Accounting Standards Board of Japan (ASBJ)
Fukoku Seimei Building 20F, 2-2, Uchisaiwaicho 2-Chome, Chiyoda-Ku Tokyo 100-0011, Japan
Phone +81-3-5510-2737 Facsimile +81-3-5510-2717 URL https://www.asb.or.jp/en/

12 August 2021

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

<u>Comments on the Discussion Paper (DP/2020/2) *Business Combinations under Common Control*</u>

1. The Accounting Standards Board of Japan ("the ASBJ" or "we") welcome the opportunity to provide our comments to the International Accounting Standards Board ("the IASB")'s Discussion Paper (DP/2020/2) *Business Combinations under Common Control* (hereinafter referred to as "the DP").

2. In Japan, we have observed transfers of businesses under common control (hereinafter referred to as "business combinations under common control" for simplicity). However, subsidiaries of listed companies that have voluntarily adopted IFRS Standards often use domestic accounting standards, and our understanding is that there are not many cases where the receiving company applies IFRS Standards, which is assumed in the DP. Accordingly, in this comment letter, we comment on the following points mainly from a conceptual perspective.

   (a) Allowing multiple methods of accounting

   (b) The accounting to be applied

   (c) The accounting to be applied under the acquisition method

3. As we explain in detail in the paragraphs that follow, we disagree with the use of multiple accounting methods as proposed in the DP. However, we note that one ASBJ board member with a user background supports the DP's proposal regarding the selecting the measurement method.

(Allowing multiple methods of accounting)

4. A business combination under common control is a business combination in which the receiving company is the acquirer and the transferred company is the acquiree, from the perspective of the receiving company. When considering this point only, applying the acquisition method is likely to be consistent with the accounting for business combinations covered by IFRS 3 *Business Combinations*. On the other hand, a business combination under common control is a transaction within the group from the perspective of the controlling party, and the values of the assets and liabilities of the transferred company do not change before and after the transaction. When considering this point only, it would be appropriate to apply the book-value method. A business combination under common control is problematic because it actually has both aspects.

5. When there are multiple views on the economic substance of a single economic event, such as in the case of business combinations under common control, we believe the accounting standard should prescribe the economic substance that becomes the basis for the accounting. The proposals in the DP prescribe the accounting that should be applied, but that accounting may change depending on the shareholder structure and the existence, characteristics and behavior of non-controlling shareholders of the receiving company. As mentioned in paragraph 2.37 of the DP, we do not think it is desirable for an accounting standard to allow multiple accounting methods, because this might create opportunities for accounting arbitrage.

6. Specifically, we see the following problems with the proposals in the DP:

   (a) The accounting may change depending on whether it affects non-controlling shareholders or not;

   (b) The accounting may change depending on whether the receiving company's shares are traded in a public market or not;

   (c) The accounting may change depending on whether all non-controlling shareholders are related parties of the receiving company or not; and

   (d) A particular accounting method is permitted unless the non-controlling shareholders object.

7. In addition, we believe that it is not necessarily clear when the judgment in the flowchart in the DP (Diagram IN.2) is made. If the judgment is to be made at each closing date, the accounting may differ from year to year, which may mean that an entity will need to continue to maintain information needed for both the book-value

method and the acquisition method, which in our view is unrealistic. Therefore, in this comment letter, our response is based on the assumption that the judgment will be made only once, at the time of the business combination.

The accounting may change depending on whether it affects non-controlling shareholders or not

8. The DP proposes that the acquisition method should be applied to business combinations under common control that affect non-controlling shareholders. We believe this proposal is inappropriate because it implies that the information needs of the controlling party should be ignored in a business combination under common control that affects non-controlling shareholders.

