MNP LLP

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SENT ELECTRONICALLY

International Accounting Standards Board
IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Sirs/Mesdames:

Discussion Paper DP/2020/2 – Business Combinations under Common Control (the "DP")

Thank you for the opportunity to comment on the above DP.

MNP LLP ("MNP") supports the International Accounting Standards Board's (the "Board") efforts to explore possible reporting requirements for business combinations under common control ("BCUCC") to improve consistency of reporting for the receiving companies and provide more relevant information for users of the financial statements.

IFRS 3 *Business Combinations* ("IFRS 3") set outs reporting requirements for business combinations. However, it does not specify how to report transactions that involve transfers of businesses between companies in which all of the combining companies are ultimately controlled by the same party. Such transactions are common in many countries around the world.

As a result of this gap in IFRS Standards, companies report these combinations in different ways. In some cases, they use the acquisition method to measure the assets and liabilities received in the combination at fair value and recognize goodwill. In other cases, companies use a book-value method to measure those assets and liabilities at their existing book values, less any impairments, if applicable. There are a variety of book-value methods used in practice. Furthermore, when using book-value method, the companies often provide little information about these combinations. This diversity in practice makes it difficult for investors to understand the effects of such transactions on companies that undertake them and to compare companies that undertake similar transactions.

We agree with the Board's view that entities should provide similar information about similar business combinations when the benefits of that information to investors outweigh the costs of providing it.

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?

MNP agrees with the scope proposed by the Board in paragraphs 1.10 to 1.23 of the DP that covers 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 combining entities to an external party, or (b) conditional on a sale of the combining entities to an external party, including:

- BCUCC; and
- Group restructurings that involve a transfer of a business or businesses under common control, but which do not meet the definition of business combinations in IFRS 3.

However, using the term "business combination" for transfers of businesses that do not meet the definition of a business combination under IFRS 3 may be misunderstood. Therefore, the Board should consider using a different term to describe such transactions in the Standards and should clarify/define the term "group restructurings".

Should the Board decide to keep the scope exclusion of "transitory control" in IFRS, the term should be defined and clarified.

For simplicity, throughout this document, we have used the term BCUCC to refer to all transactions scoped in for the purposes of this DP, including group restructurings.

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?

(a) We agree that a single measurement method is not appropriate for all BCUCC. Some BCUCC have features in common with business combinations within the scope of IFRS 3 and therefore should be accounted for similarly. Other BCUCC are simply reallocations of economic resources within the group with no change in the ultimate control or ownership interests of all parties involved. We believe that "economic substance" should be considered in determining if a BCUCC should be accounted for using the acquisition method (economic substance present) or book-value method (no economic substance present)

(b) We agree that a method similar to the acquisition method under IFRS 3 should be applied if the BCUCC results in a change in the ultimate ownership interests in the economic resources transferred to the receiving entity (i.e., when the receiving entity has non-controlling shareholders who acquire an interest in those economic resources, from the controlling party, that they did not previously have). This will generally provide consistent, relevant, and useful information to the users of the financial statements.

However, to better clarify whether the acquisition method can be applied by the receiving entity, the Board should consider introducing a magnitude/significance test of the relative ownership interest of the receiving entity's non-controlling shareholders or the relative changes to the ownership interests of non-controlling shareholders as a result of the economic resources transferred. This will reduce the risk that asset values are inappropriately increased in the receiving entity's books, while promoting consistency in accounting treatment.

(c) We further agree with applying a book-value method to all other BCUCC where there is either an insignificant or no non-controlling interest in the receiving entity, or the impact on the ownership interests of the non-controlling interest is relatively insignificant.

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 agree with the Board's preliminary view that for transactions where the non-controlling shareholders of the receiving company are affected, the acquisition method should be required if the receiving entity's shares are traded in a public market. We note that IFRS 10 *Consolidated Financial Statements* ("IFRS 10"), paragraph 4(a)(ii) defines a publicly traded company to have its debt or equity instruments traded in a "public market" (i.e., a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets). Therefore, the Board should expand the requirement, to apply the acquisition method if the receiving company's debt is traded in a public market or if the receiving company's shares are traded in a public market.

(b) We agree with the optional exemption from applying the acquisition method for private entities with third party non-controlling shareholders, as it will provide cost relief to these entities.

