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المنظمة الدولية لهيئات الأوراق المالية

1 Sept 2021

IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Our Ref: 2021/O/C1/IASB/MS/58

RE: DP/2020/2 - Business Combinations under Common Control

Dear International Accounting Standards Board (IASB) Members,

The International Organization of Securities Commissions (IOSCO) Committee on Issuer Accounting, Auditing and Disclosure (Committee 1) thanks you for the opportunity to provide our comments on the Discussion Paper *Business Combinations under Common Control* ("Discussion Paper").

IOSCO is committed to promoting the integrity of the international markets through promotion of high-quality accounting standards, including rigorous application and enforcement. Members of Committee 1 ("members" or "we") seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. Unless otherwise noted, the comments provided herein reflect the consensus among members of Committee 1 and are not intended to include all the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

General Observations

Business combinations under common control ("BCUCC") is a top priority issue for some members of Committee 1 and has been an area of frequent discussion, including the various approaches that occur in practice when accounting for BCUCC, the advantages and disadvantages in applying certain accounting approaches, and the accounting for the transfer of a business into a Newco and subsequent IPO (i.e. when control is not transitory). The importance of this latter issue was the topic of a letter sent by the chair of Committee 1 to the IASB and the IFRIC in August 2013. In light of this, we support the IASB's efforts to explore possible reporting requirements for a receiving company that would reduce the diversity in practice in the accounting of BCUCC transactions. However, while we support the project, and agree that the effect on non-controlling shareholders is relevant for determining whether the acquisition method is appropriate, most members are of the view that it should not be the sole determinative factor and believe that the Board should develop an approach that also takes into consideration the underlying objective of the BCUCC transaction. In addition, members believe the Board should also consider additional aspects of common control transactions (refer to our response to Question 1). Our detailed feedback on each section of the Discussion Paper is provided below.

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@iosco.org - www.iosco.org

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Responses to the Board's 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?

Response

Members agree that the project scope should include the transfers detailed in Question 1(a) and (b). However, some members think that the project scope should also include the following transactions and concepts that are related to BCUCC and other common control transactions for which the current IFRS standards do not provide enough guidance, thus resulting in diversity in practice:

- **Certain transactions involving a 'Newco' and clarification of the concept of transitory control**: While the scope of the project covers certain transactions involving Newcos (e.g. example 3 in appendix B), other types of Newco transactions are not included within the scope of the project. For example, a merger of entities through the formation of a Newco held by a small group of shareholders such that there is a high degree of common ownership, but no common control, or the formation of a Newco at the top of an existing group where the Newco was established for restructuring, without changing shareholders' interests). These members believe the scope of the project should explicitly address additional Newco transactions. Moreover, some members think that further clarification may be required to the term 'transitory control', if the Board determines to retain this concept within IFRS 3.

- **Transfer of associates, transfer of an interest in a joint venture, transfer of an asset or a group of assets that do not meet the definition of a business between entities under common control**: Some members observe that diversity in practice exists in the accounting for these transactions under IFRS standards. These members think that since the Board is already dedicating resources to the project on BCUCC, the Board should expand the scope of the project to include these kinds of transfers between entities under common control. If the Board does not expand the scope of the current project, consideration should be given in the future as to whether IFRS standards need to be modified when dealing with the aforementioned common control transactions.

- **Accounting by the Transferring Company***:* According to paragraph IN2 of the introduction to the DP, IFRS standards provide requirements on how companies P, A and C (in diagram IN.1) should report the

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@iosco.org - www.iosco.org

transfer of a business under common control. Members are of the view that IFRS 10 does not provide enough guidance regarding the accounting by the transferring company. Therefore, from a scope standpoint, members believe that, either as part of this project or as part of the Post Implementation Review for IFRS 10, the IASB should consider developing similar guidance for the transferring entity in a common control disposition. For example, guidance regarding whether the transferring entity in a transaction in which there are no non-controlling shareholders, should record a gain or loss when the controlling party has the ability to dictate the terms of the transaction and thereby determine the gain or loss recognized by the transferring entity, or if, instead, the transferring party should recognize these amounts as either a distribution to or contribution from the parent. As a further point, IFRS 10.B98(b) states that the transferring party would recognize "the fair value of the consideration received" and as such, there is also the question of whether the fair value of the consideration should reflect any "implied" capital transaction needed to reflect the transfer at arms-length terms

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?

