

BUSINESS COMBINATIONS UNDER COMMON CONTROL: PERSPECTIVES FROM PORTUGAL SUMMARY REPORT

8 July 2021



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Introduction

In order to receive input from Portuguese constituents and to stimulate the discussion around the IASB® Discussion Paper on *Business Combinations under Common Controls* ('the DP'), EFRAG organised a joint outreach event with the Comissão de Normalização Contabilística (CNC-Portugal), the Ordem dos Revisores Oficiais de Contas (OROC) and the IFRS Foundation on 8 July 2021. This report has been prepared for the convenience of European constituents to summarise the event and will be further considered by the involved organisations in the respective due process on the IASB proposal.

The program of the event and the speaker's biographies can be consulted [here](#).



Lúcia Lima Rodrigues, CNC-Portugal Vice-President

Saskia Slomp, EFRAG CEO

Tadeu Cendon, IASB Board Member

Chiara Del Prete, EFRAG TEG Chairwoman

Pedro Aleixo Dias, Chair CNC Private Sector Accounting Standards Committee

Fernando Araújo, Executive Board Member at The Navigator Group

Filipe Romão, partner at Uría Menéndez Proença de Carvalho

Nuno Martins, partner at PwC Portugal

Filipe Camilo Alves, EFRAG

Luisa Anacoreta, CNC Portugal

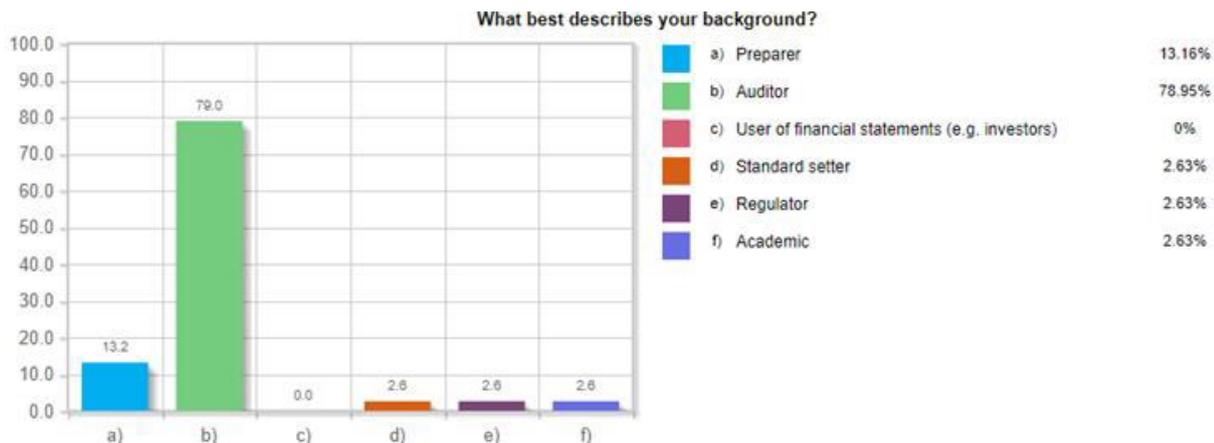
Mário Freire, Board Member at OROC

Saskia Slomp, EFRAG CEO, on behalf of EFRAG welcomed participants and panel members of this Portuguese event and provided an overview of the agenda consisting of two main topics:

- *Topic 1 – Project scope and selecting the measurement method*
- *Topic 2 – Applying the acquisition method, applying a book-value method and disclosures*

Saskia Slomp referred to EFRAG's draft comment letter (DCL) and outreach activities as a way to receive input from its constituents and to stimulate the discussion around the IASB® DP. Saskia Slomp also referred to the [EFRAG factsheet](#) on EFRAG's DCL and the EFRAG Secretariat [Briefing Business Transfers under Common Control – Potential Impact of the IASB's Proposals](#).

Finally, she launched the first polling question on the profile of the audience.



