European Securities and Markets Authority

The Interim Chair

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

Ref: IASB's Discussion Paper Business Combinations Under Common Control

Dear Mr Barckow,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to the IASB's due process regarding Discussion Paper (DP) 2020/2 *Business Combinations Under Common Control*. We are pleased to provide you with the following comments, in order to improve the enforceability and consistent application of IFRSs.

ESMA very much supports the IASB's ambition to fill the 'gap' in IFRS Standards relating to how a receiving company should report a business combination under common control (BCUCC). ESMA agrees with the Board's preliminary view that neither the acquisition method nor a book-value method should be applied to all BCUCC. Indeed the acquisition method should be applied to some such business combinations and a book-value method to all others.

ESMA agrees with most of the IASB's proposals on how to determine the measurement method as summarised in the Decision Tree presented in the DP (IN.2). However, ESMA recommends that the IASB ensures that the 'boundaries' between the two accounting methods are as clear as possible. For that purpose, ESMA recommends that the IASB further refines its definition of "public markets" since the definition provided by IFRS 10 paragraph 4.a.ii is unlikely to be robust enough to drive the selection of a measurement method. Furthermore, in order to avoid structuring opportunities, ESMA believes that the IASB should take into consideration the notion of *significance* of non-controlling shareholders both with regards to step 1 and step 3 of the proposed Decision Tree.

In addition, ESMA recommends that the Board requires at least some pre-combination information for transactions accounted for under the book value method as, in our view, not requiring any information does not strike the right balance between costs and benefits.

More detailed comments on the DP are set out in the Appendix to this letter. In case you have any questions or comments please do not hesitate to contact me or Evert van Walsum, Head of the Investors and Issuers Department (Evert.vanWalsum@esma.europa.eu).

Yours sincerely,

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Annex

Question 1

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?

1. ESMA agrees with the Board's preliminary view with regards to the transactions within the project's scope and for which it should develop proposals. As acknowledged by paragraph 1.15 of the DP, the project also considers group restructurings which do not meet the definition of a business combination ESMA welcomes the scope of the project.
2. With reference to paragraph 1.16 of the DP, ESMA recommends that, if it is not removed from the scope exclusion of IFRS 3, the notion of "transitory control" should be carefully considered and clarified during this project. For instance, when a 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 (case a) there is a risk that the transaction might be considered transitory and therefore fall outside the scope exclusion of IFRS 3 (acquisition method not applied) or, alternatively, not transitory and therefore considered as falling within the scope of the BCUCC project (acquisition method applied). Opportunistic behaviours might arise.
3. Additionally, ESMA suggests that the IASB should consider whether situations in which shareholders before and after a restructuring are *exactly* the same, in the absence of a contractual arrangement arranging control, should be considered a BCUCC as well. Under the current definitions (IFRS 3 paragraph 2(c) and B2) these transactions are not regarded as BCUCC, and acquisition accounting should be applied.

Question 2

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?

4. ESMA agrees with the Board's preliminary view that a single measurement approach would not be appropriate for all BCUCC. ESMA also agrees that, in case a BCUCC affects non-controlling shareholders (whereby "affects" means "determines a change in the ownership interest of the non-controlling shareholders in the transferred business" (DP paragraph 2.20)), both the combination itself and the composition of users of the receiving company's financial statements are comparable to a transaction under the scope of IFRS 3 as argued in paragraph 2.21 of the DP. However, ESMA encourages the IASB to further clarify the meaning of the expression "affecting non-controlling shareholders" as it seems not to be clear to various stakeholders.
5. Furthermore, ESMA is concerned that the IASB's proposed approach might give rise to structuring opportunities since a non-substantive change in ownership interest of the non-controlling shareholders in the transferred business could have an impact on the measurement method applied. Therefore, ESMA recommends that the Board takes into consideration the notion of *significance* of the change in ownership interest of the non-controlling shareholding.
6. ESMA also agrees that a book-value method should be applied to all other BCUCC.

