POSITION PAPER

EFRAG's Draft Comment Letter in response to IASB Discussion Paper DP/2020/2 Business Combinations under Common Control

ESBG (European Savings and Retail Banking Group)

Rue Marie-Thérèse, 11 - B-1000 Brussels

ESBG Transparency Register ID 8765978796-80

July 2021

ESBG

ESBG would like to thank EFRAG for the opportunity to comment on the EFRAG´s Draft Comment Letter in response to IASB Discussion Paper DP/2020/2 Business Combinations under Common Control, issued by the IASB on 30 November 2020 (the 'DP').

We welcome the IASB's efforts to develop appropriate accounting guidance for business combinations under common control. We believe the proposals in the DP completely fill in the gap that currently exists in IFRS standards and would help to reduce diversity and improve comparability and consistency in the accounting treatment of these transactions within preparers, and hence would help to provide more relevant information for stakeholders.

Below you will find our answers as well as comments to the questions raised in the Draft Comment Letter, however we would like to draw EFRAG's attention first to the following key messages:

- We agree with the scope proposal of the IASB. The definition of BCUCC in the DP, includes all transfers of a business under common control even when the transfer does not meet the definition of a business combination under IFRS 3. Hence, this approach addresses a wider range of transfers of businesses and would help to achieve the general objective of the DP. However, the existence of two definitions of BCUCC, could be confusing for preparers, and some alignment is needed.

- ESBG supports the dual approach in the DP where reporting entities are guided by a decision tree pointing to the right method to apply depending on the circumstances of each specific transaction. We believe that the accounting method should be based on the economic substance in the common control business transfer, the relevance of non-controlling shareholders and also costs and operational complexity that the acquisition method might entail. Hence, we propose that the DP should include additional guidance regarding the nature of non-controlling interest of the receiving entity when deciding which measurement method is most appropriate.

- We agree with the IASB's view that receiving companies that are publicly traded should apply the acquisition method. However, we would suggest extending the definition of publicly traded to companies with publicly traded debt instruments.

- Furthermore, we support the IASB proposals that any excess of fair value of the identifiable acquired assets and liabilities over the consideration paid should be recognized as a contribution to equity. As business combinations under common control involve the transfer of a business between two parties that are ultimately controlled by the same party, we believe that in substance, any excess better represents a contribution to equity rather than a bargain purchase gain.

- Regarding the book value method, we oppose to the IASB proposals as we believe that the receiving company should measure the assets and liabilities received using the values in the consolidated accounts. From the perspective of the controlling party the transaction does not change its control over the assets and liabilities received and hence the same value should be used.

- Also, based on the above, assets, liabilities, income and expenses of the transferred company should be included in the financial statements of the receiving entity from the beginning of the year in which de BCUCC takes place and not from the combination date as IASB proposes.

Section 1: Objective, Scope and Focus

Question for EFRAG constituents

18 Some stakeholders have raised questions about the meaning of 'transitory control', for example, in submissions to the IFRS Interpretations Committee. The IASB avoids the discussion on transitory control by including in the scope all transfers of business under common control.

19 Do you consider that it is important to clarify the meaning of "transitory control" for BCUCC, even if in the DP, the IASB addresses the issue by including in the scope all transfers of business under common control?

As the definition of Business Combination Under Common Control in the DP is wider than the one included in IFRS 3, we do not consider that additional guidance on the meaning of "transitory control" is needed within the DP. However, the existence of two definitions of BCUCC, could be confusing for preparers and some alignment is needed. Future developments, outside the scope of the DP should be undertaken by IASB.

Question for EFRAG constituents

29 Do you consider that the definition of BCUCC as described in the DP:

(a) results in transactions being included in the scope of the project that should not be within the scope; and

(b) are there transactions outside the scope of the project that should be within the scope?

We agree with the IASB's proposal to consider all transfers of businesses in which all of the combining entities are ultimately controlled by the same party. We do not consider that there are transactions out of the scope that should be included or transactions in scope that should be excluded, but we consider that although "group restructurings" are within the scope of the DP, additional guidance on the definition of "group restructurings" would be useful for stakeholders.

Section 2: Selecting the measurement method

Question for EFRAG constituents

49 Do you agree that a single measurement approach is not appropriate for all BCUCC? Based on the pros and cons of applying the acquisition method (described in paragraph 37) and a book-value method (described in paragraph 38), do constituents support these two methods being applied to particular subset of BCUCC?

50 In your jurisdiction, are there any requirements on how to account for BCUCC?

(a) If so, describe the requirements;

(b) If not, what is the current practice in your jurisdiction?

(c) For (a) and (b) above, where is the difference between the consideration paid by the receiving company and the acquired net assets recognised when:

(i) the consideration paid is higher than the acquired net assets; and

(ii) the consideration paid is lower than the acquired net assets?

We agree that neither the book-value method nor the acquisition method should be applied to all BCUCC. Although book value method would be the most appropriate in most cases, in certain transactions, for example when non-controlling interest of the receiving entity are significant, the acquisition method would result better to reflect the nature of the transaction. However, as we further develop below, we consider that the DP should include additional guidance regarding the nature of non-controlling interest of the receiving entity when deciding which measurement method is most appropriate.

For example, in Spain - BCUCC are regulated in the National Chart of Accounts (PGC). According to PGC, almost all BCUCC in Spain are accounted at consolidated book-value, with any difference between the consideration paid and the consolidated book value of assets and liabilities received recognized in equity.

Question for EFRAG constituents

65 Do you agree with EFRAG's suggestion in paragraph 62 to reverse the order of Step 1 and Step 2 of the decision tree when selecting the measurement method for BCUCC?

