IFRS Foundation
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Weinheim, 8/11/21

Dear Sir or Madam,

RE: DP/2020/2 “Business Combinations under Common Control”

We appreciate the opportunity to comment on the IASB´s discussion paper DP/2020/2 “Business Combinations under Common Control”. With this letter, we would like to contribute to the Board´s due process and take part in the discussion on the proposals in the discussion paper.

The Association for Participation in the Development of Accounting Regulations for Family-owned Entities (VMEBF) was founded in 2006 and consists of German companies with a strong family shareholder background. Beyond its members, the association represents a huge number of family-owned large and medium-sized entities in Germany, often legally organised in the form of partnerships. The objective of the VMEBF association is to make the role of German family businesses as stakeholders in the development of international (financial) reporting more visible and to act as a constructive partner for the standard-setters.

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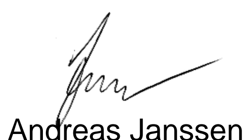
Summing up our comments on the discussion paper, we agree with large parts of the proposals. Most of the proposals should provide users of financial statements with decision-useful information on business combinations under common control, whereas today the accounting treatment of those transactions is not regulated sufficiently.

However, from our member companies we know that the book-value method is most commonly used when accounting for business combinations under common control in practice. Moreover, we note that applying the acquisition method is rather costly and therefore its use would have to be justified from a cost-benefit perspective. As we also believe that IFRS standards should not differentiate between companies with publicly listed or privately held shares, the IASB should think about allowing the receiving entity to – freely – choose between the application of the acquisition method or the book-value method when accounting for business combinations under common control. To reduce informational disadvantages for non-controlling shareholders, the Board should also think about implementing additional disclosure requirements for entities applying the book-value method that are satisfying the minimum information needs of all kinds of shareholders.

Please refer to the appendix to this letter for our detailed answers to the questions asked in discussion paper. If you have any further questions, please do not hesitate to contact us.

Kind regards,

Association for Participation in the Development of
Accounting Regulations for Family-owned Entities (VMEBF)



Andreas Janssen | Santokh Advani | Dr Michael Reuter

Axel Schade | Prof. Dr Dieter Truxius | Dr Thomas Ull

Appendix:
VMEBF comments on the additional questions

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?

We agree with the scope of the project as proposed by the IASB. The Board's approach should help to close the current "gap" in existing IFRS standards resulting in diversity in practice and irritating preparers as well as users of financial statements.

We also agree with the IASB that no exemption should be made for transfers, in which the common control transaction is preceded or followed by an external transaction. We believe that such exemptions would lead to a severe increase in complexity in the regulation to be provided and might reduce the understandability of the information prepared by the entity.

Moreover, we welcome that the project also considers transactions called "group restructurings" in the discussion paper. However, as such "group restructurings" do precisely not meet the definition of a business combination in accordance with IFRS 3, the IASB should reconsider denominating them as *business combinations* under common control.

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?

ad a) From our member companies we know, that the book-value method is most commonly used when accounting for business combinations under common control. A significant number of those companies would prefer to continue to use the book-value method in all instances. By contrast, from a stakeholder perspective we recognise numerous factors influencing the design of a business combination under common control, e.g. tax-driven, regulatory or legal factors. We are afraid that a single approach to measuring all business combinations under common control might negatively affect an entities ability to faithfully portray the economic reality of the business combination under common control. Thus, we agree with the IASB that a single approach to measuring all business combinations under common control would not lead to reasonable outcomes, as different business combinations under common control might have different characteristics and hence should also be accounted for differently.

ad b/c) We agree with the Board that some business combinations under common control have characteristics that are similar to business combinations in the scope of IFRS 3. We also support the view that when such transactions affect non-controlling shareholders, it principally seems to be reasonable to use the acquisition method. However, we note that applying the acquisition method is rather costly and therefore its use has to be justified from a cost-benefit perspective. We are also aware of the fact that cost-benefit analyses regularly require a considerable amount of judgement and are based on numerous assumptions, again promoting diversity in practice. As a consequence, the IASB should think about allowing the receiving entity to – freely – choose between the application of the acquisition method or the book-value method in the above-mentioned situations. To reduce informational disadvantages for non-controlling shareholders, the Board should also think about implementing additional disclosure requirements for entities applying the book-value method that are satisfying the minimum information needs of all kinds of shareholders.

With regard to intra-group transactions, we highly welcome the proposal to use the book-value method. In these cases, users not only have to rely on general purpose financial statements to inform themselves about the transaction.