9. The DP cites paragraph 1.5 of the *Conceptual Framework for Financial Reporting (Conceptual Framework)* and states that the controlling party does not need to rely on those financial statements for information about the combination (paragraph 1.25 of the DP), implying that the controlling party is not a primary user. Such logic would lead to the conclusion that it would be appropriate to ignore the information needs of the controlling party in all accounting standard setting circumstances, which we believe is inappropriate. We believe that the controlling party relies on general purpose financial statements. Paragraph 1.5 of the *Conceptual Framework* merely states that "*many existing and potential investors, lenders, and other creditors*" (underline added) cannot require reporting entities to provide information directly and thus we believe that it is inappropriate to exclude the controlling party from being a primary user.

10. From the discussions above, we believe that the controlling party should be treated as a primary user and that accounting standards should be developed taking into account the information needs of such controlling party.

The accounting may change depending on whether the receiving company's shares are traded in a public market or not

11. The DP proposes that the acquisition method should be applied to business combinations under common control if the receiving company's shares are traded in a public market. As mentioned above, the controlling party generally needs information based on the book-value method, and this proposal is based on the argument that the benefits of applying the acquisition method outweigh the costs when the receiving company's shares are traded in a public market.

12. The argument in the previous paragraph implies that the acquisition method is costly and that the benefits of the acquisition method would not normally outweigh the costs, but that such costs are justified when the receiving company's shares are traded in a public market. However, as mentioned above, we are of the view that the controlling party constitutes a primary user, and when their information needs are considered, the benefits of the acquisition method are not always high for business combinations under common control.

13. If we ignore who the shareholders of the receiving company are, business combinations under common control can be viewed to be the same as business combinations covered by IFRS 3 in that they are business combinations. It may be argued that accounting for business combinations under common control using the acquisition method by the receiving company whose shares are traded in a public market will enhance comparability with other companies whose shares are traded in a public market.

14. However, in a business combination under common control, the receiving company is controlled by the controlling party and the transferred company is also controlled by the same controlling party. From the perspective of the controlling party, a business combination under common control is a transaction within the group, in which assets and liabilities are merely transferred within the group, and the transfer does not change the values of those assets and liabilities. Therefore, we are of the view that the acquisition method does not always provide useful information.

15. When the shares of a receiving company that is controlled by another entity are traded in a public market, the non-controlling shareholders of the receiving company should have acquired such shares with the knowledge of the existence of the controlling party. Therefore, we are of the view that it is not necessarily necessary to account for business combinations under common control using the acquisition method, as is the case with business combinations covered by IFRS 3, simply because the shares of the receiving company are traded in a public market. Rather, we do not think that the information needs of non-controlling shareholders change depending on whether the receiving company's shares are traded in a public market or not.

16. In addition, when the accounting method is required to be different depending on whether the receiving company's shares are traded in a public market or not, and the receiving company, whose shares were previously privately held, goes public, the question may arise as to whether the acquisition method should be applied

retrospectively to business combinations under common control that have occurred in the past. As mentioned above, we do not support using different accounting methods and we note that such issue would not arise under our approach. We think this is one of the advantages of not using different accounting methods.

<u>The accounting may change depending on whether all non-controlling shareholders are related parties of the receiving company or not</u>

17. Paragraph 2.45 of the DP states that "*a privately held receiving company should not be permitted to use the acquisition method if all of its non-controlling shareholders are related parties of the company, as defined in IAS 24*" *Related Party Disclosures* and the reason for this is that "*the receiving company's related parties might not need to rely on its general purpose financial statements to meet their information needs.*"

18. We believe this reasoning is inappropriate. As mentioned above, we disagree with the view that the controlling party does not need to rely on general purpose financial statements. We believe that the non-controlling shareholders are even more likely to need to rely on general purpose financial statements. We also are not convinced that the accounting should differ depending on whether all non-controlling shareholders are related parties of the company or not.

<u>A particular accounting method is permitted unless the non-controlling shareholder objects</u>

19. We believe it is inappropriate to use different accounting methods depending on whether non-controlling shareholders object to a specific accounting method or not.

20. Some existing IFRS Standards permit an entity not to disclose information when its shareholders agree (for example, paragraph 4 of IFRS 10 *Consolidated Financial Statements*). However, IFRS Standards do not permit different accounting based on the intent of the shareholders. The proposal in the DP permits different accounting, which we believe cannot be justified solely based on the cost-benefit analysis.

