed consultation with the French national standard setter ANC on 26 July 2021.

Comments received from respondents

In addition to outreach activities, EFRAG received and considered 14 comment letters from respondents. These comment letters are available on the EFRAG website. A list of respondents in provided in the Appendix.

The comment letters received came from national standard-setters, business associations, a user organisation and EU authorities.

EFRAG's final comment letter

EFRAG submitted its final comment letter to the IASB on 8 October 2021.

Compared to the DCL, EFRAG developed and modified some of its views in the following areas:

Scope

- EFRAG proposed 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.
- EFRAG suggested the IASB to clarify the notion of 'transitory control' and consider whether BCUCC followed by an external sale with loss of control should be captured by the scope of the project.
- EFRAG suggested the IASB to clarify whether certain types of transactions were captured by the scope of the project.

Selecting the measurement method

- EFRAG acknowledged 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 accepted the IASB's decision tree as a proxy to operationalize this approach.

- EFRAG recommended the IASB to further consider the interests of other stakeholders, like lenders and other creditors, when determining the measurement method.
- EFRAG suggested the IASB to clarify and provide guidance on the criterion 'affect NCS' and on identifying the receiving company to ensure appropriate application of the proposals.
- EFRAG considered that the related-party exception should be optional rather than required.
- EFRAG recommended the IASB to provide further guidance on the practical application of the optional exemption and the related-party exception when there were different levels of receiving companies with NCS.

Applying the acquisition method

- EFRAG suggested 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.

Applying a book-value method

- EFRAG considered 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 suggested that the accounting policy choice should be applied on a transaction-by-transaction basis and be supported by additional disclosures explaining that choice.
- The respondents to EFRAG consultation expressed mixed views with respect to providing pre-combination information under the book-value method. Majority of respondents supported 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 a minority of respondents suggested 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 required to restate comparatives.

Detailed analysis of issues, comments received and changes made to EFRAG's final comment letter

EFRAG's tentative views expressed in the draft comment letter and respondents' comments

EFRAG's response to respondents' comments

Project Scope

Proposals in the ED

Paragraphs 1.10-1.23 of the DP discuss the IASB's preliminary view to develop proposals for all transfers of a business under common control even if the transfer:

- is preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies to an external party (that is, a party outside the group); or
- is conditional on a sale of the combining companies to an external party, such as in an initial public offering.

EFRAG's tentative position

EFRAG agreed with the scope as proposed in IASB's DP and welcomed that both BCUCC and group restructurings were in the scope of the project.

However, EFRAG considered that the IASB should avoid identifying or labelling group restructurings as a BCUCC, particularly when the arrangement did not meet the description of a business combination in IFRS 3. EFRAG suggested the IASB to explore using the terminology in IFRS 3 'combination of entities or businesses under common control' to scope of the project in which case there would be a need to improve and clarify the meaning of 'transitory control'.

EFRAG final position

Considering the feedback received, EFRAG maintained its initial position supporting the scope and objective of the project.

However, based on the feedback obtained from outreach and comment letters received, EFRAG recommended the IASB to further clarify whether certain types of transactions are captured by the scope of the project. A list of such transactions is provided in Appendix 2 to the EFRAG comment letter.

Furthermore, EFRAG noted that the scope of the BCUCC project did not include accounting for transfers of investments in subsidiaries under common control in the separate financial statements as such guidance is contained in IAS 27 *Separate Financial Statements*. EFRAG observed that this approach would result in substantial difference in accounting for common control transactions in the consolidated and separate financial statements depending on whether the transaction involved a transfer of incorporated or not incorporated business. Therefore, to eliminate inconsistencies in accounting for common control transactions in the consolidated and separate financial statements, EFRAG suggested that transfers of equity investments in subsidiaries under common control in the separate financial statements should be included in the scope of this project.