Response

Members agree that a single measurement approach is not appropriate for all BCUCC for the reasons outlined in the DP and support the development of a clear distinction between when to apply the acquisition method and when to apply the book-value method to BCUCC.

Most members think that although the presence of non-controlling shareholders may in some cases be an indicator that a transaction is an acquisition similar to those not under common control, it is not suitable as a sole determinant for the use of the acquisition method. Many members are particularly concerned that the use of the acquisition method for a BCUCC can result in an artificial transaction price and the recognition of goodwill that is not evidenced by a transaction price between independent parties, despite the presence of non-controlling

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@iosco.org - www.iosco.org

shareholders. In these members' view, the transaction price in a BCUCC is often determined by the ultimate controlling party – as such, it is not always clear that applying the acquisition method based on a price that potentially neither the transferring or receiving party negotiated would result in better information.

As such, these members think that the distinction between when to apply the acquisition method and when to apply the book value method should be based on the overall 'substance' of the transaction and that at minimum, the evaluation of substance should take into consideration the underlying objective of the transaction (in addition to the presence of non-controlling shareholders). This is because members are concerned that the preliminary views in the DP appear to allow for opportunities whereby entities can achieve certain accounting outcomes based on the structure of the transaction(s) alone. For example, under the preliminary conclusions reached by the Board, that the guidance in the DP would be applied by the receiving entity for all transfers of BCUCC, including when a reorganization is contingent upon an initial public offering, an entity that is preparing for an initial public offering could structure a reorganization with a non-substantive amount of non-controlling interest in order to apply the acquisition method. As such, we think that considering the objective of the transaction is a key aspect in determining the appropriate accounting approach.

In addition, some members think other considerations to make the distinction may also be relevant, for example, whether there is a more than de minimis increase in the rights or ownership of the non-controlling shareholders, whether there is a significant change in the ultimate ownership structure, whether the transaction is conducted at an independently supportable fair value, etc.

In addition, Members are concerned that the DP lacks clarity about how to apply the concept of "affects non-controlling shareholders" of the receiving entity and think that this should be clarified by the Board. For example:

- If the shareholder group (controlling and non-controlling shareholders) is the same in both the transferring and receiving company, it is unclear if the simple existence of non-controlling shareholders in the receiving company is sufficient to conclude that the BCUCC affects the non-controlling shareholders.
- If the level of ownership percentage of non-controlling shareholders influences the evaluation of whether non-controlling shareholders are affected (i.e., where non-controlling shareholders only represent a small proportion of the entity's total shares outstanding).
- Whether the evaluation of the existence of non-controlling shareholders is performed only at the receiving entity level. For example, in Diagram B.5, if non-controlling shareholders existed in entity B but entity D was 100% owned by entity B, it is clear from the DP that in entity B's consolidated financial statements the acquisition method should apply. However, it is unclear whether entity D would also apply the acquisition method in its consolidated financial statements, or whether it would apply the book value method because there are no non-controlling shareholders in entity D itself.

However, a few members are of the view that it is not possible to come up with other criteria to assess the substance of the transaction and that are sufficiently enforceable. While these members acknowledge the issues identified by other members, they agree with the Board's preliminary view and support the application of the acquisition method to BCUCC that affect the non-controlling shareholders of the receiving company. These members agree that the presence of non-controlling shareholders suggests that the transaction may be an acquisition that is similar to a business combination not under common control, and as such this approach would provide useful information to those shareholders.

Calle Oquendo 12
28006 Madrid
ESPAÑA
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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 private held companies?

Response

Some members support the Board's preliminary view that the acquisition method should be required (subject to our response in question 2) if the receiving entity's equity interests are traded in the public market. However, these members ask that the IASB further assess potential negative impacts, if any, of these requirements for the development of capital markets in terms of higher compliance costs to list on public markets and the lack of comparability between listed and non-listed entities that could impact capital allocation. In addition, some of these members are also of the view that the accounting approach should avoid different treatment between equity and debt issuers.