Question 3

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?*

7. Notwithstanding the position expressed in paragraph 5, ESMA agrees with the Board's preliminary view that the acquisition method should be required if the receiving company's shares are traded in a public market. However, ESMA deems that the current definition of public market in IFRSs as "domestic or foreign stock exchange or an over-the-counter market, including local and regional markets" (IFRS 10 paragraph 4.a.ii) is unlikely to be robust enough to drive the selection of a measurement method and there is a risk of divergent interpretation and therefore application in practice. For instance, an over the counter (OTC) market is by definition a market where participants trade bilaterally and therefore it may be questionable whether instruments listed on an OTC market are "publicly traded". ESMA recommends that the IASB further refines the existing definition and in particular the notion of "publicly traded". In addition, ESMA notes that the assumption that trading in a public market provides protection to non-controlling shareholders may not apply to all non-regulated markets or to all public markets globally.
8. With regards to step 3, ESMA tends to agree that if all non-controlling shareholders are related parties of the receiving company a book value method should be applied. There is a high probability that the transaction is not at arm's length and will not resemble a business combination under the scope of IFRS 3. However, ESMA notes that there is a risk that structuring opportunities might arise whereby a non-controlling shareholder which is not a related party is introduced only for the purpose of applying the acquisition method. For that reason, ESMA recommends that the notion of significance is introduced: it should be clarified that step 3 is applicable only if non-controlling shareholders which are not related parties are not significant.
9. With regards to step 4 of the decision tree, ESMA notes that the IASB proposes that the optional exemption from the acquisition method only applies to companies whose shares are not traded on a public market. ESMA recommends that the IASB carefully considers on the basis of the input received from investors whether the optional exemption from applying the acquisition method should apply if the receiving company has debt instruments which are traded in a public market. ESMA thinks that this would not be inconsistent with step 1 of the decision tree because whilst the focus of step 1 is to establish whether the transaction causes a change in the ownership interests in the economic resources transferred in the combination, step 4 focuses on cost-benefit

considerations in light of the information needs of users of financial information. ESMA notes furthermore that this would align the future requirements with the exemptions contained in other IFRS Standards which apply not only to companies whose equity is publicly traded, but also to companies whose *debt* is publicly traded (IFRS 10 paragraph 4(ii) and IAS 28 paragraph 17(b)).

Question 4

Paragraphs 2.48–2.54 discuss suggestions from some stakeholders that the optional exemption from the acquisition method 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?

10. Notwithstanding the comments provided in question 3, ESMA agrees with the Board's preliminary view that the optional exemption from the acquisition method and the related-party exception to the acquisition method should not be available for publicly traded receiving companies, because publicly traded companies normally have many shareholders with frequent changes in share ownership.

Question 5

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?*

11. Overall, ESMA welcomes the fact that the DP proposes to leverage to the maximum possible extent on the existing requirements under IFRS 3 and acknowledges like the Board does in IFRS 3 BC382 that in a business combination in scope of IFRS 3 it is unlikely that an overpayment could be detected at the acquisition date. Therefore, ESMA agrees with the Board's preliminary 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 applied to a business combination under common control, consistently with IFRS 3. ESMA also agrees that any 'overpayment' would be best addressed via impairment or any improved requirements resulting from the IFRS 3 Discussion Paper.
12. With regards to the requirements for the receiving company on how to recognise any excess fair value of the identifiable acquired assets and liabilities over the consideration paid (whether as a contribution to equity or as a bargain purchase gain in the statement of profit or loss), ESMA agrees that the Board 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.
13. In response to question (c), ESMA thinks that it would be useful that the IASB provides guidance on how to identify the receiving entity (the acquirer) in situations involving a NewCo where applying the existing guidance under IFRS 3 might not be relevant. As already mentioned in paragraph 2, the notion of "transitory control" would need to be considered and clarified.

Question 6

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?