Lúcia Lima Rodrigues, welcomed the participants and panel members and referred to the successful collaboration between CNC-Portugal, OROC, IFRS Foundation and EFRAG. She noted that this topic is extremely relevant to Portugal as business combinations under common control (BCUCC) are very common. Usually, they are related to group restructurings, which aim at improving economic and tax efficiencies within a group.

Lúcia Lima Rodrigues also highlighted that the lack of a specifically applicable IFRS Standards had resulted in diversity in practice in preparing IFRS financial statements. For example, in some cases companies reported these combinations using the acquisition method set out in IFRS 3 *Business Combinations*, whereas in other cases companies used a book-value method. Also, a variety of book-value methods were being used in practice. She also noted that local company law requirements could influence the accounting policies adopted by the management.

Finally, she remarked that currently there are lack of disclosures on BCUCC. Therefore, she welcomed that the IASB’s project explored potential requirements for disclosures.

Pedro Aleixo Dias moderated the panel member discussions on the two topics mentioned above and managed questions and responses from the audience.

The IASB representatives introduced the proposals, the EFRAG representatives presented EFRAG’s preliminary position, and the panellists participated in the discussion and provided their views. The IASB and EFRAG’s presentation can be consulted [here](#).

The audience provided their views on the proposals as illustrated below through polling surveys and asked questions to the speakers (below reported as “SLIDO Q&A”).

Discussion

Topic 1 – Project scope and selecting the measurement method

Tadeu Cendon, IASB Board Member provided a brief overview of the IASB's preliminary views included in the Discussion Paper which aimed at reducing diversity in practice, improving transparency in reporting these combinations and providing users of financial statements with better information. He explained that the project is considering transfers of businesses under common control and that the IASB's preliminary view was that one size does not fit all. In the IASB's preliminary view, the acquisition method should be used for combinations that affect non-controlling shareholders, subject to the cost-benefit trade-off, and a book-value method should be applied to BCUCC in all other cases.

Filipe Camilo Alves presented EFRAG's tentative positions on the IASB's preliminary views. He explained that EFRAG agrees with the scope of the project, however, it considers that the IASB should better describe what group restructurings are. He also noted that common control transactions (e.g., transfer of a group of assets that does not meet the definition of a business) is a comprehensive topic that needs to be discussed in the future, including the effects on the separate financial statements. He also explained that EFRAG agrees that a single measurement method is not appropriate for all BCUCC and supports the application of the acquisition method to BCUCC that affect the non-controlling shareholders of the receiving company (with limited exceptions). However, Filipe Camilo Alves highlighted that EFRAG proposes a few modifications to the IASB's decision tree on when to apply each method and that EFRAG is consulting constituents on the two possible modifications.

Pedro Aleixo Dias introduced the panel members and moderated the panel discussion on *Topic 1 – Project scope and selecting the measurement method*.

What are the most common BCUCC in Portugal?

Mário Freire explained that in Portugal BCUCCs typically encompass:

- transactions where one company is transferred to another company within the same group;
- transactions where an unincorporated business or a business segment is transferred to another company within the same group; and
- legal mergers or vertical integrations that involve the extinguishment of the transferred company.

Mário Freire also explained that in Portugal BCUCCs occur for different reasons. For example, management usually undertakes restructurings:

