

European Financial Reporting Advisory Group  
Françoise Flores  
35 Square de Meeûs  
B-100 Bruxelles  
Belgique

Paris, May 22, 2012

**RE: Comments on EFRAG Discussion Paper on “Accounting for Business Combinations Under Common Control”**

Dear Françoise,

Mazars welcomes the opportunity to comment on the discussion paper on “Accounting for Business Combinations Under Common Control”.

We appreciate the work carried out by EFRAG, as BCUCC are accounted for in a variety of ways, and the work represents a useful step towards a common approach.

This said, and as BCUCC represent a diverse group of transactions that are carried out for many different reasons, we understand that it is extremely difficult to identify key indicators that could be used to set up a decision tree.

Thus, if robust indicators cannot be identified to help analyse the different fact patterns in order to reach a conclusion, view 3 would probably be criticized for offering some potential for structuring opportunities, which would seriously weaken view 3 and would make view 1 look more robust.

Nevertheless, we believe that the Discussion Paper is too much focused on the relevance and applicability of IFRS 3 (view 1) to BCUCC, and does not explore sufficiently alternative to accounting treatments. Predecessor basis of accounting and fresh-start accounting (both

referred as view 2) are only addressed in pages 74 to 77 of the DP, and no variant of those methods are explored.

We believe that these methods, and in particular predecessor basis of accounting, deserve a more in depth analysis. Indeed, one cannot ignore the fact that other financial reporting sets of standards address the issue of BCUCC and make the predecessor basis of accounting mandatory. We can quote US GAAP, that are similar to IFRSs regarding business combinations, and HKFRSs. When applying the IAS 8 hierarchy in order to define an accounting policy for BCUCC, entities often refer to US GAAP and the predecessor basis of accounting.

Our answers to the specific questions raised in this DP are presented in the attached appendix.

We would be pleased to discuss our comments with you and are at your disposal should you require further clarification or additional information.

Yours sincerely



**Michel Barbet-Massin**

*Head of Financial Reporting Technical Support*

## **Appendix 1: detailed answers to the questions raised in the DP**

### **Question to constituents**

1.1 Do you think that the concerns have been accurately described in relation to the issues arising from accounting for BCUCC transactions? If not, please could you suggest other significant concerns that have not been addressed?

Yes. We believe that the DP adequately describes the concern that similar transaction could be accounted for differently, as these transactions are scoped out of IFRS 3.

### **Question to constituents**

1.2 In your experience, what approaches are typically applied by preparers in practice for BCUCC transactions and what justification is provided to support their application of these approaches?

In our experience, both “predecessor basis of accounting” and “purchase accounting” (the acquisition method, as described in IFRS 3) are commonly used.

The rationale for the use of these two methods is as follows:

- A business combination between entities under common control is, above all, a business combination. IAS 8.11.a makes the use of purchase accounting under IFRS 3 seem quite logical,
- There is no true acquirer in a business combination under common control, and the use of the predecessor basis of accounting portrays the lack of change in control. Moreover, the accounting treatment is that required under US GAAP (that have a similar conceptual framework, cf. IAS 8.12). This method is similar to the “pooling of interests” method that existed in IAS 22. Therefore this method is deemed to be compliant with the IFRS Framework.

We have not seen examples of “fresh start accounting” being used in practice for BCUCC transactions. This method is sometimes applied to the accounting for the formation of a joint venture, for the purpose of the financial statements of the joint venture itself.

**Question to constituents**

2.1 Are there any issues not included in the scope of the DP that, in your view, need to be addressed in developing an approach to accounting for BCUCC in the consolidated financial statements of the transferee?

We believe that it is appropriate to scope out some issues (listed in § 6 of chapter 2 of the DP) at this stage of the project.

Nevertheless we believe it would be important that a final standard dealing with the accounting for BCUCC addresses the consequences of the transaction for the entity that loses control.

**Question to constituents**

2.2 Do you believe that there are any specific issues to be addressed in the initial recognition and measurement of BCUCC in the separate and individual financial statements? If so, please explain what those issues are and how they should be addressed.

We believe that the issues of BCUCC in the separate and individual financial statements should be dealt with at a later stage (i.e. when the issue of BCUCC in the consolidated financial statements of the transferee has been agreed on).

We agree with EFRAG that an equity interest acquired through a BCUCC transaction should be accounted for in the separate financial statements of the transferee in accordance with IAS 27. Nevertheless, there may be issues regarding the cost of the investment (IAS 27.10.a) when consideration is paid by issuing equity instruments of the transferee.

Regarding asset deals, § 14 of the Discussion Paper questions on whether the transfer of a group of assets and liabilities that constitutes a business (an asset deal) should be accounted the same way in the transferee's separate and consolidated financial statements. IFRS 3 applies to such transactions involving entities that are not under common control in the acquirer's consolidated financial statements and in its separate financial statements as well. Thus we consider no difference should exist between separate and consolidated financial statements when the transaction is a BCUCC.

