The Institute of
Chartered Accountants
of Pakistan

CA
PAKISTAN

HEAD OFFICE

September 01, 2021

(Submitted Electronically)

International Accounting Standards Board
London, United Kingdom

Comments on Discussion Paper (DP/2021/1): *Business Combinations under Common Control*

Dear Board Members,

The Accounting Standards Board of the Institute of Chartered Accountants of Pakistan is pleased to comment on the Discussion Paper (DP/2021/1): *Business Combinations under Common Control*, published by the International Accounting Standards Board (the Board/ IASB) in November 2020.

We generally support the objectives and approach proposed by the Board and believe that project will provide the much needed guidance on accounting of common control transactions under the International Financial Reporting Standards. However, we have suggested few areas for the Board's further deliberations and reconsideration, including conditions for applicability of measurement methods to reduce complexity and facilitate a cost effective implementation.

The *Appendix* to this letter contains our detailed responses to the questions in the Discussion Paper.

We hope that our comments would be helpful to the Board's deliberations on the Discussion Paper. For any questions concerning our comments, please contact the undersigned, at shehzad@icap.org.pk

Yours truly,

Shehzad Hussain
Senior Manager - Technical Services

Encl. As above.

Question 1 – *Project Scope*
Paragraphs 1.10–1.23 discuss the Board's preliminary view that it should develop proposals that cover reporting by the receiving company for all transfers of a business under common control (in the Discussion Paper, collectively called business combinations under common control) even if the transfer: a) 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 b) is conditional on a sale of the combining companies to an external party, such as in an initial public offering. Do you agree with the Board's preliminary view on the scope of the proposals it should develop? Why or why not? If you disagree, what transactions do you suggest that the Board consider and why?

Comment

We agree with the Board's preliminary view on the scope of the proposals it should develop. This is because we concur with the Board's approach of not clarifying the meaning of 'transitory control' as the outcome of this project could lead to modification or removing the scope exclusion in IFRS 3. Therefore, the proposals should cover all transfers of businesses in which all of the combining companies are ultimately controlled by the same party, irrespective of whether the transfer is:

(a) 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

(b) conditional on a sale of the combining companies to an external party, such as in an initial public offering.

Question 2 - *Selecting the measurement method*
Paragraphs 2.15–2.34 discuss the Board's preliminary views that: a) neither the acquisition method nor a book-value method should be applied to *all* business combinations under common control. Do you agree? Why or why not? If you disagree, which method do you think should be applied to all such combinations and why? b) in principle, the acquisition method should be applied if the business combination under common control affects non-controlling shareholders of the receiving company, subject to the cost–benefit trade-off and other practical considerations discussed in paragraphs 2.35–2.47 (see Question 3). Do you agree? Why or why not? If you disagree, in your view, when should the acquisition method be applied and why? c) a book-value method should be applied to all other business combinations under common control, including all combinations between wholly-owned companies. Do you agree? Why or why not? If you disagree, in your view, when should a book-value method be applied and why?

Comment

(a) We agree with Board's preliminary view that neither the acquisition method nor a book-value method should be applied to all business combinations under common control because:

- Some transfers of businesses under common control are similar to business combinations covered by IFRS 3 and that the acquisition method would therefore provide the most useful information in such cases;

- However, some other such transfers may not be similar to business combinations covered by IFRS 3 and may, for example, instead result in the pre-existing business continuing its operations in a new legal form. In such cases, the acquisition method may not provide the most useful information.

(b) We agree that acquisition method might be more relevant in meeting the information needs of financial statement users, where the business combination under common control affects non-controlling shareholders of the receiving company. However, we consider that significance of non-controlling interest in the receiving company should be pre-requisite for permitting the application of acquisition method. Accordingly, we consider that:

- In situations where a receiving entity has a significant non-controlling interest, giving due weightage to information needs of all the primary users (i.e. both controlling and non-controlling shareholders) of the financial statements would be important and relevant. In such situations, from the perspective of non-controlling shareholders, a common control transaction and ordinary business combination would not always be different in nature.