66 Considering the options provided in paragraph 64 on how to modify the scope of the IASB's decision tree for selecting the measurement method for BCUCC, which option do you prefer? Please explain what your main considerations are for selecting that particular option*?*

We agree with the suggestion to reverse Step 1 and 2 of the decision tree for selecting the measurement method as publicly traded companies normally have non-controlling shareholders and in most cases should use the acquisition method.

Regarding the options provided in paragraph 64, we consider that option 2, including receiving companies with publicly traded shares or publicly traded debt instruments, is the most appropriate. It would make no sense to treat differently a transaction solely based on the type of instrument that is publicly traded. In addition we consider that Option 3 would not be appropriate: the accounting method should be based on the nature of the transaction and/or the nature of the relations between the receiving and the transferring company and not the economic importance or the level supervision, public scrutiny of these companies.

In addition to this, we consider that the mere existence of non-controlling shareholders in the receiving entity that are not a related party should not be enough to determine that the acquisition method is the most appropriate to account for that transaction. Whether or not they have significant influence or the nature of the company's relations with these non-controlling interests should be considered when evaluating the accounting method, a company with 49% of its shares in hands of minority interests is not equivalent to a company with only 1% of minority interests. We consider that the DP should include some guidance to help companies to analyze the nature of its non-controlling shareholders and how this should be considered when determining the accounting method.

Question for EFRAG constituents

69 Considering the proposed options to modify the IASB's decision tree as explained in paragraphs 62 and 64, do you consider that applying the optional exemption from the acquisition method, in particular, requesting approval from non-controlling shareholders would raise any concerns? Please explain.

Question for EFRAG constituents

72 Considering the arguments in paragraph 71, do you agree that the related-party exception provided by the IASB should be rather 'permitted' under the proposals and not 'required'? If you disagree, please explain.

We believe that requesting approval to non-controlling shareholders to avoid the apply acquisition method may be difficult to implement and probably costly depending on their number. Non-controlling shareholders could have opposite views and may have different level of accounting knowledge to understand costs and benefits of both alternatives. On top of that, the DP does not include any reference about what kind of approval is expected. Auditors and/or supervisors may expect some "evidence" from non-controlling shareholders' position. Approval from non-controlling shareholders should be limited to certain circumstances. It might be useful that the IASB provides some guidance on this matter. We fully agree with EFRAG that in any case the related party exception should be required and in those cases in which it considers that non-controlling shareholders have a substantive interest it should be permitted.

Section 3: Applying the acquisition method

Question for EFRAG constituents

99 Which of the two alternatives do you consider will provide the most useful information? Please explain.

100 If neither, which other approach do you recommend and why?

We agree with IASB proposals that any excess of fair value of the identifiable acquired assets and liabilities over the consideration paid should be recognized as a contribution to equity. As business combinations under common control involve the transfer of a business between two parties that are ultimately controlled by the same party, we believe that in substance, any excess better represents a contribution to equity rather than a bargain purchase gain.

Section 4: Applying a book-value method

Question for EFRAG constituents

107 EFRAG acknowledges that in some jurisdictions, the local regulator may dictate that a particular method be used. What approach is currently being applied in the financial statements in your jurisdiction? Please provide a description of this approach.

108 Do you agree with using the transferred entity's book values or with using the controlling party's book values? Please explain your reasons why.

109 If you do not agree with either approach, what approach do you suggest and why?

According to the National Chart of Accounts in some jurisdictions, almost all BCUCC in these jurisdictions are accounted at consolidated book-value, with any difference between the consideration paid and the consolidated book value of assets and liabilities received recognized in equity.

In line with the local applicable framework we consider that consolidated book value would be most appropriate to minimize impacts. Using the transferred company's individual book values could lead to differences between that values and the consolidated values that would increase the complexity of the transaction, since at consolidated level any BCUCC should have no impact.

Question for EFRAG constituents

125 Are there other forms of consideration paid apart from those identified in the DP, e.g., consideration paid in the form of a transfer of an unincorporated business, and how common are these forms of payment?

The most common forms of consideration paid are those described in the DP. In some jurisdictions, considerations paid either in cash or in assets are probably the most common.

We disagree with the DP proposal of measuring any consideration paid in assets at the book value of these assets in the receiving entity financial statements. Assets paid as consideration should be measured as their fair value.

Question for EFRAG constituents

143 EFRAG notes that the IASB proposal that the receiving entity 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 might create tension with current reporting requirements in some jurisdictions and be costly and difficult to apply in practice.

144 In your jurisdiction, do you currently provide pre-combination information about the transferred company prospectively as from combination date or retrospectively by restating comparatives? Please explain.

145 If you provide information retrospectively with pre-combination information restated, is it retrospective as from the beginning of the reporting period or as if the combining companies have always been combined?

146 you consider that providing pre-combination information about the transferred entity prospectively might be costlier than restating this information?

In some jurisdictions, assets, liabilities, income and expenses of the transferred company are incorporated in the receiving entity financial statements from the beginning of the year in which the business combination occurs as the business transferred has been part of the group since the beginning of the year. No comparative information is included as it would be very costly and probably operationally a challenge.

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 21 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 900 banks, which together employ more than 650,000 people driven to innovate at roughly 50,000 outlets. ESBG members have total assets of €5.3 trillion, provide €1 trillion in corporate loans (including to SMEs), and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking. Our transparency ID is 8765978796-80.

European Savings and Retail Banking Group – aisbl
Rue Marie-Thérèse, 11 ▪ B-1000 Brussels ▪ Tel: +32 2 211 11 11 ▪ Fax : +32 2 211 11 99
Info@wsbi-esbg.org ▪ www.wsbi-esbg.org

Published by ESBG. July 2021