KPMG IFRG Limited
15 Canada Square
London E14 5GL
United Kingdom

reinhard.dotzlaw@kpmgifrg.com

Dr Andreas Barckow
International Accounting Standards Board
Columbus Building
7 Westferry Circus
London
E14 4HD

Our ref RD/288

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Dear Dr Barckow,

Comment letter on Discussion Paper DP/2020/2 *Business Combinations under Common Control*

We appreciate the opportunity to comment on the International Accounting Standards Board's (the Board) Discussion Paper DP/2020/2 *Business Combinations under Common Control* published in November 2020. We have consulted with, and this letter represents the views of, the KPMG global organisation.

We are supportive of the Board's efforts to prescribe financial reporting requirements for a receiving company in a business combination under common control ('BCUCC') with the objectives of reducing diversity in practice, improving the transparency of reporting and providing users of the receiving company's financial statements with better information.

We are generally supportive of the proposals the Board has outlined in its Discussion Paper and agree that neither a book-value method nor the acquisition method should be applied to all BCUCC transactions. However, we encourage the Board to consider the feedback it receives as part of this stage of its research project to further develop its proposals. In particular, we ask the Board to consider whether there are additional transactions that should be accounted for using the acquisition method and whether companies should be allowed an option to restate pre-combination information when a book-value method is applied.

The Appendix to this letter contains our detailed responses to the questions on the Board's preliminary views.

Please contact Reinhard Dotzlaw at rdotzlaw@kpmg.ca or Peter Carlson at pcarlson@kpmg.com.au if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix

This appendix contains our detailed responses to the questions in the Discussion Paper.

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?

We agree that the scope of the proposals should cover all transfers of businesses under common control and welcome the inclusion of transfers to newly incorporated (Newco) entities. However, we believe the scope should be expanded to include consolidated financial statements in which a Newco is placed on top of a listed group. We do not believe this would meet the current definition of common control.

We believe that there are a number of additional issues relating to common control transactions that the Board should seek to address to further reduce existing diversity in practice. These types of transactions are not dealt with currently in IFRS Standards, and therefore judgement is required to develop an appropriate accounting policy. Issues that we believe should be addressed as part of this project include:

— accounting for mergers and amalgamations of entities under common control;

— the interaction between the Board's proposals and IFRS 1 – e.g. is a Newco considered a first-time adopter when applying a book-value method?

Additional issues that we believe should be addressed, either by expanding the scope of this project or through separate projects, include:

— transfers of equity-accounted investees between entities under common control;

— transfers of an interest in a joint operation between entities under common control;

— transfers of legal entities that are not businesses between entities under common control; and

— accounting in separate financial statements – e.g. for the transfer of investments in subsidiaries between entities under common control.

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?

We support the Board's preliminary view that neither the acquisition method nor a book-value method should be applied to all BCUCC. We agree that some BCUCC transactions are more similar in substance to business combinations in the scope of IFRS 3, whereas others are similar to reorganisations of economic resources around the reporting group.

We agree that the acquisition method should be applied if the business combination affects non-controlling shareholders of the receiving company, subject to the cost–benefit trade-off and other practical considerations discussed in Question 3.

During our internal deliberations of the Board's paper, many KPMG stakeholders supported the Board's proposed framework – i.e. that a book-value method should be applied to all other BCUCC. It was agreed that such a framework will reduce diversity in practice and eliminate the need for significant judgement about whether to apply the acquisition method or a book-value method. Supporters of the Board's proposals recognise the Board's efforts in trying to provide a framework that is practical and cautioned against too many 'buckets', exceptions or areas of choice or judgement in the framework.

Whilst accepting the Board's overall aims, some disagreed with where the Board has drawn the 'dividing line' between applying the acquisition method and a book-value method. The reasons why they ask the Board to re-consider its proposed dividing line include:

— The focus on the existence of non-controlling shareholders may not sufficiently address the information needs of other users. For example, some believe that transactions in which the receiving company has publicly traded debt should also be accounted for using the acquisition method, because that would provide lenders with better information. Similarly, some believe that when minority ownership interests in the receiving company are in the form of liabilities – e.g. some preference shares – these transactions should be treated the same way as transactions that impact non-controlling shareholders.