- However, we also believe that determination of fair values generally involves use of judgement and resources, accordingly, cost of applying acquisition method may sometime not justify the benefits of the resulting information. Fundamentally, the cost-benefit analysis also requires judgement, and the Board's proposed approach could be subject to varied understanding and application.

- As an alternative to the mandatory use of acquisition method, we suggest that for combinations in which the receiving company has significant non-controlling interest, management of the receiving entity should be allowed flexibility of adopting an accounting method for common control transactions (i.e. either book value or acquisition method), as a matter of accounting policy choice. Management of receiving entity would accordingly consider the accounting method that best serves the information needs of users of entity's financial statements.

  With regards to the assessment of whether the non-controlling interest is significant or not, we suggest that the Board should provide a quantitative threshold (i.e. a specific percentage of non-controlling interest on the date of common control transaction) that is generally indicative of non-controlling interest being significant and substantive. In this regard, further research should be carried out and specific input may be obtained from stakeholders as to what quantitative threshold should be considered as significant / substantive non-controlling interest.

(c) We agree with Board's view that book value method should be applied for all other business combinations under common control, including those between wholly-owned companies (i.e. those involving receiving entity with insignificant or no non-controlling interest).

We note that in the situations where a receiving entity does not have significant non-controlling shareholders, the existing shareholders are the controlling party. For such receiving company, the combination does not change controlling party's control of the combining companies nor its ownership interest in them. In substance, in such cases, there would be no change in economic substance of the group and combined entities. There would be no economic substance to common control transaction and the common control transaction is undertaken solely for the controlling party's purposes (business, strategic objectives etc.), therefore cost of making the fair value measurements may outweigh the benefits to the financial statement users. Accordingly, in such situations a book-value method to account for business combination under common control would be more relevant and cost-effective.

In the context of the above discussion, we also consider that the shareholders with controlling interest in the receiving entity are in a position to obtain the additional information other than general purpose financial statements, whenever they need. Therefore, if required, they can leverage their position to obtain information about fair values of assets and liabilities exchanged in a business combination e.g. in the form of management report.

Therefore, we are of the view that accounting method based on book-value method would be more effective in meeting the information needs of primary users of receiving entity's financial statements when there is no or insignificant non-controlling interest.

Question 3 – *Selecting the measurement method*
Paragraphs 2.35–2.47 discuss the cost-benefit trade-off and other practical considerations for business combinations under common control that affect non-controlling shareholders of the receiving company. a) In the Board’s preliminary view, the acquisition method should be *required* if the receiving company’s shares are traded in a public market. Do you agree? Why or why not? b) In the Board’s preliminary view, if the receiving company’s shares are privately held: (i) the receiving company should be *permitted* to use a book-value method if it has informed all of its non-controlling shareholders that it proposes to use a book-value method and they have not objected (the optional exemption from the acquisition method). Do you agree with this exemption? Why or why not? Do you believe that the exemption will be workable in practice? If not, in your view, how should such an exemption be designed so that it is workable in practice? (ii) the receiving company should be *required* to use a book-value method if all of its non-controlling shareholders are related parties of the company (the related-party exception to the acquisition method). Do you agree with this exception? Why or why not? c) If you disagree with the optional exemption (Question 3(b)(i)) or the related-party exception (Question 3(b)(ii)), in your view, how should the benefits of applying the acquisition method be balanced against the costs of applying that method for privately held companies? Do you agree? Why or why not? If you disagree, what approach do you recommend and why?

Comment

With regards to (a), we do not agree with the Board’s view that acquisition method should be required if the receiving company’s shares are traded in a public market. As commented above in Question 2(b), we suggest that for combinations that affect significant and substantive non-controlling shareholders, management of the receiving entity should be allowed the flexibility for adopting an accounting method for common control transactions (i.e. either book value or acquisition method) irrespective of receiving entity status as public or private. Management of receiving entity would accordingly consider the accounting method that best serves the information needs of users of entity’s financial statements.

With regards to (b) and (c), as commented above in Question 2(b) for BCUCC, instead of giving optional exemption or related party exception to acquisition method for privately held companies, we suggest that management of the receiving entity should be allowed the flexibility for adopting an accounting method for common control transactions (i.e. either book value or acquisition method) irrespective of receiving entity’s status as public or private.