Other members are of the view that the determination of which accounting approach to apply to a BCUCC should be made in the same manner, irrespective of whether the receiving entity's shares are publicly traded. These members think that the information needs of the non-controlling shareholders are not impacted by whether the receiving entity's shares are publicly traded, and as such the acquisition method is also appropriate for BCUCC for private entities, should such transactions have 'substance' from the perspective of the receiving entity (as described in the response to question 2 above).

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@iosco.org - www.iosco.org

However, should the Board retain the concept of requiring the acquisition method for receiving entities whose shares are traded in a public market, members are of the view that the Board needs to provide clear and adequate guidance on the following:

- The meaning of 'public market' – it is unclear whether the terminology 'traded in a public market' is meant to be broader in scope than 'listed on a stock exchange.' The term public market could be interpretated to include over the counter (OTC) markets and applying the BCUCC guidance with reference to OTC markets could be complex, because of the lower level of transparency of these markets.
- Whether the term 'company's shares' should be expanded with reference to other securities that have characteristics similar to those of the entity's equity (i.e. bond that pays interest derived from a company's earnings)

With respect to the proposed related-party exception, some members are of the view that this automatic exception should also be applicable if a receiving company whose shares are privately held has a de minimis number of non-controlling shareholders who are *not* related parties. Otherwise, an entity with an insignificant amount of unrelated parties could not automatically apply the book-value method (i.e. it would have to inform all of the non-controlling shareholder to ensure that they do not object).

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?

Response

Members observe that exceptions often create complexity in terms of their application, and in general, members are not supportive of exceptions to general requirements.

Optional Exemption

Members agree with the Board's preliminary view that the optional exemption from the acquisition method should not be available for publicly traded receiving companies for the reasons outlined in the DP.

However, as noted earlier in our response to Question 2, except for a few members, we do not agree with the general premise that the existence of non-controlling shareholders should be the sole determinative factor in the selection of the measurement method for common control transactions. Notwithstanding this, if the Board decides to adopt this approach, members agree that the optional exemption should not be extended to publicly traded companies as it will be difficult to operationalise.

Related Party Exception

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@iosco.org - www.iosco.org

Members agree that the related-party exception should not be extended to publicly traded receiving companies, as the exception will have limited practical application (i.e. since public companies would generally have non-controlling shareholders who are not related parties).

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?

Response

Most members agree with the Board's preliminary views outlined in the DP. Members think that the measure of the amount of distribution from equity would be subjective and difficult to implement.

However, some members are of the view that if the Board were to adopt its preliminary view as outlined in the DP that the acquisition method is applicable to those BCUCC that affect non-controlling shareholders (i.e. without consideration of the substance of the transaction, as outlined in our response to question 2), then the Board should require the receiving entity to recognise any consideration transferred in excess of the value of net assets received as a reduction in the receiving entity's equity (distribution), instead of including such excess consideration in the initial measurement of goodwill.

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?

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@iosco.org - www.iosco.org

Response

While many members agreed with the Board's preliminary view, as outlined in the DP, others believe that the use of the controlling party's book values would be more relevant for users because those amounts may be more up to date than the carrying amounts recognised by the transferred entity.

In addition, some members note that although using the transferred entity's basis results in the same accounting outcome regardless of how a combination is structured, the Board's proposal would allow a controlling entity to structure a business combination to avoid applying the acquisition method. For example, a sister entity of the receiving entity buys the target entity from a third party (and should apply the acquisition method) and then sell the target entity to the receiving entity who would apply book value using the target entity's book value. In this case, the new basis of the acquisition method will be eliminated, which these members believe would not be appropriate in that instance.

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?

Response

Some members agree with the Board's preliminary views outlined in Question 7(a) and (b). However, these members question whether a receiving entity that assumed a contingent liability as part of a common control acquisition would account for that liability in accordance with IAS 37, consistent with other contingent liabilities, or at fair value in accordance with the guidance on contingent consideration in IFRS 3 and IFRS 9. These members suggest that the IASB consider clarifying this point in any future exposure draft.

However, some members disagree with the Board's preliminary view that the receiving company should measure the consideration paid in assets at the receiving company's book value of those assets at the combination date, as this would result in accounting outcomes that would differ depending on whether the entity sells an asset at fair value and uses cash proceeds received as consideration in a BCUCC or whether the entity transfers the asset directly as consideration for the BCUCC. These members are of the view that the recognition of a gain or loss on the disposal of assets should not depend on whether such a disposal is related to a BCUCC.