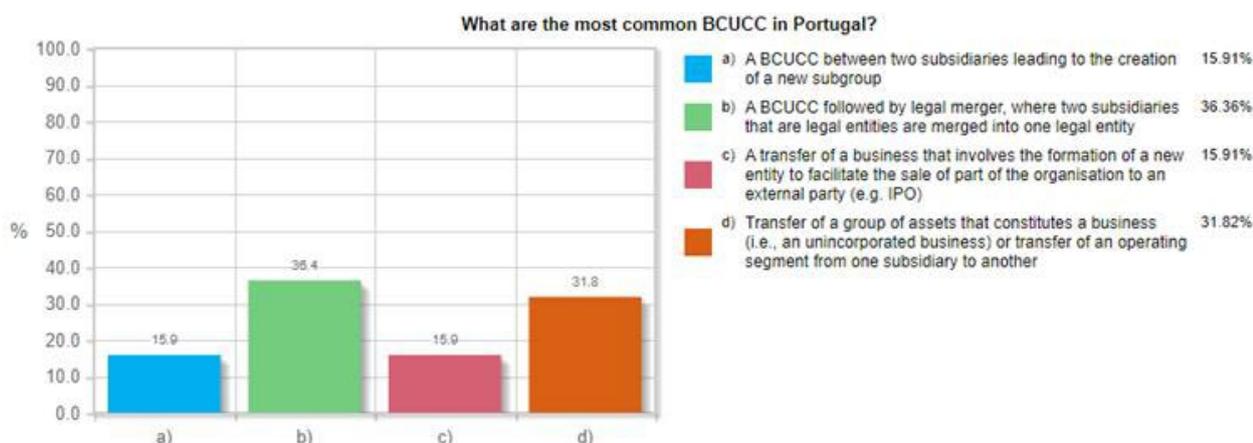
- to simplify the structure of a group;
- to prepare a family business succession by creating new subgroups that prepare consolidated financial statements;
- to prepare an Initial Public Offering (IPO) to sell a part of the business;
- to prepare a private placement to obtain financing with investors, and
- in preparation for a transformation of a company into a public interest entity.

Filipe Romão, added that tax was one of the main drivers for BCUCCs in Portugal. He also noted that the local corporate and tax framework significantly influenced management's decision on its restructuring approach. Finally, he mentioned that combinations that involved the transfer of an

unincorporated business, which would impact the separate financial statements of a company, typically took the form of:

- mergers and legal demergers
- transfer of a business for going concern purposes ('trespasse'); and
- contribution of a business to the equity of an entity.

Pedro Aleixo Dias introduced the polling question to the audience on what the most common BCUCC are in Portugal.



Who would be affected by the preliminary views in this Discussion Paper?

Mário Freire stated that many companies in Portugal would be affected by the IASB proposals. **Nuno Martins** and **Filipe Romão** agreed and added that in Portugal most of the BCUCC were accounted for under the acquisition method. Therefore, the IASB's preliminary views would lead to a significant change in practice.

Are there any other transactions that the IASB should consider?

Mário Freire highlighted that for some transactions, the 'notion of transitory control' as referred in IFRS 3 is relevant. He also highlighted that the notion of a business in IFRS 3 had been changed in 2018 and that the new definition of a business no longer reflects the purpose of 'lowering costs or other economic benefits directly to investors or other owners, members or participants'. He considered that the new IASB's definition was more restrictive and that some transactions would no longer be classified as a business combination as many restructurings were made with the objective of 'lowering costs'. This would put pressure on the accounting for other common transactions.

Which measurement(s) method(s) should apply to business combinations under common control (BCUCC)?

Many panel members were in favour of using the acquisition method in accordance with IFRS 3.

Nuno Martins referred that in Portugal most entities use the acquisition method in accordance with IFRS 3 to account for BCUCC. He also suggested that the IASB should focus on the substance of the transaction. That is, the IASB should focus on how different BCUCCs are in substance to justify a different accounting treatment rather than focus on when a BCUCC is similar to a business combination in accordance with IFRS 3.

Filipe Romão considered that if the objective was to achieve consistency and reduce diversity in practice, then he preferred the use of the acquisition method. This is because in most cases, a company would have to fair value its assets and liabilities for tax purposes (e.g., transfer pricing legislation). Therefore, in his view the cost-reduction argument did not justify the use of a book-value method. In addition, he considered that the acquisition method provided more relevant information to investors and regulators. Still, on certain specific transactions such as those involving real estate business, the controlling shareholders may appreciate having the book method value as it will result in a lower taxable basis for certain tax events occurring in a BCUCC (if the legal framework stays the same).