Question 4 – *Selecting the measurement method*
Paragraphs 2.48–2.54 discuss suggestions from some stakeholders that the optional exemption from and the related-party exception to the acquisition method should also apply to publicly traded companies. However, in the Board's preliminary view, publicly traded receiving companies should always apply the acquisition method. a) Do you agree that the optional exemption from the acquisition method should *not* be available for publicly traded receiving companies? Why or why not? If you disagree, in your view, how should such an exemption be designed so that it is workable in practice? b) Do you agree that the related-party exception to the acquisition method should *not* apply to publicly traded receiving companies? Why or why not?

Comment

As commented above in Question 2 and Question 3, for a common control transaction that affects non-controlling shareholders (i.e. receiving entity with significant non-controlling interest), we suggest the Board that instead of considering optional exemption or related-party exception to the acquisition method, an accounting policy choice should be given to the receiving entity (i.e. they can elect to apply either book-value method or acquisition method) to account for common control transactions irrespective of receiving entity's status as publicly traded or privately held.

Question 5 – *Applying the acquisition method*
Paragraphs 3.11–3.20 discuss how to apply the acquisition method to business combinations under common control. a) In the Board's preliminary view, it should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity when applying the acquisition method to a business combination under common control. Do you agree? Why or why not? If you disagree, what approach for identifying and measuring a distribution from equity do you recommend and why? In particular, do you recommend either of the two approaches discussed in Appendix C or do you have a different recommendation? b) In the Board's preliminary view, it 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. Do you agree? Why or why not? If you disagree, what approach do you recommend and why? c) Do you recommend that the Board develop any other special requirements for the receiving company on how to apply the acquisition method to business combinations under common control? If so, what requirements should be developed and why are any such requirements needed?

Comment

(a) We agree with the Board's view that it should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity when applying the acquisition method to a business combination under common control.

In general, we understand that such a situation occurs when a buyer overpays for the acquisition. We noted that the Board also considered a similar issue when it developed IFRS 3, whether to provide special requirements for business combinations in which a buyer 'overpays' for the acquisition which is explained in the Basis for Conclusion of IFRS 3. No such requirements are included in IFRS 3, because the Board concluded that, in practice, an overpayment is unlikely to be detectable or known at the acquisition date and that the overpayment would be difficult, if not impossible, to quantify. Accordingly, under IFRS 3, if an overpayment occurs, it is initially included in goodwill recognised in a business combination and is addressed through subsequent testing of goodwill for impairment.

(b) We agree with the Board's view that the receiving company should recognise a contribution to equity if the value of the identifiable assets acquired and liabilities received exceeds the consideration paid, instead of recognising that difference as a gain on a bargain purchase in the statement of profit or loss, as required by IFRS 3.

We note that the requirements of acquisition method under IFRS 3 have been developed for the business combinations carried out on arm's length basis. We understand that for BCUCC, this may not be the case as the receiving company and the transferring company might not have been involved in deciding how much consideration is paid. Instead, the controlling party might have determined the amount of consideration. As a result, the consideration transferred may not necessarily reflect the fair value of the acquired business and synergies expected as a result of combination.

Furthermore, a business combination under common control may be undertaken in order to benefit other entities within the group and not necessarily the receiving entity. For example, the transaction may be undertaken to minimize operating costs in the group or to obtain tax benefits for the group as a whole (or for the controlling party). In such circumstances, a difference between the fair value of the consideration transferred and the fair value of (a) the acquired business and (b) the economic benefits embedded in expected synergies arguably arise because there is an equity transaction (a transaction with owners in their capacity as owners) in addition to the acquisition of a business. However, it would be difficult, if not impossible, to measure in practice the amount relating to equity transaction in addition to an amount relating to an acquisition of business (i.e. the amount that would have been paid to an unrelated party in an arm's length transaction).

(c) Currently we do not have any recommendation to develop any other special requirements for the receiving company on how to apply the acquisition method as we are of the view that acquisition method under IFRS 3 would be applied without any modification except mentioned in point (b) above.