EFRAG's tentative views expressed in the draft comment letter and respondents' comments	EFRAG's response to respondents' comments
Finally, EFRAG considered that other common control transactions were important and comprehensive topics that need to be discussed in the future, including their effects on the separate financial statements. *Respondents' comments* 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. Also, 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 where some supported the IASB proposals while others considered that the economic substance of the transaction should also be taken into account. Furthermore, additional suggestions were made to: • clarify whether certain types of BCUCC transactions are captured by the scope of the project and reconsider whether BCUCC followed by an external sale shall be captured by the scope of the project; • consider the effects of common control transactions on the individual and separate financial statements. In particular, to consider extending the scope to include transfers of equity investments in subsidiaries under common control in the separate financial statements of the receiving entity.	

EFRAG's tentative views expressed in the draft comment letter and respondents' comments

EFRAG's response to respondents' comments

Selecting the measurement method

Proposals in the ED

The IASB's DP proposes that neither the acquisition method nor a book-value method should be applied to all BCUCC. In principle, the acquisition method should be applied if the BCUCC affects NCS of the receiving company subject to the cost-benefit trade-off and other practical considerations and a book-value method should be applied to all other BCUCC, including all combinations between wholly-owned companies.

EFRAG's tentative position

EFRAG agreed that a single measurement approach is not appropriate for all BCUCC. EFRAG supported that the acquisition method was applied to BCUCC which affect the NCS of the publicly traded receiving company subject to the cost-benefit and other practical considerations. EFRAG also agreed that a book-value method should be applied to all other BCUCC where the controlling party's ownership interest is unchanged.

EFRAG considers that establishing an appropriate dividing line between applying the acquisition method and a book-value method to BCUCC is crucial for achieving the project's objectives. EFRAG consulted constituents whether the DP's proposed decision tree should be modified and further extended to include entities with publicly traded debt. Furthermore, EFRAG noted that selecting the measurement method will depend heavily on the definition of a public market which may not be sufficiently robust to distinguish between different types of BCUCC.

EFRAG final position

Based on the feedback received, EFRAG considered that the starting point for selecting the measurement method should be to assess the economic substance of the BCUCC transaction. This approach is superior because it would capture the underlying drivers for such transactions.

Considering the variety of possible transactions that impact economic substance, EFRAG noted that developing a principles-based approach based on economic substance would be difficult to apply in practice, including due to the level of judgement involved and possible divergence in practice. This is consistent with the feedback EFRAG has got from its previous proactive research on the same topic in the past years and with evidence from jurisdictions that currently already apply an approach based on economic substance. Therefore, based on practical considerations, EFRAG acknowledged that the IASB's decision tree might provide a proxy to operationalise the decision of when to apply the acquisition method and when to apply the book-value method. However, EFRAG encouraged the IASB to elaborate further on the notion of NCS and recommended the IASB to explore the possibility of having a rebuttable presumption when using the concept of 'affecting NCS' when selecting the measurement method.

Furthermore, EFRAG suggested that the IASB further clarify and provide guidance on the criterion 'affect NCS', in particular:

EFRAG's tentative views expressed in the draft comment letter and respondents' comments

Respondents' comments

Almost all respondents agreed that neither the acquisition method nor a book-value method should be applied to all BCUCC.

Majority of respondents supported the IASB's decision tree that the acquisition method should apply to BCUCC that affected NCS, subject to the cost benefit trade off, and that a book-value method should apply in all other cases. However, some respondents did not support the use of the proposed decision tree in the DP and considered that the economic substance of the transaction was a better starting point to capture the underlying drivers for such transactions which were conducted for various reasons.

Many respondents suggested that the IASB should further clarify and provide guidance on the expression "affect NCS" and provide more guidance when identifying the receiving company in a BCUCC both under the acquisition method and a book-value method.

EFRAG's modified decision tree received limited feedback and there were mixed views with respect to reversing Step 1 and Step 2 of the IASB's decision tree as well as expanding the scope of the proposed Step 1 to include also debt traded in a public market. Respondents considered that with the proposed modifications, it would be difficult to determine how broad the scope should be.

