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Mr. Jean-Paul Gauzès

Chairman

European Financial Reporting Advisory Group

35 Square de Meeüs

Brussels B-1000

Belgium

Ref: *EFRAG´s Comment Letter on the IASB´s DP/2020/2 Business Combinations under Common Control.*

Madrid, 30th July 2021

Dear Jean-Paul,

In the present letter ICAC gives its view on EFRAG's position presented in your draft comment letter on IASB's Discussion Paper DP/2020/2 *Business Combinations under Common Control*. ICAC welcomes the initiative to face the current absence of a specifically applicable IFRS Standard to business combinations under common control, in which all of the combining companies or businesses are ultimately controlled by the same party, both before and after the combination (BCUCC), being the receiving company required to develop its own accounting policy, since such combinations are outside the scope of IFRS 3 Business Combinations.

We consider positive that the IASB includes in the scope all transfers of business under common control to cover as much as possible all the business combinations that currently are not covered by IFRS Standards. In this sense, it would be useful that IASB clarify the meaning of "transitory control" and align the concept with IFRS 3. Relating to this, in the case of a company spinning off a business to sell the shares, applying the BCUCC PD criteria it would be accounted for at book values. However, in our opinion the new company in this transaction economically is an extension of the

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buyers, and it is therefore an acquirer, so for us it seems clear that the acquisition method should be applied in the balance sheet. In other words, the transfer of a business under common control for the purpose of its subsequent sale to third parties is an operation that should be governed by the acquisition method.

The DP covers the so-called sub-consolidated financial statements of the acquiring company. In addition, the DP would also cover the separate financial statements and the individual financial statements of an entity, except when control of a business is transferred through the acquisition of the shares of the acquired company because in its opinion, the applicable criterion of this operation is adequately covered by IAS 27 (which establishes the general standard for recognition at the initial moment for the fair value, with limited exceptions) and should not be modified.

In our opinion, from the perspective of the separate financial statements of the acquiring company, the acquisition of the shares of another subsidiary is an operation equivalent to the acquisition of all its equity elements by virtue of a merger agreement and therefore, both operations should be included in the scope of the IASB's project. We also strongly agree with EFRAG comment that the IASB should address other transactions under common control and the accounting in the separate financial statements of these operations and the broader issue of transfer pricing.

Also, we believe it would be appropriate for the IASB to provide further explanations about the scope. In particular, we consider that in the strict interpretation of the definition of BCUCC contained in the IFRS 3 it would be included dissolutions with refund of contributions, share capital reductions, demergers, distributions of dividends when there is a transfer of a business involved and reverses merges (for instance, a subsidiary company absorbs the parent company), although we would like to confirm this interpretation from the IASB.

Initially, the ICAC does not appreciate sufficient arguments to conclude that the application of two methods to the BCUCC is an adequate approach based on the criterion that non-controlling shareholders participate in the receiving company or that have their shares traded in a public market.

The inclusion of this dividing line, fundamentally the one relating to non-controlling shareholders, may result that the participation in the shareholding of the subsidiary can be instrumented in such a way as to avoid the application of the book value method. We are aware that preserving relevant

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information based on fair value is a desirable objective when non-controlling shareholders participate in the acquiring or acquired subsidiaries. However, when this principle conflicts with the rationale behind the book value method in the BCUCC (reliability of valuations in the absence of conflicting interests), we consider that it is preferable to maintain the book value method for all operations in those that the acquired business, before and after the transaction is kept under common control.

However, we do consider it necessary to exempt the book value method and follow the acquisition method when the consideration given is in cash or by the issuance of a liability because, from the perspective of the separate financial statements and the preparation of the individual annual accounts, the application of the book value method in these cases can cause a serious equity problem.

Therefore, we would like to recommend to the IASB that it analyze the implications of the sale of a business in the absence of accumulated earnings in the receiving company that can absorb the loss of equity that originates in the latter due to the difference between the fair value of the consideration given and the preceding book value of the elements that make up the business received.

According to the Spanish GAAP, BCUCC are accounted applying the book-value method, with the book values of the consolidated financial statements of the parent entity when the consideration is paid with the own shares. Any differences in the book-value method between the consideration paid and acquired net assets are recognized in reserves.

However, in our opinion if the acquisition method is applied, the general standard should be followed and therefore, any negative difference should appear in Profit and Loss always when there is evidence that the transaction price is the market price in conditions of free competition. Otherwise, any difference should be treated as a contribution or distribution, depending on whether the receiving company pays more or less of the fair value for the business it receives.

We agree that listed company have non-controlling shareholders but, for this reason also, we do not find practical differences derived of the reversion of the decision tree. We think that the decision tree should be an instrument for the best interpretation and application of the standard content. Notwithstanding, we do not appreciate any different concerns about applying the optional

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exemption in the modified decision tree from the original decision tree. Besides, the Spanish GAAP does not consider the companies with debt instruments listed relating to BCUCC. This would be a new perspective that may enter in contradiction with the scope of the project, the common control. Besides, we consider that EFRAG should give more guidance about its proposed new tree, in particular, about the option three "shares or debt traded in a public market or assets held in a fiduciary capacity".

Regarding the application of the book-value method, we would like to highlight that in Spanish GAAP it is used the book values of the controlling party in its consolidated financial accounts. We support this option because provides a more recent valuation of the assets and liabilities acquired in consonance with IFRS. The use of the consolidated value leads to the same solution as the use of individual values in those cases where group companies have been formed within the group, provided that there are no internal transactions with results pending elimination. When businesses are acquired from third parties and subsequently the group agrees to an internal restructuring, the choice of the consolidated value allows a better representation of the accounting succession for reporting the acquisition price of the business between third parties.

Also, in relation to the assessment of the payment in other assets, we consider that, contrary to the proposal from the DP, it is more appropriate to use its fair value, and not at book value, since it would be a derecognition of assets, and according to the applicable IFRS, it would entail the recognition of the result. It could be possible as well that the BCUCC could be used to hide capital gains or capital gains or losses on assets. We disagree with the argument of the DP about the difficulty of valuing a non-cash asset, that is not applied to many other transactions, e.g., exchanges of fixed assets. Specifically, we understand that the general standards should be applied, including those relating to exchange of operations.

We share the view that it is not necessary to prescribe when the book-value method is applied, in which component, or components of equity of the receiving company should be presented the difference between the consideration paid and the book value of the assets and liabilities received in the BCUCC. However, the IFRS standards do distinguish when something is a contribution/distribution of equity or when it is a result. Consequently, we consider that the IASB should provide an analysis of the nature of the equity adjustment. It seems logical to consider that,

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according to the underlying logic of applying the book-value method, it would be more appropriate to consider that we are facing a contribution/distribution of equity.

We would like to point out that in Spanish GAAP the pre-combination information is required form the beginning of the reporting period, but only if any of the companies involved entered in the common control during the year the BCUCC is carried out. In the other case, it is used the combination date.

Finally, it should be noted that the ICAC is currently conducting a more in-depth analysis of these transactions with the aim of approving a development standard on BCUCC and that in view of how the debate evolves within the working group created, it is possible that the position expressed by the Institute also can be nuanced in the future.

Please don't hesitate to contact us if you would like to clarify any point of this letter.

Yours sincerely,

Santiago Durán Domínguez

Chairman of the ICAC

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