(The accounting to be applied)

21. As mentioned in paragraph 5 of this comment letter, we believe the accounting standard should prescribe the economic substance that becomes the basis for the accounting, and we disagree with the use of multiple accounting methods as proposed in the DP. We believe that it is appropriate to apply the book-value method uniformly for the following reasons:

(a) The IASB staff's desktop review of reporting practices for business combinations under common control indicates that the majority of entities apply the book-value method[1].

(b) The controlling party always constitutes a primary user, and for that controlling party, a business combination under common control is merely a transaction within the group. From the perspective of the controlling party, the assets and liabilities of the transferred company are merely transferred within the group, and the transfer does not change the values of those assets and liabilities. The information provided by the acquisition method is only hypothetical and thus is not useful.

(c) Non-controlling shareholders should have acquired the shares of the receiving company with the knowledge of the existence of the controlling party. Therefore, it is not necessarily necessary to account for business combinations under common control using the acquisition method in the same way as business combinations covered by IFRS 3.

(d) A business combination under common control is merely a transaction within the group from the perspective of the controlling party. For the purpose of preparing the consolidated financial statements of the controlling party, the receiving company needs to provide the controlling party with information based on the book-value method. If the acquisition method were to be applied in the financial statements of the receiving company, the receiving company would need to maintain information for both the acquisition method and the book-value method, and the costs of doing so would not justify the benefits.

(The accounting to be applied under the acquisition method)

22. The DP states that in a business combination under common control, the receiving company and the transferring company might not have been involved in deciding how much consideration is paid, and the difference between the amount of such consideration and the amount that would have been paid to an unrelated party in an arm's length transaction indicates that the combination includes an additional

[1] In Agenda Paper 23B "*Due process*" Appendix C "*Desktop Review of Business Combinations under Common Control*" for discussions at the February 2020 IASB Board Meeting, the IASB reviewed the accounting of 267 business combination transactions under common control among the annual reports of entities applying the IFRS standards worldwide published between 1 January 2018 to 31 March 2019. The results showed that 94.0% of the transactions were reported applying the book-value method, 4.5% applying the acquisition method, and 1.5% of transactions was not sufficient to determine which method was applied.

component - a transaction with the owners acting in their capacity as owners (paragraph 3.6 of the DP). The DP further goes on to propose that, with respect to the accounting when the acquisition method is applied, if the consideration paid is higher than the fair value of the identifiable assets and liabilities acquired, that excess does not constitute a distribution from equity (paragraph 3.16 of the DP), but if the consideration paid is lower than the fair value of the identifiable assets and liabilities acquired, that difference constitutes a contribution to equity (paragraph 3.20 of the DP).

23. As mentioned above, we believe that the book-value method should be applied uniformly to business combinations under common control. However, when the acquisition method is to be applied to business combinations under common control, we disagree with the proposals in the DP as described in the previous paragraph for the following reasons:

    (a) The proposal in the DP is to compare the fair value of the identifiable assets and liabilities acquired and the consideration paid, and depending on the larger, it may or may not be an equity transaction. Whether a transaction is an equity transaction or not should be determined by the counterparty and the nature of the transaction; not by the size of the consideration paid.

    (b) The proposal in the DP is that if the consideration paid is less than the fair value of the identifiable acquired assets and liabilities, that difference should be accounted for as a contribution to equity. The argument is to consider that there is a difference between the consideration paid and the price in an arm's length transaction, and to treat the difference as a transaction with owners (that is, an equity transaction). Such hypothetical accounting does not represent the economic substance of the transaction. For related party transactions, IAS 24 acknowledges that the prices may be different from those in arm's length transactions but does not require different accounting (that is, there is no hypothetical accounting for the transactions). Instead, IAS 24 requires additional disclosures. We believe that the proposal in the DP requires different accounting and cannot be justified solely based on the cost-benefit analysis.