Finally we believe that it would be necessary to address the wider issue of accounting for transactions between entities under common control, and not only business combinations under common control. The "push down" accounting has been introduced in IFRS 2 regarding share-based payment transactions among group entities. This principle, and the nature of the transactions to which it applies, deserve to be clarified,

**Question to constituents**

2.3 Are there any specific issues you think need to be addressed when considering what information about a BCUCC should be disclosed in the notes to the financial statements of the transferee?

We believe that the issue of the level of information to be provided in the notes for BCUCC should be dealt with at a later stage (i.e. when the issue of BCUCC in the consolidated financial statements of the transferee has been agreed on).

Nevertheless we believe that the general objective of the disclosures regarding BCUCC transactions should be similar to the one stated in IFRS 3.59: to enable users of the financial statements to assess the nature and financial effect of a business combination.

**Question to constituents**

3.1 Do you agree that an important step is to understand the information needs of users in the financial reporting of a BCUCC transaction? If not, how else would you set out an approach that satisfies the objective of financial reporting?

We agree that it is important to understand what the information needs of users of the financial statements of the transferee are.

However, care given to the needs of the users should not be detrimental to the usefulness of information, especially when the needs of users are diverse.

**Question to constituents**

3.2 It is noted above that the analysis in this DP is taken from the perspective of the transferee (entity perspective) as opposed to the perspective of the owners (proprietary perspective). Do you agree that, to be consistent with existing IFRS, the entity perspective should be dominant when considering BCUCC? If not, why not?

We agree with the approach taken in the DP that the accounting treatment should be analysed from the perspective of the transferee (i.e. an entity perspective), as this approach is consistent with IAS 27R (2008).

**Questions to constituents**

3.3 Do you agree with applying the “logic” of the IAS 8 hierarchy in developing an approach to accounting for BCUCC transactions? If not, what alternative would you propose and how would you reconcile that approach with existing IFRS?

3.4 Do you agree that if and when an analogy to IFRS 3 is considered to apply, it is appropriate to assume that fair value at initial recognition provides information that is more decision-useful than values based on previously recognised amounts or any other measurement attribute? If not, please explain why?

3.5 Do you agree that if the analogy to IFRS 3 does not apply, defining an appropriate measurement attribute should be guided by an analysis of the information needs of users? If not, why not?

3.3 We agree with the approach used by EFRAG to develop the DP. IAS 8 is required to be used whenever IFRS do not specifically apply to a transaction. Moreover, the very same approach is used by the IFRS Interpretations Committee. Nevertheless we do not think that, under the specific circumstances, applying such hierarchy would permit finding a solution, considering the diversity of accounting rules and practices.

3.4 We agree that fair value is normally more decision-useful than book value (or another measurement basis) whenever IFRS 3 is deemed appropriate.

3.5 Whenever IFRS 3 is not deemed appropriate, we agree that the definition of a measurement attribute should take into account the information needs of users.

**Questions to constituents**

4.1 Do you agree with the main features of a BCUCC identified above? If not, what other features would you highlight?

4.2 It is noted above that BCUCC can be substantially different in nature from business combinations between unrelated parties. Do you agree that a BCUCC can be different to a business combination under IFRS 3? If so, describe examples you have encountered in practice that verifies this. If not, please explain why?

4.1 We agree that the main distinguishing features of a BCUCC are listed in the introduction of chapter 4 of the DP.

4.2 We agree that a BCUCC can be very different from a business combination between unrelated parties.

As explained in the DP, the fact that a BCUCC is not necessarily subject to market forces means that the purchase price paid by the transferee may not be at arm-length (as it is a transaction between related parties). Furthermore, it may not be easily determinable as consideration paid may be in equity instruments of the transferee. When the transferee and the business transferred are fully owned subsidiaries of one direct parent (no NCI), and when the combination consists in the merger of the two subsidiaries, the ‘price’ of the transaction has no actual significance and the transaction is arm-length whatever the value attributed and the number of transferee’s shares issued as consideration.

However, this does not mean that the price will always be different from the price that would have been paid by an unrelated acquirer. In this regard, the legal environment plays an important role, as laws and regulations may make it more difficult to carry out a transaction other than at fair value (i.e. a market based transaction). The level of non-controlling interests may also play a part, since NCI would probably look more closely to the BCUCC if they own a substantial share of the transferee (or of the business transferred).

#### **Question to constituents**

4.3 Do you agree with the analysis that has been performed in relation to the information needs of users? If not, why not?