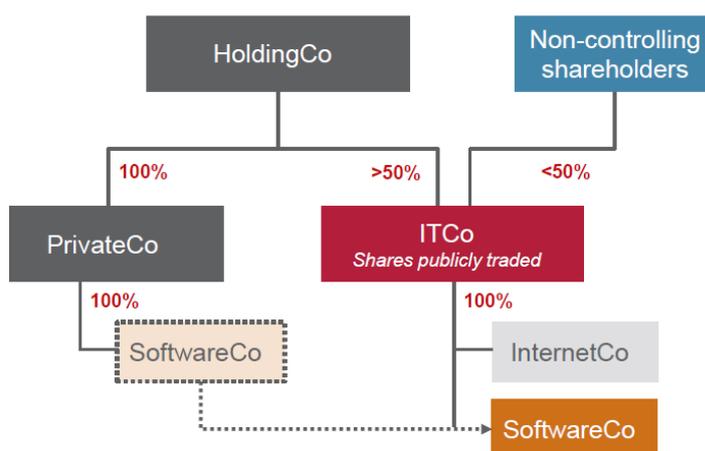
When should the acquisition method be applied to a BCUCC and when should a book-value method be applied to a BCUCC?

Fernando Araújo acknowledged that currently there was diversity in practice, however it was important to understand why companies opted for different measurement methods. Companies tended to consider the following factors when selecting a measurement method for BCUCC:

- the impact of the different measurement methods on the level of debt of the company, particularly if there were contractual financial covenants. For example, the use of the acquisition method could have a positive impact for the entity in terms of meeting its financial covenants;
- the impact of the different measurement methods on local tax compliance. For example, the use of the book values may help a company achieve the tax neutrality principle; and
- the impact of different measurement methods on the distribution of dividends in the year of the acquisition and in the following years.

Fernando Araújo generally agreed with the IASB’s preliminary views on when to apply each measurement method. However, he:

- questioned whether the measurement method to be used would be different depending on the structure of the transaction. For example, whether the accounting treatment was different if the SoftwareCo would be the acquirer rather than the target (IASB’s example). This could have a significant impact on how management structured a reorganisation of its group.

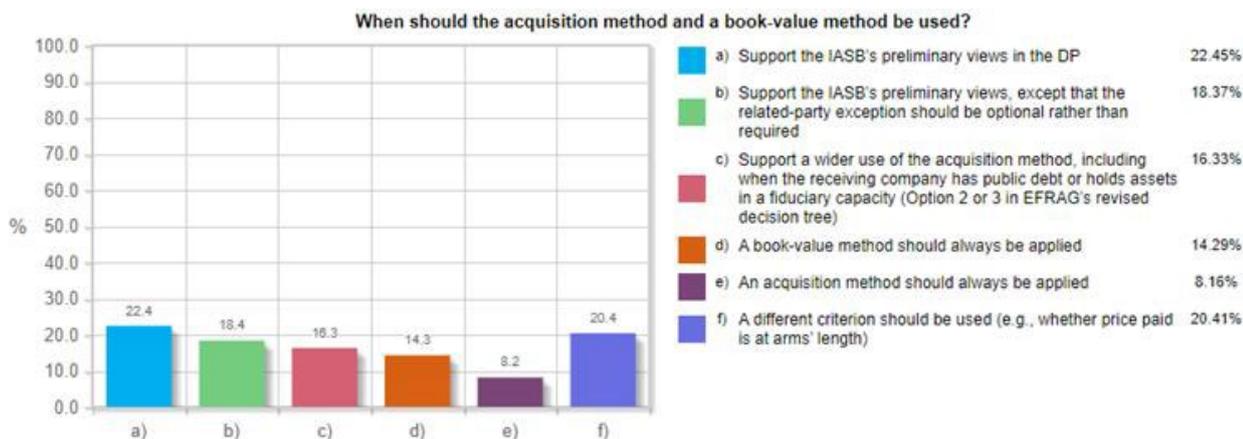


- concerning the optional exemption, suggested the introduction of a threshold for non-controlling shareholders to object the use of a book-value method as a single non-controlling shareholder could oppose to the use of a book-value method.

