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Mr Andreas Barckow, Chair
International Accounting Standards Board
Columbus Building 7
Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

30 August 2021
602/636

Dear Mr Barckow

Re.: IASB Discussion Paper DP/2020/2 'Business Combinations under Common Control'

The IDW appreciates the opportunity to comment on the IASB's Discussion Paper (DP/2020/2) 'Business Combinations under Common Control'.

We very much welcome the fact that the Board is now intensively dedicating itself to this project, as this is a crucial issue in practice. The IDW has repeatedly highlighted the urgency and importance of this project (we refer to our comment letters relating to the 2015 Agenda Consultation, dated 18th December 2015 and the Agenda Consultation 2011, dated 25th October 2011).

As you will be aware, business combinations under common control were explicitly scoped out of IFRS 3 in 2008 in order to avoid further delay in releasing that standard. However, work on the project 'business combinations under common control' was then subsequently deferred in 2009 once again due to both, the multitude of other (more urgent) convergence projects and projects related to the financial crisis. Since then, due to the absence of specific guidance, entities have had no option but to select an appropriate accounting policy following the hierarchy described in IAS 8. The IFRS IC has also expressed concern as to the diversity in practice and hence underlined the need for the IASB to develop accounting guidance for business combinations under common control. We are therefore pleased that work on the project is now progressing with the IASB's first proposals on accounting for such transactions having been issued for comment.

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Daniela Kelm, RA LL.M.;
Melanie Sack, WP StB

The IDW would welcome uniform and consistent guidance addressing the accounting treatment of business combinations under common control to reduce the current diversity in practice. In our view, the focus should be on the application of the acquisition method (if necessary, in a slightly modified form), since ultimately business combinations under common control are also business combinations. The application of the book-value method should be limited to clearly defined exceptional cases.

We still have some doubts as to whether the proposal that the existence of non-controlling shareholders might constitute a distinguishing criterion for applying either the acquisition method or the book-value method is an appropriate and practicable approach. In our view, the economic substance of a transaction is crucial in determining its accounting treatment (e.g., the reasons for undertaking an intra-group restructuring).

Further, we would like to comment on the specific proposals as follows:

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?

The IDW agrees with the overall objective of the project, i.e., reducing diversity in practice and providing users of the receiving company's financial statements with better information on common control transactions.

Although the term 'business combinations under common control' according to IFRS 3 was not (formally) adjusted in the DP, it seems to be being treated as different and, above all, broader in this project.

In this context, we explicitly welcome the fact that group restructurings – i.e., transactions that involve a transfer of a business combination under common

control but do not meet the definition of a 'business combination' in IFRS 3 – are also taken into account. However, in order to ensure sufficient clarity, we recommend the Board define both, the terms 'group restructuring' (adding application guidance if necessary) and 'common control transaction' (which is, from our point of view, the overarching term encompassing both 'business combinations under common control' and 'group restructurings').

Although, we generally agree with the project scope proposed in the DP, we believe guidance would be helpful on the following transactions:

- upward and downward mergers
- the transfer of joint ventures and associates under common control,
- the transfer of a group of assets that does not meet the definition of a business, and
- the transfer of a subgroup under a Newco within a group.

With reference to Example 4 in Appendix B of the DP, we also question whether the transfer of control of companies A and B to a Newco conditional on the success of the initial public offering of shares in the Newco actually constitutes a business combination under common control. An explanation of this would also be helpful.

Finally, the IASB should examine whether the project has any impact on, or gives rise to consequential changes to, IFRIC 17 *Distributions of Non-cash Assets to Owners*.

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 <u>all</u> 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?

The IDW agrees with the Board's preliminary view that neither the acquisition method nor a book-value method should be applied to *all* business combinations under common control.

We would welcome uniform and consistent requirements to govern the accounting treatment of business combinations under common control in order to reduce the current diversity in practice. Therefore, in our opinion, the focus must be on the application of the acquisition method (if necessary, in a slightly modified form), since ultimately business combinations under common control are also business combinations. The application of a book-value method should be limited to clearly defined exceptional cases.

We still have some doubts as to whether the proposal that the existence of non-controlling shareholders might constitute a distinguishing criterion for applying either the acquisition method or a book-value method is an appropriate and practicable approach. Finally, in our view, the economic substance of a transaction is crucial in determining its accounting treatment (e.g., the reasons for undertaking an intra-group restructuring).

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?

a) We concur with the Board's preliminary view that the application of the acquisition method should be required if the receiving company's shares are traded in a public market. However, the same should apply to receiving companies whose debt instruments are publicly traded. Both, receiving companies with publicly traded shares and receiving companies with publicly traded debt instruments are accountable to investors, warranting the same information being provided for the same kind of transaction.

b) – c)

Optional exemption from the acquisition method

In general, we agree with the proposal that a receiving company whose shares are privately held should be permitted to use a book-value method.

As a prerequisite for a planned use of the optional exemption, the Board proposes that the receiving company must inform all its non-controlling shareholders and that they do not express any objections to the application of a book-value method. In this respect, we have some questions and concerns, especially regarding the practical feasibility of this exemption, e.g.:

- Does every single non-controlling shareholder have to agree or is the achievement of a certain quorum sufficient? (If the former is true, it is questionable whether it will be possible for receiving companies with numerous non-controlling shareholders to use the optional exemption).