(Conclusion)

24. For our comments on the specific questions, please refer to the Appendix of this comment letter.

25. We hope our comments contribute to the IASB's deliberations. Please contact us if you have any questions.

Yours sincerely,

Atsushi Kogasaka
Chair
Accounting Standards Board of Japan

Appendix

<u>Our comments on the specific questions in the DP</u>

Project Scope
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. We agree with the preliminary view, except for the following points.

2. The DP states that all transfers of business under common control are addressed in this project regardless of whether the control is transitory or not (paragraph 1.16 of the DP). In the same paragraph, some stakeholders have raised that the meaning of "transitory control" should be clarified, but the IASB has not yet considered this issue because the outcome of this project could lead the IASB to modify or remove the scope exclusion in IFRS 3.

3. Paragraph BC28 of the IFRS 3 (issued in 2004), which has been amended, stated, "The Board noted the concern expressed by some that business combinations between parties acting at arm's length could be structured through the use of 'grooming' transactions so that, for a brief period immediately before the combination, the combining entities or businesses are under common control" and "Thus, the Board decided that for a business combination to be excluded from the scope of the IFRS as one involving entities or businesses under common control, the combining entities or businesses should be controlled by the same party or parties both before and after the combination, and that control should not be transitory."

4. However, we believe that the concept of "transitory control" should be removed from the definition, considering that current IFRS Standards usually do not set standards

on the grounds of preventing abuse, and that IFRS 3 includes, rather than excludes, temporary control in the business combinations covered by that Standard.

Selecting the measurement method
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?

Question (a)

5. We disagree with the preliminary view. The reasons are described below.

6. A business combination under common control is a business combination in which the receiving company is the acquirer and the transferred company is the acquiree, from the perspective of the receiving company. When considering this point only, applying the acquisition method is likely to be consistent with the accounting for business combinations covered by IFRS 3. On the other hand, a business combination under common control is a transaction within the group from the perspective of the controlling party, and the values of the assets and liabilities of the transferred company do not change before and after the transaction. When considering this point only, it would be appropriate to apply the book-value method. A business combination under common control is problematic because it actually has both aspects.

7. When there are multiple views on the economic substance of a single economic event, such as in the case of business combinations under common control, we believe the

accounting standard should prescribe the economic substance that becomes the basis for the accounting. The proposals in the DP prescribe the accounting that should be applied, but that accounting may change depending on the shareholder structure and the existence, characteristics and behavior of non-controlling shareholders of the receiving company. As mentioned in paragraph 2.37 of the DP, we do not think it is desirable for an accounting standard to allow multiple accounting methods, because this might create opportunities for accounting arbitrage.

8. Therefore, we disagree with the use of multiple accounting methods as proposed by the DP. We believe that it is appropriate to apply the book-value method uniformly for the following reasons:

   (a) The IASB staff's desktop review of reporting practices for business combinations under common control indicates that the majority of entities apply the book-value method[2].

   (b) The controlling party always constitutes a primary user, and for that controlling party, a business combination under common control is merely a transaction within the group. From the perspective of the controlling party, the assets and liabilities of the transferred company are merely transferred within the group, and the transfer does not change the values of those assets and liabilities. The information provided by the acquisition method is only hypothetical and thus is not useful.

   (c) Non-controlling shareholders should have acquired the shares of the receiving company with the knowledge of the existence of the controlling party. Therefore, it is not necessarily necessary to account for business combinations under common control using the acquisition method in the same way as business combinations covered by IFRS 3.

   (d) A business combination under common control is merely a transaction within the group from the perspective of the controlling party. For the purpose of preparing the consolidated financial statements of the controlling party, the receiving company needs to provide the controlling party with information based on the book-value method. If the acquisition method were to be applied in the financial statements of the receiving company, the receiving company would

[2] See footnote 1

need to maintain information for both the acquisition method and the book-value method, and the costs of doing so would not justify the benefits.

Question (b)

9. We disagree with the preliminary view. We believe that there is a problem with the DP's proposal that the accounting may change depending on whether the business combination under common control affects non-controlling shareholders or not.