<u>Question 3</u>

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 understand that general purpose financial statements should principally provide more information when external users are affected by a transaction. However, due to the reasons described in our answer to question 2 we would suggest the IASB to think about allowing the receiving entity to choose between the application of the acquisition method or the book-value method if the receiving company's shares are traded in a public market. To reduce informational disadvantages for non-controlling shareholders in those instances, the Board should also think about implementing additional disclosure requirements satisfying the minimum information needs of all kinds of shareholders.

With regard to situations, in which the receiving company's shares are privately held, we would suggest the IASB to also allow the receiving entity to freely choose between the application of the acquisition method or the book-value method and require additional disclosures if the book-value method is applied.

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?

As already pointed out in our answers to questions 2 and 3, we believe the Board should allow the receiving entity to freely choose between the application of the acquisition method or the book-value method in all instances. From our perspective, IFRS standards should not differentiate between companies with publicly listed or privately held shares. To reduce informational disadvantages for non-controlling shareholders, the Board should think about implementing additional disclosure requirements for entities applying the book-value method satisfying the minimum information needs of all kinds of shareholders.

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?***

We agree with the Board that if the consideration paid by the receiving party is greater than the fair value of the identifiable acquired assets and liabilities, it is included in goodwill recognised in a business combination and is addressed through subsequent impairment testing. Hence, the IASB should not develop requirements for the receiving company to identify, measure and recognise a distribution to the controlling party when applying the acquisition method.

When the consideration paid is lower than the identifiable assets and liabilities acquired in the business combination, we agree with the IASB that a resulting gain should be treated as a contribution to equity rather than included in profit or loss – although this treatment differs from that applied to arm's length transactions under IFRS 3. We believe that in a transaction under common control the receiving company as well as the transferring company might not have been involved in setting the purchase price. It is rather the controlling party that might have determined the consideration to be paid. As a consequence, the difference between that consideration and the amount that would have been paid in an arm's length transaction can be interpreted as the result of an owner's transaction.

<u>Question 6</u>

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 believe that measuring the assets and liabilities received using the transferred company's book values would be the simplest and least costly approach to accounting

for such a transaction (provided the book values are aligned with the receiving company's IFRS accounting policies). However, we think that the IASB should provide further guidance on how to apply the book-value method in practice.

<u>Question 7</u>

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 with the proposal not to 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.

We also agree with the recommended measurement of consideration paid in assets and liabilities. Using the receiving company's book values at the combination date provides an approach to measuring consideration that is not too complex or costly.

With regard to consideration paid by incurring or assuming liabilities, we believe that several existing IFRS standards already deal with such transactions and therefore agree with the measurement at the amount determined on initial recognition of the liability at the combination date applying those IFRS standards.

<u>Question 8</u>

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 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.

We also agree that the Board should not prescribe in which component (or components) of equity the receiving company should present any difference between the consideration paid and the book value of the assets and liabilities received.

<u>Question 9</u>

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 to a business combination under common control, the receiving company generally should recognise transaction costs as an expense in the period in which they are incurred. We also agree that the costs of issuing shares and debt instruments should – as an exception to the above-mentioned rule – be accounted for in accordance with the applicable IFRS standards already existing.

<u>Question 10</u>

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 agree 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. From our point of

view, retrospective application would lead to accounting requirements posing an enormous burden for preparers of financial statements with benefits usually not justifying the cost of preparing the information.

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?

We principally agree that for business combinations under common control to which the acquisition method is applied, the disclosure requirements set out in IFRS 3 should be applied. However, the IASB should think about not making all of the disclosure requirements set out in IFRS 3 mandatory. This is due to the fact that non-controlling shareholders not necessarily have to rely on information presented in an entity's financial statements. Having that in mind, the Board could think about classifying certain disclosures as contingent disclosure requirements.

We also agree with the IASB that it should provide additional application guidance on how to apply those disclosure requirements. With regard to the disclosure requirements in IAS 24 we believe that the Board should provide additional guidance to help companies apply those disclosure requirements to business combinations under common control. However, we would suggest the IASB to keep in mind that most business combinations under common control are likely to be arm's length transactions (e.g. due to the influence of the non-controlling shareholders or according to transfer pricing regulation).

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?

We agree with the IASB that for business combinations under common control only some of the disclosure requirements in IFRS 3 are appropriate – especially when the book-value method is applied. Thus, a reduced catalogue of disclosure requirements should be applied to business combinations under common control.

We also agree that it does not seem necessary to require pre-combination information, as the informational benefits of such information would not be able to outweigh the costs incurred to generate it. However, the Board should allow preparers of financial statements to provide pre-combination information if the reporting entity chooses to do so.