- Do the non-controlling shareholders have to give their agreement in writing or is verbal agreement sufficient? (In the latter case, verifiability issues would arise).
- Does silence count as consent after a certain feedback period?
- If the composition of the non-controlling shareholders does not change over time and a book-value method was applied to an earlier business combination under common control, does the receiving company have to repeatedly inform its non-controlling shareholders in case of a further business combination under common control each time?

We recommend the Board undertake further outreach activities to identify and resolve such application issues. In our view, adding application guidance to the future standard would be helpful.

Related-party exception to the acquisition method

Regarding the above-mentioned optional exemption especially, we question why a book-value method should be mandatory when all the receiving company's non-controlling shareholders are related parties. At least within the capital market legislation applicable in Germany, there is no distinction between related parties and others as far as the need to protect non-controlling shareholders is concerned. Regarding the need for investor protection and information, we consider it appropriate to require equal treatment for all non-controlling shareholders – regardless of whether they are related parties or not.

Finally, should the IASB decide to introduce optional exemptions from applying the acquisition method in a future standard on accounting for business combinations under common control, we recommend aligning the wording of such exemptions to that of paragraph 4 of IFRS 10, for reasons of clarity and understandability.

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?

If the receiving company is a publicly traded company, the application of the acquisition method should be mandatory. Accordingly, we agree that publicly traded receiving companies should be precluded from using both the optional exemption from the acquisition method and the related-party exception to the acquisition method.

However, we would like to point out once again that any requirements for publicly traded receiving companies should not only be applicable to receiving companies whose equity instruments are publicly traded, but also to those whose debt instruments are publicly traded.

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?

a) The IDW agrees with the Board's preliminary view that it should not develop a requirement for receiving companies to identify, measure and recognise a distribution to the controlling party applying the acquisition method. If an overpayment occurs in a business combination under common control that affects non-controlling shareholders, it should initially be included in goodwill and addressed through subsequent testing of goodwill for impairment as is the case for a business combination according to IFRS 3. In this regard, we also concur with the Board's view that distributions from equity would be unlikely to occur in practice in business combinations under common control that affect non-controlling shareholders of the receiving company for the reasons stated in paragraph 3.13 of the DP.

b) We concur with the Board that the receiving company should recognise any excess fair value of the identifiable acquired assets and liabilities over the consideration paid as a contribution to equity and 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.

c) In our view, the Board should not develop other special requirements, but instead underline that the receiving company must apply in full all existing requirements of the acquisition method according to IFRS 3 to business combinations under common control (i.e., those to contingent consideration and pre-existing relationships).

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?

The IDW does not agree with 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.

Business combinations under common control, often involve the transfer of companies that themselves neither prepare IFRS financial statements nor report IFRS figures. For reasons of practicability, we are in favour of either (1) applying *a* controlling party's book values at the time of the transaction or (2) granting the reporting receiving company flexibility, i.e., an accounting policy choice of one of the following:

- applying book values of the transferred company, if they are available,
- applying book values of the transferring company or
- applying book values of a controlling party.

The receiving company should be able to exercise this accounting policy choice anew for each transaction under common control using a book value method. Of course, any resulting disclosure requirements would need to be taken into account.

We are concerned, that if the IASB continues to follow its preliminary view so as to provide for measuring the assets and liabilities received using the transferred company's book values only, certain currently established and well-functioning solutions for reporting capital market transactions (including spin-offs) will no longer be possible in the future (e.g., extraction method, presentation of complex financial history). As a result, preparers be faced with considerable additional work and costs.

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?

We agree with the Board's preliminary views.

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?

The IDW generally agrees with the Board's proposals.

However, we are of the opinion that it would be helpful to clarify how the receiving company has to deal with items included in the other comprehensive income of the transferred company.

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?

We agree that transaction costs should be recognised as an expense in the period in which they are incurred. Further, costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS standards, as proposed by the Board.

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?

The IDW does not agree with the Board's proposal.

As correctly mentioned in paragraph 4.60 of the DP, typically historical information about each of the combining companies is often required by capital market regulations if the combination is undertaken in preparation for an initial public offering. For example, in the European Union, audited historical financial information – prepared according to IFRS – covering the latest three financial years together with the respective auditor's reports is needed.[1]

We agree that, from a practical perspective, the retrospective approach would be more costly to apply than a prospective approach. Nevertheless, we believe that companies that want to apply a retrospective approach with pre-combination information restated to include the transferred company's assets, liabilities, income and expenses from the beginning of the earliest period presented or even need to do so due to capital market regulation should not be precluded from using such an approach. Therefore, we are in favour of an accounting policy choice for each of these transactions. This would circumvent any gap between IFRS and capital market regulation, and, from a preparers point of view, would also avoid considerable additional costs.

With regard to comparability aspects, the two approaches (i.e., the prospective approach with no restating pre-combination information by the receiving company and the retrospective approach) would only provide different information in the financial statements for the period in which the combination occurs and as comparative information in the financial statements for the subsequent period.

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[1] We refer to the Commission delegated regulation (EU) 2019/980 of 14 March 2019, Article 18 in conjunction with Section 18, Item 18.1.

The differences between the approaches would not cause any other differences in the financial statements for later periods. Therefore, in our view, the benefits of an accounting policy choice would far outweigh any disadvantages.

Question 11 – Disclosure requirements

Paragraphs 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?

We agree with the Board's preliminary views.

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?

In our opinion, in respect of the specificities of business combinations under common control, the disclosure requirements for business combinations under common control accounted for under a book-value method as proposed in the DP would provide appropriate information.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

Bernd Stibi
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Reporting

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