10. The DP proposes that the acquisition method should be applied to business combinations under common control that affect non-controlling shareholders. We believe this proposal is inappropriate because it implies that the information needs of the controlling party should be ignored in a business combination under common control that affects non-controlling shareholders.

11. The DP cites paragraph 1.5 of the *Conceptual Framework* and states that the controlling party does not need to rely on those financial statements for information about the combination (paragraph 1.25 of the DP), implying that the controlling party is not a primary user. Such logic would lead to the conclusion that it would be appropriate to ignore the information needs of the controlling party in all accounting standard setting circumstances, which we believe is inappropriate. We believe that the controlling party relies on general purpose financial statements. Paragraph 1.5 of the *Conceptual Framework* merely states that "*many existing and potential investors, lenders, and other creditors*" (underline added) cannot require reporting entities to provide information directly and thus we believe that it is inappropriate to exclude the controlling party from being a primary user.

12. From the discussions above, we believe that the controlling party should be treated as a primary user and that accounting standards should be developed taking into account the information needs of such controlling party.

Question (C)

13. We disagree with the preliminary view. Our view is as mentioned in our response to question (a), and we disagree with the use of multiple accounting methods as proposed by the DP, and believe that it is appropriate to apply the book-value method uniformly.

Selecting the measurement method
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?

<u>Question (a)</u>

14. We disagree with the preliminary view. We believe that there is a problem with the proposal in the DP that the accounting may change depending on whether the receiving company's shares are traded in a public market or not.

15. The DP proposes that the acquisition method should be applied to business combinations under common control if the receiving company's shares are traded in a public market. As mentioned in our response to Question 2(a), the controlling party generally needs information based on the book-value method, and this proposal is based on the argument that the benefits of applying the acquisition method outweigh the costs when the receiving company's shares are traded in a public market.

16. The argument in the previous paragraph implies that the acquisition method is costly and that the benefits of the acquisition method would not normally outweigh the costs, but that such costs are justified when the receiving company's shares are traded in a public market. However, as mentioned in our response to question 2(b), we are of the view that the controlling party constitutes a primary user, and when their information needs are considered, the benefits of the acquisition method are not always high for business combinations under common control.

17. If we ignore who the shareholders of the receiving company are, business combinations under common control can be viewed to be the same as business combinations covered by IFRS 3 in that they are business combinations. It may be argued that accounting for business combinations under common control using the acquisition method by the receiving company whose shares are traded in a public market will enhance comparability with other companies whose shares are traded in a public market.

18. However, in a business combination under common control, the receiving company is controlled by the controlling party and the transferred company is also controlled by the same controlling party. From the perspective of the controlling party, a business combination under common control is a transaction within the group, in which assets and liabilities are merely transferred within the group, and the transfer does not change the values of those assets and liabilities. Therefore, we are of the view that the acquisition method does not always provide useful information.

19. When the shares of a receiving company that is controlled by another entity are traded in a public market, the non-controlling shareholders of the receiving company should have acquired such shares with the knowledge of the existence of the controlling party. Therefore, we are of the view that it is not necessarily necessary to account for business combinations under common control using the acquisition method, as is the case with business combinations covered by IFRS 3, simply because the shares of the receiving company are traded in a public market. Rather, we do not think that the information needs of non-controlling shareholders change depending on whether the receiving company's shares are traded in a public market or not.

20. In addition, when the accounting method is required to be different depending on whether the receiving company's shares are traded in a public market or not, and the receiving company, whose shares were previously privately held, goes public, the question may arise as to whether the acquisition method should be applied retrospectively to business combinations under common control that have occurred

in the past. As mentioned above, we do not support using different accounting methods and we note that such issue would not arise under our approach. We think this is one of the advantages of not using different accounting methods.

<u>Question (b)(i)</u>

21. We believe it is inappropriate to use different accounting methods depending on whether non-controlling shareholders object to a specific accounting method or not.

22. Some existing IFRS Standards permit an entity not to disclose information when its shareholders agree (for example, paragraph 4 of IFRS 10). However, IFRS Standards do not permit different accounting based on the intent of the shareholders. The proposal in the DP permits different accounting, which we believe cannot be justified solely based on the cost-benefit analysis.