EFRAG's response to respondents' comments

- to consider the notion of significance for the change in ownership interest of the NCS;
- to explain how the criterion will apply when the consolidated financial statements were prepared at different consolidated levels of receiving companies;
- to clarify the scope of NCS with respect to what financial instruments should be considered as equity instruments in light of the guidance provided in IAS 32 *Financial Instruments: Presentation*; and
- to clarify how to apply the criterion 'affect NCS' in situations where legally there could be NCS which will not be presented as non-controlling interest in an entity's statement of financial position.

The definition of a receiving company in the DP and the definition of the acquirer in IFRS 3 were not identical which raised uncertainty and further clarifications were necessary in this respect. EFRAG noted that the DP considered that the receiving company under the acquisition method was the acquirer in a BCUCC. However, applying the current requirements in IFRS 3 in situations where a Newco was created to execute a BCUCC transaction created an uncertainty whether the Newco could be identified as the acquirer; clarification is needed to explain whether a newly establish entity could be identified as an acquirer or not.

EFRAG's tentative views expressed in the draft comment letter and respondents' comments

EFRAG's response to respondents' comments

Selecting the measurement method: Practical considerations

Proposals in the ED

The IASB's preliminary view is that the acquisition method should be required if the receiving company's shares are traded in a public market. The DP also provides an optional exemption for the receiving company to use a book-value method if it has informed all of its NCS that it proposes to use a book-value method and they have not objected. Furthermore, the receiving company should be required to use a book-value method if all of its NCS are related parties of the company.

EFRAG's tentative position

EFRAG supported the optional exemption and related-party exception to the acquisition method for privately-held entities based on a cost-benefit consideration and availability of information to related parties.

However, EFRAG consulted constituents on whether the related-party exception should be 'optional' rather than 'required' because it was possible that NCS did not have the information they needed about the transaction, for instance, investors with significant influence over the reporting entity.

Respondents' comments

Majority of respondents agreed with the IASB's proposal to require the application of the acquisition method when the receiving company's shares were traded in a public market.

Respondents, however, provided mixed views regarding the related-party exception to the acquisition method for privately held company. Many respondents supported the exception, however, considered that it opened

EFRAG final position

Considering the feedback received, EFRAG retained its position unchanged from its DCL regarding the application of the optional exemption from the acquisition method. However, EFRAG considered that additional guidance was necessary to make the exemption workable in practice and suggested the IASB to:

- avoid situations where NCS, representing a negligible portion of interests in the receiving company's equity, could impose the use of the acquisition method;
- provide guidance on the practical application of the exemption when there were different levels of receiving companies with NCS;
- consider excluding the related parties from the NCS when considering the exemption process.

Furthermore, EFRAG supported the related-party exception to the acquisition method for BCUCC affecting the NCS of a privately-held receiving entity. However, EFRAG considered that the related-party exception should be optional rather than required because the information needs of different related parties could be different given the broad composition of related parties as defined in IAS 24 *Related Party Disclosures*.

EFRAG's tentative views expressed in the draft comment letter and respondents' comments	EFRAG's response to respondents' comments
possibilities for structuring opportunities. Some respondents disagreed with the exception as the information needs of different related parties could be different. Some respondents agreed with EFRAG that the related-party exception should be 'permitted' rather than 'required'. Some respondents agreed with the optional exemption, however, some respondents suggested that further guidance was necessary regarding the practical application of the exemption.	EFRAG suggested the IASB to provide further guidance on the practical application of the exemption and the exception when there were different levels of receiving companies with NCS.

EFRAG's tentative views expressed in the draft comment letter and respondents' comments	**EFRAG's response to respondents' comments**

Applying the acquisition method: Contribution to equity

Proposals in the ED

The IASB should develop a requirement for the receiving company to recognise any excess fair value of the identifiable acquired assets and liabilities over the consideration paid as a contribution to equity, not as a bargain purchase gain in the statement of profit or loss, when applying the acquisition method to a business combination under common control.

