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International Accounting Standards Board
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Board Members,

RESPONSE TO DISCUSSION PAPER – BUSINESS COMBINATIONS UNDER COMMON CONTROL ("DP")

ISCA sought views from its members on the above ED through a six-month public consultation and from the ISCA Financial Reporting Committee which includes experienced technical accounting professionals from large accounting firms, preparers and other stakeholders.

As business combinations under common control transactions (BCUCC) fall outside the scope of IFRS 3 *Business Combinations*, we support the Board's efforts in embarking on a research project on this topic to address this long-standing gap in accounting requirements.

Currently, entities which engage in common control transactions would have to select an appropriate accounting policy in accordance with the requirements set out in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, and this could result in a diversity in practice.

ISCA issued Recommended Accounting Practice 12 (RAP 12)[1] "Merger Accounting for Common Control Combinations for Financial Statements" in December 2006, which explains how merger accounting (book-value accounting) could be applied to common control transactions. We note that there are differences in the accounting treatment for common control transactions in RAP 12 as compared to that in the Board's proposals. For example, RAP 12 currently recommends that for the book-value method, the receiving company should measure the assets and liabilities received at the book values reported by the controlling company, instead of the transferred company as proposed in this DP. This has been further elaborated in one of our concerns in "(ii) Unintended consequence of companies structuring their business combinations to achieve a certain desired accounting outcome" below.

[1] https://isca.org.sg/media/2803/rap-12-isca.pdf

Nevertheless, we are encouraged that the Board is exploring possible reporting requirements for such common control transactions, and we believe that national accounting standard-setters and professional accountancy bodies would view this as a useful step to ensure better standardization across reporting of such transactions among IFRS adopters.

We generally agree that the acquisition method should be applied to some combinations while a book-value method should be applied to other combinations. We also agree that with the Board's view that if the business combination under common control affects non-controlling shareholders of the receiving company, then it would be appropriate to use the acquisition method.

However, we note that the proposed criteria for whether acquisition method / book-value method should be used may be too restrictive and may result in structuring opportunities for companies.

We would like to share the following concerns regarding the Board's proposals:

(i) Provide guidance on the term "transitory" for common control

As defined in paragraph B1 of IFRS 3, a business combination under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

In paragraph 1.16 of this DP, we note that the Board has reached the preliminary view that its proposals should cover all transfers of businesses in which all of the combining companies are ultimately controlled by the same party, irrespective of whether the transfer is:

(a) preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies to an external party (that is, a party outside the group); or

(b) conditional on a sale of the combining companies to an external party, such as in an initial public offering (see Example 4 in Appendix B).

We disagree with the Board's preliminary view to disregard the criteria for control to be "not transitory". In our view, it is important to consider whether the group structure after the combination is "transitory" so as to reflect the substance of a business combination.

The Board should consider providing guidance on what is considered "transitory" control to address the challenges with the application of this requirement.

(ii) Unintended consequence of companies structuring their business combinations to achieve a certain desired accounting outcome

We understand the Board's intention to reduce diversity in practice when accounting for BCUCC. However, the Board's current proposals suggest that companies would no longer have the flexibility in applying accounting policy choice when accounting for BCUCC and may result in receiving companies structuring their business combinations to achieve either fair value / book value accounting. Hence, the Board should consider allowing some flexibility in the application of their criteria. For instance, refer to our illustration below:

Paragraph 1.16 of the DP explains that "the Board has reached the preliminary view that its proposals should cover all transfers of business in which all of the combining companies are ultimately controlled by the same party, irrespective of whether the transfer is (a) preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies to an external party...".