We believe that the analysis could be presented in a more “user friendly” way, starting with the question of whether the information needs of users in relation to a BCUCC are different to those in relation to a business combination.

In this regard, the drawing line appears to be whether (or not) the controlling shareholder is considered to be a user of the financial statements. This user may be more interested in keeping the existing values to assess the historical performance, rather than using fair values.

**Questions to constituents**

4.4 Do you think that with BCUCC it may be difficult in some circumstances to identify an acquirer (View A) or do you believe that an acquirer can always be identified (View B)?

4.5 If you believe that an acquirer can always be identified in a BCUCC, do you think that an analogy to IFRS 3 is not valid because the ultimate parent entity can direct the identification of an acquirer so that the accounting outcome is not a faithful representation of the underlying BCUCC transaction?

4.4 Even though it may be difficult to identify an acquirer, we believe that an acquirer can always be identified.

In some circumstances it may be difficult to assess whether the BCUCC transaction is a reverse acquisition or not, since the ultimate parent controls both of the combining entities before and after the transaction.

Nevertheless this situation is not very different from a “merger of equal” where IFRS 3 would still require an acquirer to be identified, even if the identification is highly judgmental (meaning that a similar set of facts and circumstances may lead to different conclusions being reached).

4.5 This said, we agree that the ultimate parent company could direct the identification of the acquirer, so as to obtain the desired accounting outcome. This, in turn, creates structuring opportunities for the ultimate parent entity, thereby casting doubt on the faithful representation this method of accounting purports to represent.

**Question to constituents**

4.6 Do you agree with the analysis above that under IFRS 10 “control” should be assessed from the perspective of the reporting entity and not from that of the ultimate parent entity? If not, why not?

Yes. If control was assessed from the perspective of the ultimate parent company, there would be no business combination, but merely a restructuring within the group.

See above our answer to question 3.2.



**Question to constituents**

4.7 Do you agree that the definition of a “business” in IFRS 3 raises no particular issues for BCUCC? If not, why not?

We agree that the definition of a “business” does not raise significantly more issues in the case of a BCUCC.

However:

- We note that the notion of “business” is not always easy to apprehend, as evidenced by the submissions received by the IFRS Interpretations Committee relating to this issue;
- The intragroup aspect of BCUCC means that there is a greater potential for structuring (i.e. a business may be transferred through several transactions, in order to reach a desired accounting result).

**Question to constituents**

4.8 Do you think the absence of a market-based transaction can have consequences when applying the recognition principle in IFRS 3 because of a lack of measurement reliability? If so, do you agree with the analysis? If not, why not?

It seems difficult to consider that IFRS 3 must be applied, as the BCUCC transaction is not significantly different from another business combination, and at the same time consider that the IFRS 3 principles should be adapted / adjusted.

With IFRS 3 (2008), the use of fair value is required for the acquirer previously held equity interest in the acquiree and allowed for any remaining non-controlling interests, whereas there may not have been any transaction, for example when control is achieved by contract alone. Even when there has been a transaction, the transaction price may not be a relevant basis for measuring the fair value of previously held interests or non-controlling interests:

- the price paid for taking control may include a significant control premium, or
- the consideration paid may consist in equity instruments of the acquirer, whose value may have significantly changed between the date when the number of equity instruments to be issued has been agreed and the acquisition date.

Despite those difficulties in measuring fair value, IFRS 3 requires the measurement to be done, regardless of its reliability.

Therefore, if a BCUCC is accounted for according to IFRS 3, we consider that no adaptation should be made to the recognition principle, since the common control feature of the transaction does not create additional difficulties.

As far as the recognition of acquired assets and liabilities is concerned, IFRS 3 (2008) no longer conditions the recognition of intangible assets to an existing reliable fair value. Furthermore, in a business combination the only transaction relates to the whole business acquired. Measuring the fair value of identifiable assets does not rely on specific individual transactions involving those assets. That is why we believe that the absence of a market transaction in a BCUCC would not prevent an entity from applying the acquisition method as required by IFRS 3.

#### **Question to constituents**

4.9 Do you think it is appropriate to apply the measurement principle in IFRS 3 to BCUCC when the analogy to IFRS 3 is valid? If not, why not?

To the extent that an IFRS 3 accounting outcome is relevant to the users of the financial statements of the acquirer, we believe that it is difficult to justify not applying the IFRS 3 measurement principle. The main issue remains to find robust indicators to determine when IFRS 3 application is relevant.

#### **Questions to constituents:**

5.1 Do you believe that the transaction price should be referenced against the fair value of the business acquired and bifurcated (when the transaction price exceeds the fair value of the business acquired) if the transaction price does not reflect a proxy for fair value? This ensures the BCUCC transaction reflects two transactions: a) a contribution from (distribution to) the ultimate parent entity, and b) a business combination.