Question 6 – *Applying a book-value method*
Paragraphs 4.10–4.19 discuss the Board’s preliminary view that, 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. Do you agree with the Board’s preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

Comment

We agree with the Board’s preliminary view that, 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. This approach would:

- ensure comparability with the historical financial information about the transferred company, that is useful in analyzing trends (comparing the performance of the transferred business post combination with its pre-combination performance);

- present the combination from the perspective of the combining companies (i.e. receiving entity and transferred entity), rather than from the perspective of the controlling party; and

- treat the assets and liabilities of the combining companies, on the same basis. That is, following the combination, each company’s assets and liabilities would continue to be measured at the book values previously reported by that company. Such an approach would provide similar information about the assets and liabilities of the combining companies, irrespective of how the combination is structured.

Question 7 – *Applying a book-value method*
Paragraphs 4.20–4.43 discuss the Board's preliminary views that: a) the Board should not prescribe how the receiving company should measure the consideration paid in its own shares when applying a book-value method to a business combination under common control; and b) when applying that method, the receiving company should measure the consideration paid as follows: (i) consideration paid in assets—at the receiving company's book values of those assets at the combination date; and (ii) consideration paid by incurring or assuming liabilities—at the amount determined on initial recognition of the liability at the combination date applying IFRS Standards. Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

Comment

(a) We agree with Board's view that for 'Consideration paid in own shares', it should not prescribe the measurement method. This is because the reporting of components within a reporting company's equity and the measurement of issued shares for the purpose of that reporting are often affected by statutory and legal provisions applicable to receiving entity.

(b) We agree with the Board's view that:

(i) the receiving company should measure the consideration paid in assets at the receiving company's book values of those assets at the combination date. This is because we understand that:

- measuring the consideration paid in assets at their carrying values instead of fair values would not result in any gain or loss on disposal of such assets. This would be more consistent with the measurement of assets and liabilities received in a business combination under common control, under the book value method. Further, this approach would also allow payment of consideration in assets and receipt of assets in the business combination under common control to be viewed as a single transaction (i.e. an exchange of the consideration for the business) rather than two separate transactions.

- measuring the consideration paid in assets at their fair values could be costly and could involve significant measurement uncertainty.

(ii) the receiving company should measure the consideration paid by incurring or assuming liabilities at the amount determined on initial recognition of the liability at the combination date applying IFRS Standards. This is because IFRS Standards that apply on initial recognition of liabilities would provide the most useful information about those liabilities in such transactions and those standards would continue to apply to subsequent measurement of those liabilities.

Further to above comments on consideration transferred/paid, we suggest that the Board should also cover the possible scenario that involves 'nil consideration'. Under such a scenario, the receiving entity would be obtaining net assets of transferring entity without paying any consideration to the transferring entity, and questions would arise that for accounting of business combination under common control, the consideration transferred is nil or equivalent to the net assets acquired (i.e. no gain no loss basis), or measured on another basis (as per the underlying substance of the overall arrangement).

We understand that scenarios involving business combination under common control with nil consideration would not be very common, however, we believe that the Board's guidance on this aspect would ensure holistic coverage of topic of 'consideration paid' and would also eliminate varied understanding and diversified accounting practices of common control transactions with nil consideration.

Question 8 – *Applying a book-value method*
Paragraphs 4.44–4.50 discuss the Board's preliminary views that: a) when applying a book-value method to a business combination under common control, the receiving company should recognise within equity any difference between the consideration paid and the book value of the assets and liabilities received; and b) the Board should not prescribe in which component, or components, of equity the receiving company should present that difference. Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

Comment

(a) We agree with the Board's view that under book value method difference between the consideration paid and the book value of the assets and liabilities received in business combination is recognised in equity. This is because, we concur with the Board's preliminary proposals and conclusions that:

- From the point of view of the combined entity, the difference represents a change in the combined entity's assets and liabilities. That change does not, at least not in its entirety, result from transactions with owners acting in their capacity as owners.

- Furthermore, it does not constitute an item of income or expense that could be recognised in other comprehensive income as this change does not arise from a periodic remeasurement. Therefore, we understand that recognising difference in equity would be more appropriate and faithful representation of the transaction than recognising it as an asset, liability, income or expense.