Question 8
Paragraphs 4.44–4.50 discuss the Board's preliminary views that:

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@iosco.org - www.iosco.org

(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?

Response

Members agree with the Board's proposals to recognise within equity any difference between the consideration paid and the book value of the assets and liabilities received. Members also agree with not specifying the component of equity in which such a difference should be presented, albeit this may result in some diversity in practice.

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?

Response

Members agree with the IASB's preliminary views.

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?

Response

Most members disagree with the Board`s preliminary view for the following reasons:

- Re-stating pre-combination information of the transferred entity in the financial statements would provide valuable information, particularly in pre-IPO scenarios, and would be comparable to the information that would be provided if, instead of creating a Newco to effect the IPO, the business was already housed in a legal entity in advance of the IPO. These members note that in many pre-IPO

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@iosco.org - www.iosco.org

scenarios, an entity may undertake a group restructuring - the purpose of the financial statements with pre-combination information is to provide information about a group that was under the stewardship of common management or under common control. Thus in these members' view, such historical financial statements are a reflection of the substance of the BCUCC over its legal form. As such, these members disagree with the perspective that pre-combination information is 'hypothetical information' (as referred to by some users and described in paragraph 4.60 of the DP).

- Historical information is valuable for users to fully assess and understand the impact of the BCUCC, including pre-combination trend information of all combining entities or businesses. These members note that users have also acknowledged that pre-combination information for all combining companies could be useful and think that users may not otherwise have access to the information of the entity transferred before the BCUCC. These members think that it is important for such information should be included in the *audited* financial statements.

- If only the receiving entity's financial information is included in the comparative periods, the determination of which entity is the receiving entity becomes more significant. Given that the DP suggests that the determination of 'receiving entity' is to be based on the legal form of the transaction, this will allow entities to structure a transaction to present their preferred information in the historical periods.

One member supports the Board's preliminary view that when applying the book value method to a BCUCC, the receiving company should include in its financial statements the assets, liabilities, income and expenses of the transferred company prospectively from the combination date because such an approach is consistent with the preference of users, based on the Board's feedback to date (as described in paragraph 4.60 of the DP).

Notwithstanding the differing views above, members think that the IASB should not prohibit the retrospective approach as this could create conflicts with the requirements of some securities regulators and IFRS. In many cases, regulatory requirements drive the inclusion of pre-combination comparative financial statements and preventing entities from providing such information within the primary financial statements would not be a desirable result. Members think that at minimum, the IASB should permit entities to have the *option* to restate pre-combination information within the financial statements. This will ensure that receiving entities would still be able to state compliance with IFRS in those jurisdictions with requirements for pre-combination information within the primary financial statements, without having to incur the burden and cost of creating separate information for regulatory purposes.

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.

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@iosco.org - www.iosco.org

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

Response

For the reasons noted in the DP, our preliminary view is that we agree with these proposals. However, we think the Board should consider a clarification about the disclosure requirements that address bargain purchase gains given the preliminary view that any excess of the fair value of net assets over the consideration paid will be recorded as a contribution to equity.

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 summarized 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 recognized 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?

Response

Members think that the Board should consider the following with respect to the disclosure when the book-value method is applied:

- If the Board proceeds with its preliminary view and does not require the restatement of pre-combination information, members think that the receiving entity should be required to disclose at least some pre-combination information, such as that required by paragraph B64(q)(ii) of IFRS 3. Members think that information would be very useful to users and given its limited scope, it is not expected that it would be excessively costly for preparers.

- Members think that it would be useful information to provide the users of the financial statements with the reason for the transaction.

Calle Oquendo 12
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ESPAÑA
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We appreciate your thoughtful consideration of the views provided in this letter.

If you have any questions or need additional information, please do not hesitate to contact Cameron McInnis, Chair of the Accounting Subcommittee of Committee 1 at +1 416-593-3675 or myself. In case of any written communication, please mark a copy to me.

Yours sincerely,

Makoto Sonoda

Chair
Committee on Issuer, Accounting, Audit and Disclosure
International Organization of Securities Commissions

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: + 34 91 417.55.49 Fax: + 34 91 555.93.68
mail@iosco.org - www.iosco.org