5.2 Do you believe that goodwill and/or identifiable intangible assets should not be recognised in the balance sheet of the acquirer on the basis that they cannot be reliably measured?

5.3 Do you believe that where the consideration transferred is lower than the fair value of the net assets acquired, the difference should reflect a contribution from the ultimate parent entity or recognised as income?

5.1 We have sympathy for the proposed approach, so that the financial statements reflect faithfully the economics of the transaction.

However, and as indicated in § 21 of chapter five of the DP, we note that this approach is not consistent with other related party transactions, that are accounted for based on the transaction price (with additional information provided in the notes), as opposed to being accounted for based on a market price.

A possible rationale for applying this logic could be that (a) BCUCC are not supposed to be as frequent as other related party transactions and (b) those transactions generally involve significant amounts.

In other words, the principle would be that fair value should be used for related party transaction but, as a practical expedient, common related party transactions (such as sales and purchases) would not need to be adjusted .

This principle needs to be analysed in a larger debate regarding transactions between a reporting entity and its owners. Such a debate should define the criteria for distinguishing transactions made in their capacity of owners from other transactions, and define the extent to which ‘push down’ accounting and equity accounting should be applied.

5.2 We do not see much rationale in this approach. Assuming that IFRS 3 accounting outcome is relevant to the users of the financial statements of the acquirer, we believe that it is difficult to justify not applying the IFRS 3 measurement principle in its entirety.

As stated in our answer to question 3.8, we believe there is no difference, when measuring the fair value of identifiable assets and liabilities acquired, between a business combination and a BCUCC.

5.3 Subject to the limitations exposed in § 5.1 above, we believe that the transaction price should be adjusted to represent the fair value of the business acquired, as it better portrays the economic reality.

As a consequence, where the consideration transferred is lower than the fair value of the net assets acquired, we believe that the difference should be considered as a contribution from the ultimate parent entity.

We also believe that this principle should be extended to some unusual related party transactions other than BCUCC.

**Questions to constituents:**

**5.4** Do you think that the BCUCC should be viewed as a “transfer” of a business rather than an acquisition of a business when the analogy to IFRS 3 can never be applied?

**5.5** Do you believe that all the arguments and views presented are valid when it is not appropriate to apply an analogy to IFRS 3?

5.4 When the analogy to IFRS 3 cannot be applied, and depending on who the users of the financial statements are, and what their needs are, the transaction could be viewed:

- as a transfer, thereby justifying the use of the “predecessor basis of accounting”.
- as a creation of an entirely new entity, thereby justifying the use of the “fresh start” method.

5.5 Yes. We believe that the arguments and views presented are valid.

**Question to constituents:**

**5.6** Do you agree that the approaches outlined in Appendix 3 are unlikely to result in decision-useful information? If not, why not?

5.6 We understand from the reasons outlined in appendix 3 that the initial approach, consisting to identify indicators as possible discriminants for establishing the basis for initial measurement, was abandoned.

Although identifying key indicators may prove difficult, and as further explained in § 5.8 below, we believe that this is the only alternative.

**Questions to constituents:**

5.7 Do you believe that the diversity in the information needs of users when compared to a business combination and the cost constraint in financial reporting provide justification to consider whether or not the recognition and measurement principle in IFRS 3 are appropriate when accounting for BCUCC?

5.8 Do you believe that all the arguments presented in relation to view three are valid or are there others that you would consider?

5.7 We agree that diversity in both BCUCC situations and information needs of users, as well as the cost constraint, should be taken into account to determine the appropriate accounting treatment.

5.8 Although we understand view 1, we believe that view 3 should be further developed.

Even though it may be difficult to identify key indicators (as explained in § 57-58 of chapter five), we believe that providing examples and / or indicators would be most useful for preparers.

The example in § 73-75 tries to illustrate the change in the ability of the reporting entity to meet existing claims against the combining entities.

In the initial fact pattern, as both entity A and entity B are profitable, it is considered that merging those entities would not change the amount, timing and uncertainty of the future cash flows to be generated. As a consequence, the use of the predecessor basis of accounting is deemed justified.

In the altered fact pattern, A is profitable whereas B is not. As a consequence, merging these entities would have an effect on the ability of the entity to meet the existing claims of capital providers, and the use of IFRS 3 is considered to be the appropriate approach.

We understand the approach but we believe that additional work needs to be carried out to better explain / justify the different approaches used. In effect, modifying the transfer prices between A and B could make B profitable, thereby changing the conclusion, whereas all the decisions are really made by the ultimate parent.

In other words, if robust indicators cannot be identified to help analyse the different fact patterns, in order to reach a conclusion, view 3 would probably be perceived (as well as criticized) as offering some potential for structuring opportunities. That would seriously weaken view 3, and view 1 would be considered as more robust.