ANNEX

HKAB's Comments on IASB Discussion Paper DP/2020/2 Business Combinations under Common Control

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<tr><th>Question No</th><th>IASB Question</th><th>HKAB Comments</th></tr>
<tr><td colspan="3">Section 1: The Project's Objective, Scope and Focus</td></tr>
<tr><td>1</td><td>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?</td><td>We agree with the Board's preliminary view that transactions described in 1(a) and 1(b) should be in scope. Diversity in practice is noted in the accounting for these transactions and hence it would be necessary to address them in this project.

For transactions involving the insertion of a Newco which are common in Hong Kong, they do not meet the definition of business combinations technically but diversity of accounting practice exists. Scoping in these transactions in the DP could facilitate the alignment of accounting practice.

It should also be noted that some of these transactions such as "group restructurings" as referred to in paragraph 1.15, are technically not business combinations as defined in IFRS 3, for example a transfer of a business to a newly established parent company. We suggest that the Board should re-visit the definition of "business combination" and "combination of entities or businesses under common control" (which is scoped out of IFRS 3 under IFRS 3.2(c)). It would be important to bring clarity on which IFRS this type of transactions is in scope. Having said that, restructuring is common for IPO companies and sizeable companies. The development of the proposal could align the accounting treatment for all such transfers and thus enhance the comparability on receiving company's financial statements, which is useful for users of the financial statements.</td></tr>
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Section 2: Selecting the Measurement Method		
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?	(a) We agree with the Board's preliminary view. Acquisition method may be costly for privately held companies with no non-controlling shareholders. Hence, it is necessary to consider the different economic substance of those transactions in order to apply an appropriate measurement method. (b) We agree with the principle. Such transactions can involve transfer of interests in a business outside the group rather than a mere reallocation of economic resources with the group. We would like to further suggest the Board to grant flexibility for not applying acquisition method when the non-controlling interests are insignificant and the receiving company itself is a privately held company, otherwise the benefits may not outweigh the costs. The Board may provide guidance on conducting the insignificance test of non-controlling interests. (c) For combinations between wholly-owned companies, the transactions represent reallocation of resources within the group under the direction of the controlling shareholder and hence book values will provide more relevant information to users of the receiving company's financial statements given that the ultimate shareholder of the receiving company is the controlling shareholder. Furthermore, the benefits from applying acquisition method may not outweigh the cost, especially for combinations not involving non-controlling interests and with shares of holding companies which are privately held. Hence, the book-value method would serve as a more appropriate valuation for these combinations.

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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?	(a) We agree with the Board's preliminary view. Relevant companies usually have a significant proportion of non-controlling shareholders who do not have the channel to request additional information they need but can only rely on the general-purpose financial statements of the receiving company. This could provide a clear picture to non-controlling shareholders on intra-group business transfer and require all the assets and liabilities are recognised at fair value. (b) (i) The industry generally agrees that it would be preferable if the receiving companies that are privately held could adopt for the book-value method. However, certain stakeholders are of the view that shareholders' choice should not determine the accounting method. (b) (ii) We would like to clarify whether this is implying that the Board would be making the cost-benefit decisions for all shareholders under the circumstances that book-value method is made mandatory in case if all non-controlling shareholders are related parties of the receiving company. In that sense, the "related-party exception to the acquisition method" might not be appropriate. (c) Not applicable.

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	(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?	
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?	The industry generally agrees with the Board's preliminary view that publicly traded receiving companies should always apply the acquisition method for the purpose of investor protection since they are likely to have a significant proportion of non-controlling shareholders. Furthermore, the industry has the following responses on the two questions raised: (a) Considering the challenges to obtain consent from all non-controlling shareholders for receiving companies which are listed in sizeable markets, the Board may consider allowing the Board of Directors' level of companies the authority to grant optional exemption from the acquisition method. Certain stakeholder, however, is of the view that such authority should not be granted to the Board of Directors for the purpose of protecting non-controlling shareholders. (b) We agree with the treatment proposed. It is unusual that all non-controlling shareholders are related parties, subject to the regulatory restrictions on shareholding structure for listed companies from respective publicly traded markets.
Section 3: Applying the Acquisition Method		
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	(a) We agree that guidance on this scenario is not a priority. Since a distribution from equity would mean transferring wealth from those non-controlling shareholders to the transferring company, we agree that such distributions to the controlling party are unlikely to occur in