<u>Question (b)(ii)</u>

23. We disagree with the preliminary view. We believe that there is a problem with the proposal in the DP that the accounting may change depending on whether all non-controlling shareholders are related parties of the receiving company or not.

24. Paragraph 2.45 of the DP states that "*a privately held receiving company should not be permitted to use the acquisition method if all of its non-controlling shareholders are related parties of the company, as defined in IAS 24*" and the reason for this is that "*the receiving company's related parties might not need to rely on its general purpose financial statements to meet their information needs.*"

25. We believe this reasoning is inappropriate. As mentioned above, we disagree with the view that the controlling party does not need to rely on general purpose financial statements. We believe that the non-controlling shareholders are even more likely to need to rely on general purpose financial statements. We also are not convinced that the accounting should differ depending on whether all non-controlling shareholders are related parties of the company or not.

<u>Question (c)</u>

26. As mentioned above, we disagree with the use of multiple accounting method as proposed by the DP, and believe that it is appropriate to apply the book-value method uniformly.

Selecting the measurement method
Question 4
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?

27. We disagree with all preliminary views. Our view is provided in our responses to question 3.

Applying the acquisition method
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?

Question (a) and (b)

28. We disagree with all preliminary views. Our view is described below.

29. The DP states that in a business combination under common control, the receiving company and the transferring company might not have been involved in deciding how much consideration is paid, and the difference between the amount of such consideration and the amount that would have been paid to an unrelated party in an arm's length transaction indicates that the combination includes an additional component-a transaction with the owners acting in their capacity as owners (paragraph 3.6 of the DP). The DP further goes on to propose that, with respect to the accounting when the acquisition method is applied, if the consideration paid is higher than the fair value of the identifiable assets and liabilities acquired, that excess does not constitute a distribution from equity (paragraph 3.16 of the DP), but if the consideration paid is lower than the fair value of the identifiable assets and liabilities acquired, that difference constitutes a contribution to equity (paragraph 3.20 of the DP).

30. As mentioned above, we believe that the book-value method should be applied uniformly to business combinations under common control. However, when the acquisition method is to be applied to business combinations under common control, we disagree with the proposals in the DP as described in the previous paragraph for the following reasons.

    (a) The proposal in the DP is to compare the fair value of the identifiable assets and liabilities acquired and the consideration paid, and depending on the larger, it may or may not be an equity transaction. Whether a transaction is an equity transaction or not should be determined by the counterparty and the nature of the transaction; not by the size of the consideration paid.

    (b) The proposal in the DP is that if the consideration paid is less than the fair value of the identifiable acquired assets and liabilities, that difference should be accounted for as a contribution to equity. The argument is to consider that there is a difference between the consideration paid and the price in an arm's length transaction, and to treat the difference as a transaction with owners (that is, an equity transaction). Such hypothetical accounting does not represent the economic substance of the transaction. For related party transactions, IAS 24 acknowledges that the prices may be different from those in arm's length transactions but does not require different accounting (that is, there is no hypothetical accounting for the transactions). Instead, IAS 24 requires additional disclosures. We believe that the proposal in the DP requires different accounting and cannot be justified solely based on the cost-benefit analysis.

Question (c)

31. No comment.

Applying a book-value method
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?

32. We disagree with the preliminary view. We believe that the receiving company should be permitted to select using either the transferred company's book values or using the transferring company's (consolidated) book values as its accounting policy for the following reasons:

    (a) The nature of the transaction

    From the perspective of the controlling party, business combinations under common control are transactions that transfer net assets within the group, which are considered to be internal transactions. Hence, the values of the assets and liabilities of the transferred company should not change before and after the business combination. For the transferred company's assets and liabilities that are transferred to the receiving company, a measurement method that uses the transferred company's book values (that is, a method that keeps the book values unchanged) is more consistent from the perspective of faithfully representing the nature of the transaction than a measurement method that replaces the transferred company's book values to the controlling party's book values by using the controlling party's book values.

