

Dear Madame, dear Sirs,

This paper should give a short feedback on EFRAG’s ideas related to the future reporting on business combinations under common control from the perspective of a preparer of financial statements according to IFRS.

Questions 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?

Yes-the major issue is of course the diversity of approaches used in accounting practice. Whatever might be the regulation defined in a future standard it should put an end to this diversity and (re-)establish comparability between consolidated financial statements.

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 the Austrian context the commonly used method is a quite strict application of the predecessor approach, i.e. in the consolidated accounts the affected assets and liabilities are valued in the same way before and after the transaction, any resulting gain/loss is eliminated on consolidation. The basic arguments for the application of this method are:

- On a consolidated basis a Group of companies is seen as one closed unit (“Einheitstheorie”)- accordingly a transaction within this unit cannot alter the value of the affected assets/liabilities as this one unit and its components did not change.
- In case of full fair value accounting for BCUCCs (i.e. revaluation of assets/liabilities) it has to be questioned as well why the effects of other internal transactions (e.g. transfers of fixed assets, sale of inventory from a production to a sales company) should be eliminated.
- As there is not external effect from such transactions no fair market values can be assessed which would be required in order to justify a revaluation.
- Overstatement of intangible assets (from PPA) and goodwill

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 BUCC in the consolidated financial statements of the transferee?

We would recommend taking a broader scope and include the consolidated financial statements of the higher level parents (including the ultimate) as well. The reason for this is the fact that some effects might appear on higher levels of the Group (e.g. a goodwill initially recognized in Parent 2 might be impaired due to the fact that the value in use of subsidiary Y decreased as a consequence of the business transferred to Parent 1)

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.

In most jurisdictions the individual financial statements are the basis for the assessment of dividend payments. Accordingly a BCUCC might have a significant impact on the pay-out potential of the affected company. Although it will depend on how such effects are treated in different countries it

might be appropriate to clarify if revaluations in the course of BCUCC shall be included or excluded from retained earnings available for distribution.

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?

Basic information about the transaction (target, consideration paid) should be required independent which method will be required for recognition and measurement. Moreover at least a condensed overview of assets/liabilities transferred and the impact on the p&l shall be disclosed.

Anyhow such data and analysis will only be relevant if the transferee publishes consolidated financial statements. In many countries (and also IFRS 10.4 foresees exemptions) the fact that the transferee is included in the consolidated financial statements of a higher level parent exempts the transferee from publishing its subgroup accounts.

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?

Agreed-however it will be important to define the really relevant “user” in the case of a BCUCC. In most cases this will be the owners of the ultimate parent company of the. Accordingly the “user” should be defined as the already existing or potential investors of the highest level parent. However this issue is somewhat clarified by par. 7 and related footnote on page 18.

3.2. It is noted above that the analysis in the 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?

Yes, definitely.

3.3. Do you agree with applying the logic of IAS 8 hierarchy in developing an approach to accounting for BCUCC transactions?

Basically yes, as a new standard should fit in to the already existing IFRS/IFRIC environment.

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 recognized amounts or any other measurement attribute? If not, please explain why?

Not necessarily. Especially the consideration paid could be considerably biased as it is not market defined and the acting parties are not “market participants” as defined in IFRS 13. Moreover the transaction could well be one the transferee would not have entered into if acting independently on the market.

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?

Agreed, as the users’ information needs are the driving forces of all IFRSs.

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

We agree.

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?

We definitely agree. In many cases the BCUCC is a merger between subsidiaries in order to reap synergy effects by future cost savings with no consideration paid (if a sidestep merger) or a merger gain or loss (when up- or downstream mergers become effective) which is eliminated on consolidation. In case of a BCUCC with no former direct shareholding between the affected entities the consideration is often oriented on the net assets transferred (purchase price=equity) without any negotiations and/or bargaining processes.

Another reason for BCUCC might be the restructuring of an underperforming entity which has a subsidiary that is sold to a related party in order to get cash and equity to its books. In such cases the purchase price is often oriented on the equity needs of the selling company.

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

Lenders: will basically be interested in the repayment ability in respect to their loans/receivables. This repayment ability could be adversely affected if the acquiring company is loaded with debt or pays excessive cash. On the other hand lenders to the selling company might have an advantage from such a deal.

Investors: will be interested in cash flow improvements either by cost savings or by better market performance. Anyhow it can be doubted whether these future potential should already be reflected in the initial accounting of BCUCC as it is not a present resource available at the time of the transaction.

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)?

Although there might be some more sophisticated structures it will in most cases be possible to identify the acquirer.

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 presentation if the underlying BCUCC transaction?

Basically the ultimate decision power of the parent can influence the BCUCC in many aspects, one of them being the possibility to structure the deal in order to achieve a favorable effect in the books.

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? If not, why not?

We agree from a scientific and consistency point-of-view although the party triggering the transaction is almost always the ultimate parent company (at least its consent is needed) so one has to give some more thoughts in this matter.

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.

4.8. Do you think that 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?

We agree. Although a solution based on level 3 inputs in the meaning of IFRS 13 would be technically possible the doubts about the reliability (hard to cross-check against market data) of these inputs used remain.

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?

We do not agree. The fact that a BCUCC does not involve any external market participant makes a biased assessment of fair values at least probable. Even if level 3 inputs can be used to simulate fair market values it will be hard to prove the objectivity of parameters used. This is even more the case as BCUCC to some extent are designed for a specific purpose (e.g. tax optimization, restructuring) and are not developed through a bargaining and negotiation process as an external business combination.

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

Yes. The fact that neither the consideration paid nor the fair value of net assets transferred can be measured reliably (and objectively checked against a similar open market transaction) will necessarily lead to this conclusion.

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 recognized as income?

The difference should be treated as a capital contribution at the transferee.

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?

Basically yes. BCUCC are in almost all cases structured for a specific purpose identified by the ultimate parent and lacks the higher degree of objectivity a market-based transaction would provide. Generally spoken a BCUCC is similar to a combined intercompany transfer of specific assets and related liabilities. The effects from intercompany transactions (i.e. gains at the selling company) must be eliminated during consolidation, as the value increase assumed through the selling price exceeding the carrying amounts transferred had no external impact on the Group. The same should be applied for BCUCC, which consequently would require predecessor accounting.