Applying the preliminary views set out in the DP to a transaction which is preceded by an acquisition of 100% interest in a subsidiary from an external party and subsequently transferring the acquiree to another 100% owned subsidiary would result in the receiving entity accounting for the transaction applying the book value method. When the subsidiary was first acquired from an external party, the acquisition method would have been applied to account for this acquisition under IFRS 3 by the acquiring entity. When this acquired subsidiary is subsequently transferred to another entity controlled by the same party (i.e. the receiving entity), the receiving entity would then account for this transfer using the book values of the acquired subsidiary and not the values previously recorded by the acquiring entity. This provides structuring opportunity to achieve book value accounting in the consolidated financial statements of the receiving entity.

It is not uncommon for a group restructuring to be put in place to create a new group to be sold to an external party upon the request of the acquirer or for the purpose of initial public offerings. Applying the preliminary views set out in the DP to such transaction would result in the parent of the new group accounting for the restructuring using the book value method i.e. the consolidated financial statements of the new parent would reflect the book values of the entities in the group. The subsequent disposal of the new group to the external party would not change the financial numbers reflected in the consolidated financial statements. This provides structuring opportunity to achieve book value accounting in the consolidated financial statements of the new group by having the seller restructure the group before the sale.

(iii) Provide option for acquisition method accounting should one of the related parties of the receiving company object to book-value accounting

One of the proposals in the DP is 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 (the

related-party exception to the acquisition method).” In this scenario, if one of the related parties objects notwithstanding its related party, then in our view, there should be an option to apply acquisition accounting instead.

(iv) Allow companies the choice to apply acquisition method of accounting even though the receiving company has no non-controlling shareholders

In our view, requiring receiving companies which have no non-controlling shareholders to use the book-value model of accounting may be too prescriptive and cause unintended consequences. For example, receiving companies which would like to apply the acquisition method could structure the business combination by introducing a non-controlling shareholder just before the business combination occurs.

It may be better to allow such companies to apply an accounting policy choice, either applying the acquisition or book-value model, as we do not believe that there is any downside to applying the acquisition method for users of the financial statements. Companies would then have to make the appropriate disclosures on why they chose to use a particular method.

(v) Consider requiring the inclusion of pre-combination information if the book-value method is applied

We disagree with the Board’s views to include the transferred company from the combination date, without restating pre-combination information.

Paragraph 1.15 of the DP states that “The Board has reached a preliminary view that it should develop proposals on all transfers of a business under common control, even if the transfer does not meet the definition of a business combination in IFRS 3.” Example 3 in Appendix B of the DP sets out a scenario where a Newco is inserted between parent P and subsidiary A as an intermediate holding company, which is within scope of the BCUCC project. Applying the preliminary views set out in the DP to the transaction would result in the Newco accounting for the transaction applying the book value method prospectively from the combination date, without restating pre-combination information.

The approach in the DP disregards the substance of the transaction i.e. that the Newco is in-substance a continuation of subsidiary A and results in loss of pre-combination information relating to subsidiary A.

Such structures are commonly used for the purpose of IPOs where the Newco is created to be the listing vehicle. The requirement to include the financial information of subsidiary A prospectively from combination date may result in Newco not being able to present historical track record for the purpose of listing on the stock exchange.

Pre-combination information provides useful information about the combined company. Such historical information about each of the combining companies would typically be required by capital market regulations if the combination is undertaken in preparation for an IPO.

For instance, ISCA RAP 12 recommends the inclusion of pre-combination information and paragraph 9(c) states:
"The practical effects of merger accounting are that: comparative amounts in the financial statements are presented…as if the entities or businesses had been combined at the previous balance sheet date unless the combining entities or businesses first came under common control at a later date."

Hence, we recommend the Board to consider requiring the inclusion of pre-combination information if the book-value method is applied.

Should you require any further clarification, please feel free to contact myself, Ms Jezz Chew or Mr Marcus Chan, TECHNICAL: Financial Reporting, from ISCA via email at jumay.lim@isca.org.sg, jezz.chew@isca.org.sg or marcus.chan@isca.org.sg.

Yours faithfully,

Ms Ju May, LIM
Deputy Director
TECHNICAL: Financial Reporting;
Ethics & Specialised Industries;
Audit & Assurance;
Sustainability & Climate Change