— Valid commercial reasons could exist as to why transactions are completed at fair value, including cases in which the receiving company does not have non-controlling shareholders – e.g. cross-border transactions or transactions undertaken at fair value for tax purposes.

— There could be an increase in grooming transactions – e.g. the insertion of temporary or insignificant non-controlling shareholders in the receiving company in order to use the acquisition method.

— They believe that the Board's proposed dividing line considers the legal form of the transaction and the group's structure over the substance of the transaction – e.g. in situations where there is a very small percentage of non-controlling shareholders.

To address the concerns above, those that disagreed with the Board's proposed dividing line have suggested that the Board consider whether there are additional types of transactions that should be accounted for using the acquisition method. For example, if there are no non-controlling shareholders impacted and the transaction is priced at fair value, then they suggest that the receiving company should have a choice to account for the transaction using the acquisition method. The rationale for this approach is that these transactions are more like business combinations under IFRS 3 and applying the acquisition method could provide useful information.

Overall, during our discussion no one suggested that the acquisition method is appropriate in all circumstances and we would not support a requirement to apply the acquisition method in all cases. Even those that disagree with the proposed dividing line believe that a book-value method is appropriate in some cases.

If the existence of non-controlling shareholders is ultimately the dividing line, we also note that it may be difficult in some more complex cases to determine whether non-controlling shareholders are affected – e.g. if there are share options, warrants or conversion features exercised at the time of the BCUCC transaction. It would be helpful for some of these application questions to be addressed by the Board if the proposed framework is developed further.

We acknowledge that determining where to draw the dividing line is fundamental to the Board's proposals. The comments above highlight the challenges of developing requirements for BCUCC transactions. We encourage the Board to consider the feedback it receives on this key question during its future deliberations before concluding on this matter.

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?

We agree that the acquisition method should be required if the receiving company's shares are publicly traded.

As mentioned in our response to Question 2, some KPMG stakeholders believe that if the receiving company has publicly traded debt, then the BCUCC transaction should also be accounted for using the acquisition method.

We also agree that if the receiving company's shares are privately held, then the receiving company should be permitted to use a book-value method if it has informed all of its non-controlling shareholders. However, we have some concerns that this exemption may be challenging to apply in some cases as it would depend on the corporate governance and legal framework in a particular jurisdiction. Therefore, it would be helpful if further application guidance is provided – e.g. how and when a

company should notify its non-controlling shareholders and the length of time during which a non-controlling shareholder can object.

We generally support the Board's proposal that 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. However, some noted that there may be related parties (who may not be members of the common control group) who would be interested in the fair value information and, in those cases, could be given the opportunity to object to the use of a book-value method in the same way as other (unrelated) non-controlling shareholders.

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?

We agree that the optional exemption from the acquisition method and the related-party exception to the acquisition method should not apply to publicly traded receiving companies.

We note that the optional exemption would be difficult to apply for publicly traded companies because they often have many shareholders which are widely dispersed. We also note that share ownership in publicly traded companies is likely to change more regularly than those in private companies.

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?

Overall, we agree with the Board's proposal that it should not require the receiving company to recognise a distribution from equity when applying the acquisition method.

Some questioned whether this proposal reflects the substance of the transaction and whether recognising a distribution would provide better information. However, ultimately, we note that an overpayment is unlikely to arise in practice and would likely be identified through subsequent impairment testing. Therefore, we support the Board's proposal from a cost-benefit perspective.

We agree that the receiving company should not recognise a gain on a bargain purchase in the income statement, but instead recognises that difference in equity as a contribution. We think that this approach better reflects the substance of the transaction.

There are no other areas where we recommend the Board develops guidance (other than the disclosure considerations dealt with in Question 11 – e.g. disclosures to assist users in understanding whether the price paid in a BCUCC transaction is reasonable).

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?

We acknowledge there is current diversity in practice and agree with the proposal to restrict the choice of book values to a single method. The outcome of our internal discussion on this issue has resulted in mixed views as to whether the transferred company's book values should be used as the single method allowed.