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	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?	business combinations involving non-controlling shareholders due to legal requirements and regulations that are designed to protect the interests of non-controlling shareholders. Such cases are not frequently observed in terms of business combinations. Furthermore, for receiving companies with shares publicly traded, it would be unfair to non-controlling shareholders if the excess of the consideration over the fair value of the acquired business results in a distribution of equity and may trigger certain regulatory issues on certain listing market that have restrictions for non-controlling shareholders protection. (b) We agree with the Board's preliminary view. Although such contributions are unlikely to occur in practice, the amount of contribution is a useful information to users of financial statements and the amount of the excess should be measurable in case such contributions occurred. We also agree that the contribution in excess of the fair value of the identifiable acquired assets and liabilities to be recognized in equity which better reflect the substance and nature of the business combination transaction. The excess arises from a transaction with shareholders and hence should be recognised as a contribution to equity rather than a bargain purchase gain in the statement of profit or loss. (c) We do not have other recommendation.
Section 4: Applying a Book-value Method		
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.	The industry generally agrees with the Board's preliminary view. The proposed measurement of the assets and liabilities received is the easiest and most practical way in reflecting the most recent value of the company involved

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	Do you agree with the Board's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?	in the business combinations under common control. Furthermore, the values used would not change as the transaction structure changes. Having said that, given that the book value method prescribed in the preliminary view is different from the existing local guidance of merger accounting under a common control combination (which is equivalent to View A mentioned in Paragraph 4.7), we would like to clarify with the Board on the following: 1) whether an illustrative example to elaborate the difference could be provided; 2) whether the Board's preliminary view on the application of book-value method will apply to business combinations under common control prospectively without the need to adjust those business combination transactions retrospectively. The industry supports the prospective approach.
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	(a) We agree that the reporting of components within a reporting company's equity and the measurement of issued shares for the purpose of that reporting are often affected by national requirements and regulations, and are generally not prescribed in IFRS Standards. (b) (i) We agree with the Board's preliminary view that consideration paid in the form of assets would be measured at the receiving entity's book values of those assets at the combination date. We consider that information about the gain or loss on disposal of the assets paid would be of limited use to users of the receiving company's financial statements in business combinations under common control to which a book-value method would be applied. (b) (ii) We agree with the Board's preliminary views for reasons similar to those set out in (b)(i) above. We consider that information about the gain or loss on disposal of the assets paid would be of limited use to

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	(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?	users of the receiving company's financial statements in business combinations under common control to which a book-value method would be applied. Hence, the logical measurement would then be the amount determined on initial recognition of the liability at the combination date applying IFRS Standards.
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?	(a) We agree with the Board's preliminary view. Through applying the book-value method to a business combination under common control, this recognises the fact that the controlling entity has an important role to play in decisions relating to the transaction. The treatment of recognising the difference between the consideration paid and the book value of the assets and liabilities received in equity is consistent with the principle in IAS 1 that transactions with owners in their capacity as owners are presented in equity. The recognition of the difference could help to avoid distorting the financial performance from the view of the controlling party. (b) We agree IFRS Standards generally do not prescribe within which component of equity particular amounts should be presented. It is not necessary to specify the equity component as it may be different between companies.
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.	We agree with the Board's preliminary view. The proposed accounting treatment is consistent with the current requirements under IFRS 3 and we agreed that there is no reason for a book-value method to treat transaction costs differently from the approach required by IFRS 3.

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	Do you agree with the Board's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?	
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?	We agree with the Board's preliminary view. From the perspective of users of the financial information as well as from controlling party, it may not be useful when the financial information retrospectively accounted for the relevant financial information, but may increase the complexity on dealing with such types of transactions. Hence, the benefits of information provided by a retrospective approach may not outweigh the costs of providing that information.
Section 5: Disclosure Requirements		
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.	We agree with the Board's preliminary views on the proposed disclosure requirements and application guidance to be developed. This facilitates comparability between companies with similar transaction and improve the transparency of reporting these combinations.

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	Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?	
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 Board's preliminary views on the proposed disclosure requirements.

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Other Comments		
13	Do you have any comments other than the proposed questions as stated above? Please state here.	We would like to provide further comments as below for the Board's consideration: 1) All requirements developed as a result of this project should be applied prospectively; 2) We do not agree that the analogy used in paragraph 2.39 to provide exemption from preparing consolidated financial statements under IFRS 10 is appropriate. This is because the exemption under IFRS 10 only affects whether consolidated financial statements have to be prepared whereas the proposed exemption under this Discussion Paper would affect measurement of assets and liabilities in the financial statements.