We also agree with the requirement to use a book-value method when all non-controlling shareholders of the receiving entity are related parties. Moreover, we recommend that this requirement is expanded to include the receiving entities with immaterial non-controlling interests based on a similar magnitude/significance test as discussed in response to Question 2 (b) above. This will reduce the risk of inappropriate increase of asset values in the receiving entity's books.

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 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 apply to publicly traded receiving companies, because publicly traded companies normally have many shareholders and frequently change share ownership. Their shareholders often do not have direct access to the entity's management or decision-relevant internal information. There may be a risk that the book-value method could obscure impairment and other information that investors might find useful to their decision-making process. In most cases, the acquisition method may result in a "fair" and transparent value, more reflective of market.

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) We agree with the Board's preliminary view that an excess payment is unlikely to be detected at the acquisition date when the acquisition method is applied. As such, the Board should not develop a requirement for the receiving entity to identify, measure and recognize a distribution from equity for potential overpayment of the consideration compared to the fair value of the identifiable assets acquired and liabilities assumed by the receiving entity. Rather, the difference would be recognized as goodwill and subsequently addressed through impairment, which is consistent with the guidance on acquisition method in IFRS 3.

(b) We agree with the Board's preliminary view that the Board should develop a requirement for the receiving entity to recognize any excess fair value of the identifiable assets acquired and liabilities assumed over the consideration paid as a contribution to equity. Due to the nature of a BCUCC being a related party transaction, it would seem inappropriate to recognize any bargain purchase gain.

(c) We do not have any recommendations on any other special requirements in addition to the ones discussed above. In general, the Board should ensure the guidance, when applying acquisition method to BCUCC, is as close as possible to the acquisition method in IFRS 3.

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 agree with the Board's preliminary view that when applying a book-value method to a BCUCC, the receiving entity should measure the assets and liabilities received using the transferred entity's book values, provided these book values include the fair value bumps from any previous business combination acquisitions (to eliminate any outside basis differences), as these book values provide uninterrupted historical information about the transferred entity, which is generally useful to the users.

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?

(a) We agree with the Board's preliminary views that the Board should not prescribe how the receiving entity should measure the consideration paid in its own shares when applying a book-value method to a BCUCC. Any difference between the book value of the assets and liabilities received and the consideration paid would be recorded in equity and therefore there would be no difference in the net impact to the receiving entity's total equity.

(b) We also agree the consideration paid in assets should be measured at the receiving entity'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.

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 with the Board's preliminary views that when applying a book-value method to a BCUCC, the receiving entity should recognize within equity any difference between the consideration paid and the book value of the assets and liabilities received. We further agree that the Board should not prescribe in which component, or components, of equity the receiving entity should present that 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 with the Board's preliminary view that transaction costs should be recognised as an expense when incurred except that the costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS Standards.

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 preliminary view that the receiving entity should include in its financial statements the assets, liabilities, income and expenses of the transferred entity prospectively from the combination date, without restating pre-combination information.

In our experience, it is common practice to prepare post-combination financial statements as if the entities had always been combined. This provides better visibility to the users of the financial statements to assess that nothing in substance has changed in the BCUCC transaction and provides useful information for comparative purposes. In addition, some regulators in Canada require this restated comparative information when a BCUCC occurs for the purposes of a go-public transaction.

We propose that there should be an option when applying the book-value method to a BCUCC as to whether the receiving entity 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 (for example, private entities may choose prospective disclosure as the less costly or complex option); **or**
- include in its financial statements the assets, liabilities, income and expenses of the transferred company retrospectively from the combination date, with restating pre-combination information (for example, when an entity's regulator requires such disclosure).

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 proposed disclosure requirements for BCUCC to which acquisition method is applied. The proposed disclosures will provide relevant information to users of financial statements about the transaction.

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 agree with the Board's preliminary views on the proposed disclosure requirements for BCUCC for which a book-value method applies as these disclosures would provide relevant information about the transaction.

However, we recommend the Board consider a minimum disclosure requirement of pre-combination information that would provide useful comparative information to the financial statement users on major financial indicators – for example, total current and long-term assets, total current and long-term liabilities, revenues and net income.

We would be pleased to offer our assistance to the Board in further exploring issues raised in our response and in helping to find alternative solutions which meet the needs of the financial statement users.

Yours truly,

MNP LLP

Jody MacKenzie, CPA, CA
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