14. ESMA tends to agree with the Board's preliminary view that when applying a book-value method to a BCUCC, the receiving company should measure the assets and liabilities received using the transferred company's book values.
15. Indeed, using the receiving company's book values would conceptually be more sound than using the controlling party's book value because information about transactions and events should be provided from the perspective of the company that prepares financial statements, which in this case is the receiving company. Furthermore the controlling party's book values would be less appropriate since the controlling party is not – strictly speaking – a party to the combination.

16. In addition, ESMA agrees that it is important that the chosen methodology provides uninterrupted historical information about the transferred company. ESMA notes that the IASB already foresees that its "future detailed proposals might address, for example, how to determine the book values of the assets and liabilities received when those book values are not readily available" (paragraph 4.5 of the DP). ESMA indeed encourages the IASB to address such issue and explain in which situations IFRS figures would not be available.

Question 7

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?

17. ESMA agrees with the IASB's preliminary views that 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 BCUCC. This is mainly because reporting of the components of equity and the measurement of issued shares for reporting purposes need not be prescribed by IFRS Standards.
18. ESMA also agrees the consideration paid in assets should be measured at the receiving company's book values of those assets at the combination date and that the consideration paid by incurring or assuming liabilities should be measured at the amount determined on initial recognition of the liability at the combination date applying the relevant IFRS Standards.
19. Lastly, ESMA recommends that the IASB addresses any tension between IFRIC 17 *Distributions of Non-cash Assets to Owners* and future requirements for common control transactions.

Question 8

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?*

20. ESMA agrees with the Board's preliminary views that when applying a book-value method to a BCUCC the receiving company should recognise within equity any difference between the consideration paid and the book value of the assets and liabilities received. This is consistent with the fact that BCUCC accounted for under the book-value method may not to be priced at arm's length and may involve related parties (and therefore include a contribution to or distribution from the receiving company's equity), and with the requirements of IAS 1, which states that transactions with owners acting in their capacity as owners should be reported in the statement of changes in equity.
21. Furthermore, ESMA agrees that the Board should not prescribe in which component(s) of equity the receiving company should present that difference since that is not normally prescribed by IFRS Standards.

Question 9

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?

22. ESMA notes that under IFRS 3 transaction costs other than costs of issuing shares or debt instruments are not deemed part of the exchange between the buyer and the seller for the business but rather as separate transactions in which the buyer pays for the services received.
23. ESMA agrees that there is no reason for a book-value method to treat transaction costs differently from the approach required by IFRS 3 and therefore agrees with the Board's preliminary views in these regards.

Question 10

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?

24. ESMA thinks that requirements for companies applying a book value method to a BCUCC should be consistent with the requirements of IFRS 3, i.e. the receiving company should include in its financial statements the assets, liabilities, income and expenses of the transferred company prospectively, i.e. from the date of the combination. The prospective approach does not require the receiving company to restate pre-combination information.
25. As further discussed in response to question 12, however, ESMA recommends that the IASB develops requirements for the receiving company to disclose pre-combination information in the notes to its financial statements, which would also be consistent with the requirements of IFRS 3.

Question 11

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?

26. ESMA agrees with the Board's preliminary views that for BCUCC to which the acquisition method applies the receiving company should be required to comply with the disclosure requirements in IFRS 3, including any future improvements thereof resulting from the recent Discussion Paper.
27. ESMA is also very supportive of 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.

Question 12

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?*

28. ESMA concurs with most of the Board's preliminary views with regards to BCUCC to which a book-value method applies, including that some but not all of the disclosure requirements in IFRS 3 and future improvements thereof would be appropriate.
29. However, ESMA disagrees that the Board should not require the disclosure of any pre-combination information for transactions accounted for under the book value method since from ESMA's perspective this does not strike the right balance between costs and benefits. ESMA recommends that the Board requires at least some pre-combination information, such as the revenue and profit or loss of the combined company for the current reporting period, as if the combination had occurred at the beginning of the reporting period as already required by paragraph B64(q)(ii) of IFRS 3. ESMA deems that this information would be very useful to users; given its limited scope, it is not expected that it would be excessively costly for preparers.
30. Last, but not least, ESMA supports the proposed transparency required by the receiving company over (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(s) of equity that includes this difference.