    On the other hand, from the perspective of the controlling party, the values of the assets and liabilities of the transferred company should not change before and after the business combination. Accordingly, it would be more consistent to measure the transferred assets and liabilities using the transferring company's (consolidated) book values.

In this regard, the question is whether the transferred company's book values or the transferring company's (consolidated) book values should be uniformly used, or either book value should be permitted to select as its accounting policy.

The nature of a business combination under common control when the book-value method is applied is merely a reorganization within the group. In addition, the transferred company's book values and the transferring company's (consolidated) book values are usually the same, and the cases where the book values differ are limited. In view of these factors, even if it is left to the discretion of the entity to use either book value, the opportunity for accounting arbitrage is likely to be very limited. In addition, if the use of the transferred company's book values is uniformly required, an entity would not be able to select the measurement method that is more consistent from the perspective of the nature of the transaction. On the other hand, if the use of the transferring company's (consolidated) book values is uniformly required, practical application issues are likely to arise in cases where the receiving company has no access to the transferring company's (consolidated) book values.

From the above discussions, we believe that the receiving company should be permitted to select using either the transferred company's book values or the transferring company's (consolidated) book values as its accounting policy.

(b) Costs for preparers of financial statements

As mentioned in paragraphs 4.17 of the DP, whether the cost of using the transferred company's book values is lower than the cost of using the controlling party's book values depends on a variety of factors, including the nature of the business combination, how the subsidiaries are controlled and the application status of IFRS Standards.

However, from the viewpoint of the costs to obtain information, when measuring the assets and liabilities using the controlling party's (consolidated) book values or the transferring company's (consolidated) book values, the receiving company usually does not know those amounts and would need to obtain information from the controlling party. Therefore, it may be preferable to measure the assets and liabilities using the transferred company's book values, which would not require such costs.

Based on the discussions above, we believe that when applying the book-value method to a business combination under common control, the receiving company should be permitted to select using the transferred company's book values or using the transferring company's (consolidated) book values as its accounting policy as the method of measuring the assets and liabilities received.

Applying a book-value method
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?

Question (a)

33. We agree with the preliminary view. Considering that the measurement of shares issued is often affected by national regulations and is generally not prescribed in IFRS Standards, and the accounting for the disposal of treasury shares is similarly not prescribed in detail, we do not believe that requirements should be prescribed.

Question (b)

34. We agree with the preliminary view. Our view is described below.

35. The application of the book-value method in a business combination under common control is a method that carries over the previous book values of the assets and liabilities within the group and is a procedure to transfer those book values at the time of the business combination. When the consideration is paid in assets, we believe that

the proposals in the DP stating that the consideration paid should be measured at the book values of the assets at the date of the business combination is considered to be consistent with this understanding.

36. For the same reason as in the previous paragraph, the consideration to be paid when the receiving company assumes liabilities of the transferring company should not be measured at fair value, but should be measured at the amount determined on initial recognition of the liabilities.

37. As for the consideration paid when the receiving company recognises a liability to the transferring company as consideration paid, as mentioned in the DP, in some cases (for example, financial liabilities), applying applicable IFRS Standards, the liability would be measured at fair value on initial recognition, and the result will be the same for both approaches. In a business combination under common control, when the receiving company recognises a liability to the transferring company as consideration paid, it would generally recognise a financial liability. The consistency with the measurement methods used when the consideration is paid in assets or when the consideration is paid by assuming liabilities should also be considered. Therefore, we believe that the consideration to be paid by incurring liabilities should be measured at the amount determined on initial recognition of the liabilities.

Applying a book-value method
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?

<u>Question (a)</u>

38. We agree with the preliminary view. Our view is described below.

39. As mentioned above, from the perspective of the controlling party, business combinations under common control are transactions that transfer net assets within

the group, which are considered to be internal transactions. Therefore, it would not be appropriate to recognise a gain or loss from the difference.

40. If the consideration is paid in its own shares, it would consistent to recognise the difference in equity because it is a difference arising from an equity transaction.