(b) We further concur with the Board's view that it should not prescribe in which component, or components, of equity the receiving company should present that difference. This is because these matters are affected by national laws, regulations or other requirements in particular jurisdictions.

Question 9 – *Applying a book-value method*
Paragraphs 4.51–4.56 discuss the Board's preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should recognise transaction costs as an expense in the period in which they are incurred, except that the costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS Standards. Do you agree with the Board's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

Comment

We concur with Board's view that transaction costs should be recognised as expenses in the statement of profit or loss in the period in which they are incurred, except the costs of issuing shares or debt instruments. The costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS Standards.

We understand that transaction costs incurred to effect a business combination are not part of the exchange between the buyer and the seller of the business. Rather, these are separate transactions in which the buyer pays for services received. Accordingly, the costs of those services received and consumed during the period should be recognised as expense in the statement of profit or loss.

Question 10 – *Applying a book-value method*
Paragraphs 4.57–4.65 discuss the Board's preliminary view that, 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. Do you agree with the Board's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

Comment

We agree with the Board's view that when applying a book-value method, 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. This approach would be:

- consistent with the requirements of IFRS 3 *Business Combinations* and IFRS 10 *Consolidated Financial Statements*, that require the consolidation of an acquired business or subsidiary from the date of acquisition;

- less costly than retrospective approach; and

Further, presenting combining entities or businesses retrospectively as if they had always been combined would result in pro-forma (or hypothetical) information. There can be operational challenges and costs involved in preparing such pro-forma information.

Question 11 – *Disclosure requirements*
5.5–5.12 discuss the Board's preliminary views that for business combinations under common control to which the acquisition method applies: a) the receiving company should be required to comply with the disclosure requirements in IFRS 3 *Business Combinations*, including any improvements to those requirements resulting from the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*; and b) the Board should provide application guidance on how to apply those disclosure requirements together with the disclosure requirements in IAS 24 *Related Party Disclosures* when providing information about these combinations, particularly information about the terms of the combination. Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

Comment

(a) We agree with Board's preliminary view that receiving company to which acquisition method applies should be required to comply with the disclosure requirements in IFRS 3 including any improvements to those requirements resulting from the Discussion Paper Business Combinations—Disclosures, Goodwill and Impairment.

In our view, acquisition method should be applied where the business combination under common control affects non-controlling shareholders of the receiving company. In such situation the composition of users (due to presence of substantive minority interest) relying on receiving company's financial statements for meeting their information needs about the combination is similar to the business combination covered by IFRS 3.

(b) We concur with Board's view that application guidance should be provided, on how to apply disclosure requirements under IFRS 3 together with the disclosure requirements in IAS 24 when providing information about combinations under common control. We also understand that in particular, the information about the terms of the combination would provide useful and relevant information to users of financial statements.

Question 12 - *Disclosure requirements*
Paragraphs 5.13–5.28 discuss the Board's preliminary views that for business combinations under common control to which a book-value method applies: a) some, but not all, of the disclosure requirements in IFRS 3 *Business Combinations*, including any improvements to those requirements resulting from the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*, are appropriate (as summarised in paragraphs 5.17 and 5.19); b) the Board should not require the disclosure of pre-combination information; and c) the receiving company should disclose: (i) the amount recognised in equity for any difference between the consideration paid and the book value of the assets and liabilities received; and (ii) the component, or components, of equity that includes this difference. Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

Comment

For business combination under common control to which a book-value method applies:

(a) We agree with the Board's view that some, but not all, of the disclosure requirements in IFRS 3 are appropriate for BCUCC to which a book-value method applies. This is because there are vast differences in the IFRS 3 prescribed acquisition and book value method, as the latter does not require any fair value measurement and goodwill recognition.

(b) We agree that Board should not require the disclosure of pre-combination information for all combining entities as we understand that the benefits of the disclosure of pre-combination information for all combining entities would not outweigh the costs of doing so.

(c) We also agree with Board's view that receiving company should disclose the amount recognised in equity between the consideration paid and the book value of the assets and liabilities received; and the component, or components, of equity that includes this difference. We understand that such information about that difference would be useful to users of the receiving company's financial statements.