- noted that in many jurisdictions, including those outside of Europe, companies used book-value methods. Therefore, he questioned whether the IASB's proposals would be aligned with current practice at international level, particularly when considering U.S. GAAP requirements.

Finally, in his view, it did not make sense to extent the use of the acquisition method for privately held entities with debt traded in a public market, as lenders and other creditors usually preferred a book-value method as it was a more prudent method, particularly when considering the recognition of significant amounts of intangible assets.

Pedro Aleixo Dias introduced the polling question to the audience on when the acquisition method and a book-value method should be used.



Mário Freire noted that when applying the acquisition method in BCUCC, usually companies in Portugal made a revaluation of the previously recognised assets and liabilities of the transferred entities but were reluctant to recognise new intangible assets. This was to avoid a book-value method and its significant impact on equity.

Mário Freire and **Nuno Martins** highlighted that companies used the equity method in the separate financial statements and questioned the impact of the IASB's preliminary views on the equity method of the receiving entity.

Fernando Araújo highlighted that the results of the polling question reflected the idea that one size does not fit all. In addition, he considered that the IASB's preliminary views could reduce diversity in practice but not eliminate it. Finally, he highlighted that there was not only diversity in practice on the use of a book-value method but also diversity in practice on the use of the acquisition method in Portugal.

Filipe Romão, preferred the use of an improved acquisition method rather than using different methods in a BCUCC (book-value method and acquisition method) as there were too many variables involved in a BCUCC, making it difficult to reach a consensus on one or more criteria for the selection of a measurement method.

Q&A: *What are the current views of IASB, EFRAG or the panel on previously held interests in the receiving company? Should the remeasured be in equity or profit or loss.*

Tandeu Cendon replied that the IASB had not discussed detailed guidance on previously held interests in the receiving company. However, in his view preparers applying the acquisition approach would have to apply the existing guidance in IFRS 3. For preparers applying the book value method, any difference between the consideration paid and the assets and liabilities assumed would be presented in equity.

Q&A: *Does the panel envisage any impacts on the asset management sector?*

Mário Freire did not expect significant consequences if companies would still be able to use the acquisition method in accordance with the DP. If a book-value method would be used, then there may be impacts.

Topic 2 – Applying the acquisition method, applying a book-value method and disclosures

Tadeu Cendon, IASB Board Member provided a brief overview of the IASB's preliminary views included in the DP. He explained that the receiving company should not be required to identify, measure and recognise a distribution from equity. However, the receiving company should recognise a contribution to equity if the fair value of the assets and liabilities received in BCUCC exceeded the fair value of the consideration paid. Tadeu Cendon also explained the IASB's preliminary view on a single book-value method, including the IASB's view on how an entity should measure the assets and liabilities received; measure the consideration paid; report the difference between those amounts; and provide pre-combination information.

Chiara Del Prete presented EFRAG's tentative positions on the IASB proposals. EFRAG agreed with the IASB that it should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity. However, EFRAG was consulting its constituents whether a contribution to equity should be recognised. In general, EFRAG agreed with the IASB's preliminary views on how to apply the book-value method. However, EFRAG was consulting its constituents on the advantages and disadvantages of using the carrying amounts in the consolidated financial statements of the transferred company's controlling party and use of the carrying amounts in the financial statements of the transferred company.

Pedro Aleixo Dias moderated the panel discussion on applying the acquisition method, applying a book-value method and disclosures.

Applying the acquisition method to BCUCC: Should the IASB require the receiving company to recognise a distribution from or a contribution to equity when applying the acquisition method?

In general, panel members were in favour of using the acquisition method in accordance with IFRS 3. They considered that the recognition of a distribution of equity or contribution to equity seemed a theoretical approach when considering that they were unlikely to occur.