41. On the other hand, there is a view that, when the consideration is not paid in its own shares, the difference should not be recognised in equity because it is a difference arising from transactions other than equity transactions. However, when the acquisition method is not applied, goodwill, negative goodwill, or any other asset or liability should not be recognised. As a result, it would be most appropriate to recognise the difference in equity.

42. Based on the discussions above, we believe that it is appropriate to recognise within equity any difference between the consideration paid and the book value of the assets and liabilities received, regardless of the type of consideration.

<u>Question (b)</u>

43. We agree with the preliminary view. Our view is shown in our response to question 7(a).

Applying a book-value method
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?

44. We disagree with the preliminary view. Our view is described below.

45. The proposals in the DP seem to be based on the understanding that, IFRS 3 requires identifiable net assets to be measured at fair value (rather than acquisition cost) in a business combination, and because transaction costs are normally not included in the measurement of fair value, transaction costs should not be included in the measurement of assets and liabilities acquired in a business combination.

46. However, we believe that while, the purchase price allocation of the acquiree or the acquired business references fair value, its objective is to allocate the total

consideration, which is based on cost, to identify the historical costs of each asset acquired and liability assumed in a business combination.

47. The *Conceptual Framework* states that the historical cost of an asset when it is acquired is the value of the costs incurred in acquiring the asset, comprising the consideration paid to acquire the asset plus transaction costs[3]. In the Basis for Conclusions of the *Conceptual Framework*, it is explained that although the transaction costs are not part of the transaction price, the entity could not have acquired the asset or incurred the liability without incurring those transaction costs, hence they are reflected in the historical cost of an asset[4].

48. We understand that in past discussions, there was an argument that if the transaction costs were not recognised as an expense when applying the acquisition method, the amount of goodwill would become larger for that amount. However, whether to recognise transaction costs as an expense or as an asset should be determined based on the nature of the transaction, and it would be inappropriate to recognise transaction costs as an expense simply because the amount of assets may become larger. We note that this concept would also apply when the book-value method is applied.

49. Accordingly, we believe that, in a business combination, regardless of whether it is a business combination under common control or not, the receiving company should include the transaction costs in the acquisition cost.

Applying a book-value method
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?

50. We agree with the preliminary view. Our view is as follows:

    (a) IFRS 3 does not require a retrospective approach[5].

---

[3] Paragraph 6.5 of the *Conceptual Framework*

[4] Paragraph BC6.32(a) of the *Conceptual Framework*

[5] The preliminary view in the Discussion Paper "*Business Combinations - Disclosures, Goodwill and Impairment*" published by the IASB in March 2020 also does not propose a retrospective approach.

(b) Applying the retrospective approach results in the depiction of a combined company that did not exist before the combination. Information provided would only be hypothetical. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* applies the retrospective approach to changes in accounting policies, but the new accounting is applied to transactions in prior periods that actually existed. Inclusion of the assets, liabilities, income and expenses of the transferred company in the financial statements of the receiving company for the periods when the business combination has not yet taken place is a concept that is not adopted in IFRS Standards.

(c) While the retrospective approach is more costly than the prospective approach, the information needs for the retrospective approach may be limited, and thus cases where the benefits exceed the costs may be limited.

Disclosure requirements
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?

51. No comments.

Disclosure requirements
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?

<u>Question (a)</u>

52. No comments.

<u>Question (b)</u>

53. We agree with the preliminary view. As mentioned in our response to Question 10, we believe that the restatement of pre-combination information by the receiving company when applying the book-value method to a business combination under common control would be costly and would not justify the benefits. If pre-combination information were required in the disclosures, it is likely that the same level of costs would be incurred. Accordingly, we do not think that pre-combination information should be required.

<u>Question (c)</u>

54. We agree with the preliminary view. We believe that the information about the difference between the consideration paid and the book values of assets and liabilities received in a business combination under common control would be useful to users. We believe that, because the amounts are determined to perform the accounting, the additional costs of disclosure are small and the benefits to users would outweigh such costs.