EFRAG's tentative position

EFRAG supported recognising the above stated excess of the fair value both as a contribution to equity and also consistency with IFRS 3 (i.e., recognising a gain in profit or loss). Therefore, EFRAG consulted its constituents on this topic.

Respondents' comments

There were mixed views regarding recognition as a contribution to equity or as a bargain purchase gain in the statement of profit or loss (consistency with IFRS 3).

EFRAG final position

Considering the mixed feedback received from the comment letters received as well as the outreach activities, EFRAG saw merit in using each of the two approaches. Therefore, EFRAG suggested that the IASB further explores these approaches in order to provide relevant information to users of financial statements.

EFRAG's tentative views expressed in the draft comment letter and respondents' comments

EFRAG's response to respondents' comments

Applying the book-value method: Measuring the assets and liabilities received

Proposals in the ED

When applying a book-value method to a business combination under common control, the receiving company should measure the assets and liabilities received using the transferred company's book values.

EFRAG's tentative position

EFRAG considered 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. Therefore, EFRAG consulted its constituents on this topic.

Respondents' comments

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 favoured an option as it would depend on specific facts and circumstances of a transaction.

EFRAG final position

Considering the mixed feedback received from the comment letters received as well as the outreach activities, EFRAG considered that using one or the other carrying amounts would depend on facts and circumstances of the receiving company including cost/benefit considerations.

As a result, EFRAG proposed an accounting policy option to allow the use of the carrying amounts in the consolidated financial statements of the transferred company's controlling party.

EFRAG further suggested that the accounting policy option should be applied on a transaction-by-transaction basis and be supported by additional disclosures explaining the option selected.

EFRAG's tentative views expressed in the draft comment letter and respondents' comments

EFRAG's response to respondents' comments

Applying the book-value method: Providing pre-combination information

Proposals in the ED

When applying a book-value method to a business combination under common control, the receiving company should include in its financial statements the assets, liabilities, income and expenses of the transferred company prospectively from the combination date, without restating pre-combination information.

EFRAG's tentative position

EFRAG agreed with the IASB proposals.

Respondents' comments

There were mixed views on whether the receiving entity should provide information 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.

EFRAG final position

EFRAG took into consideration the mixed views from the respondents and also from the outreach activities. A majority of EFRAG Board members considered that providing information prospectively without restating pre-combination or retrospectively by restating pre-combination information would depend on facts and circumstances of the BCUCC transaction.

Therefore, these EFRAG Board members supported an accounting policy option between providing pre-combination information prospectively (from the combination date) or retrospectively (until the beginning of the reporting period). Furthermore, these EFRAG Board members supported that this option should be applied on a case-by-case basis.

Appendix: List of respondents

Table 1: List of respondents

Name of respondent[1]	***Country***	***Type / Category***
The Danish Accounting Standards Committee (DASC)	Denmark	National Standard Setter
The Dutch Accounting Standards Board (DASB)	The Netherlands	National Standard Setter
The European Securities and Markets Authority (ESMA)	Europe	Regulator
European Savings and Retail Banking Group (ESBG)	Europe	Preparer organisation
Instituto de Contabilidad y Auditoria de Cuentas (ICAC)	Spain	National Standard Setter
Comissão de Normalização Contabilística (CNC)	Portugal	National Standard Setter
Organismo Italiano di Contabilità (OIC)	Italy	National Standard Setter
Autorité des Normes Comptables (ANC)	France	National Standard Setter
BUSINESSEUROPE	Europe	Preparer organisation
The Accounting Standards Committee of Germany (ASCG)	Germany	National Standard Setter
The European Federation of Financial Analysts Societies (EFFAS)	Europe	User organisation
The Polish Accounting Standards Committee (PASC)	Poland	National Standard Setter
The Swedish Financial Reporting Board (SFRB)	Sweden	National Standard Setter
Draft comment letter received		

[1] Respondents whose comment letters were considered by the EFRAG Board before finalisation of the comment letter.