Some agree with the Board's proposals that the transferred company's book values should be used and have observed that this approach is typically less costly. However, for some who supported this approach, the use of the transferred company's book values is dependent upon the transferred company preparing IFRS financial statements because there may be significant costs involved in preparing IFRS financial statements for this purpose only. This group would support using the next highest parent companies' IFRS book values where the transferred company's financial statements are not prepared in accordance with IFRS.

Others take a different view and support using the book values of the next highest parent company that prepares consolidated IFRS financial statements as a starting point. If no higher company prepares consolidated IFRS financial statements, then they support using the transferred company's book values. Some of those that prefer using a higher level than the transferred company's book values noted that this would help prevent write-offs of goodwill through equity at the intermediate parent level.

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 that the Board should not prescribe how the receiving company measures consideration paid in shares because this will often be subject to local legal requirements.

We support the Board's proposal that the receiving company should measure consideration paid in assets at its book values of those assets and consideration paid by incurring or assuming liabilities at the amount determined on initial recognition of the liabilities applying IFRS Standards.

However, we also note that there are often existing transactions between entities under common control, including amounts due between the receiving company and the transferee ("pre-existing relationships") that would need to be eliminated as part of the accounting for the BCUCC. Pre-existing relationships are currently covered in IFRS 3. We think similar guidance for BCUCC when a book-value method is applied would be useful.

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?

We agree that if there is a difference between the consideration paid and the book values of assets and liabilities received, it should be recognised within equity and not in profit or loss.

We also agree that the Board should not prescribe in which component(s) of equity the receiving company presents the difference.

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 when applying a book-value method, the receiving company should recognise transaction costs as expenses in the statement of profit or loss in the period in which they are incurred, except for the costs of issuing shares or debt instruments. This is in line with the requirements for transaction costs for business combinations in the scope of IFRS 3 and we do not see a reason for treating transaction costs differently under a book-value method.

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?

We disagree with the Board's proposal to prohibit the restatement of pre-combination information. We would support the Board providing an option to allow the receiving company to restate, rather than requiring restatement. Our reasons for this difference of view are as follows:

— Book values are the product of history – e.g. historical cost (or initial recognition amounts) or historical accruals of income etc. – and hence it is inconsistent to include book values but not their history. We believe that an underlying principle of the application of book-value accounting to BCUCC transactions is the continuation of such financial information.

— If the Board goes ahead with its proposed view, only the receiving company's history is presented. For example, if the receiving company is a Newco, not allowing the restatement of pre-combination information would result in the Newco having no comparatives in its consolidated financial statements. This outcome would not reflect the economics of the transaction, which is that this is a continuation of the existing business under a new company. Further, it would also limit the amount of information available for analysis by users.

— Some regulators and local legislation require pre-combination information. For example, this type of transaction is often seen in advance of an IPO and it is not clear, in that case, whether it would be considered appropriate, or accepted by the markets, for the new group not to include its financial information for all periods presented. Further, this may create an inconsistency between pre- and post-transaction information provided by the receiving company.

We understand that the Board has explored an option to disclose pre-combination information. However, we do not believe this achieves the same objective as restating, and we therefore recommend that at a minimum, the Board allows an option to restate pre-combination information.

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 approach being taken by the Board that the disclosure requirements in IFRS 3 should be applied. This is consistent with the view that if fair value accounting is applied, then the company should provide the disclosures required by IFRS 3.

In principle, we also support including improvements resulting from the Goodwill and Impairment project – e.g. information to help users of the financial statements assess whether the price paid in a BCUCC was reasonable, such as information about expected synergies. We will reserve judgement on the appropriateness of such disclosures until they are provided in detail by the Board.

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?

We acknowledge that the Board has not yet fully developed the book-value method it would require, although we agree in principle with the preliminary approach being taken by the Board to apply some, but not all, of the disclosure requirements in IFRS 3, including those improvements resulting from the Goodwill and Impairment project. We believe the proposals would provide relevant information for the users of the receiving company's financial statements where a book-value method is applied. We look forward to providing further feedback when the specific disclosure requirements are shared by the Board.

We agree that the Board should not require the disclosure of pre-combination information. However, we believe there should be an option to disclose this information or restate pre-combination (comparative) information (see our response to Question 10).

We agree that the receiving company should disclose the amount recognised in equity for differences between consideration paid and the book value of the assets and liabilities received, and the component(s) of equity.