Nuno Martins considered that distributions from equity were unlikely to occur in practice in BCUCC that affect non-controlling shareholders of the receiving company, particularly when considering:

- the existing legal requirements and regulations (e.g., transfer pricing regulations) designed to protect the interests of non-controlling shareholders;
- the difficulties in assessing whether there is an overpayment as, for example, a company might take into account own synergies when determining the price for a business combination; and
- the unlikelihood of the group deciding to make a contribution to non-related minority shareholders.

Nuno Martins also considered that the IASB was being very conservative in relation to contributions to equity, when such contributions were unlikely to occur in BCUCC that affect non-controlling shareholders of the receiving company.

Therefore, from an economic point of view, **Nuno Martins** considered the acquisition method in accordance with IFRS 3 would be the best approach to account for BCUCC that affect non-controlling shareholders of the receiving company.

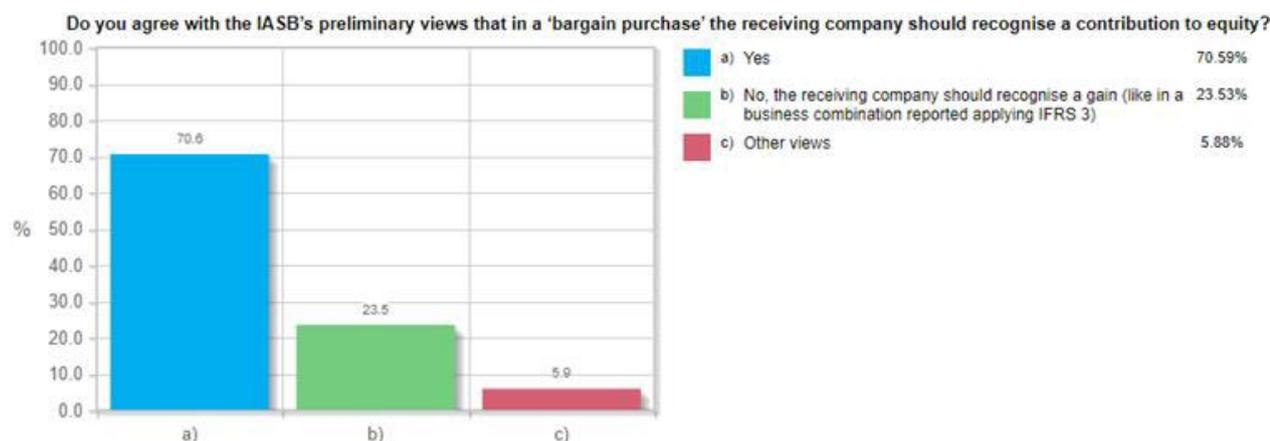
Fernando Araújo agreed. In his view, it did not make sense to create different versions of the acquisition method.

Mário Freire considered that the notion of distribution from equity could be misleading and easily confused for distribution of dividends. He acknowledged the dilemma of recognising a bargain purchase in profit or loss when the transaction is with the owners acting in their capacity as owners. Still, he also favoured using the acquisition method in accordance with IFRS 3, without any modification.

Filipe Romão, understood the IASB’s reasoning for recognising any excess of the fair value of the identifiable acquired assets and liabilities over the consideration paid as a contribution to equity, rather than as a gain in the statement of profit or loss in equity. Nonetheless, he considered that:

- bargain purchases under common control were very unlikely to occur;
- regulators would raise many questions on these types of business combinations;
- the IASB’s preliminary view on contribution to equity would create an inconsistency with IFRS 3; and
- currently, Portuguese tax authorities treat any excess of the fair value of the identifiable acquired assets and liabilities over the consideration paid as a taxable gain. The IASB’s preliminary views would, from a tax perspective, raise an inconsistency between business combinations (the excess would be taxable) and BCUCC (the excess would not be taxable).

Pedro Aleixo Dias introduced the polling question to the audience regarding contribution to equity.



Nuno Martins thought that the results of the polling questions were aligned with the IASB’s preliminary views, therefore the IASB seemed to have convinced the audience with its arguments.

Should the receiving company provide pre-combination information about the transferred company when applying a book-value method, either on the face of primary financial statements or in the notes?

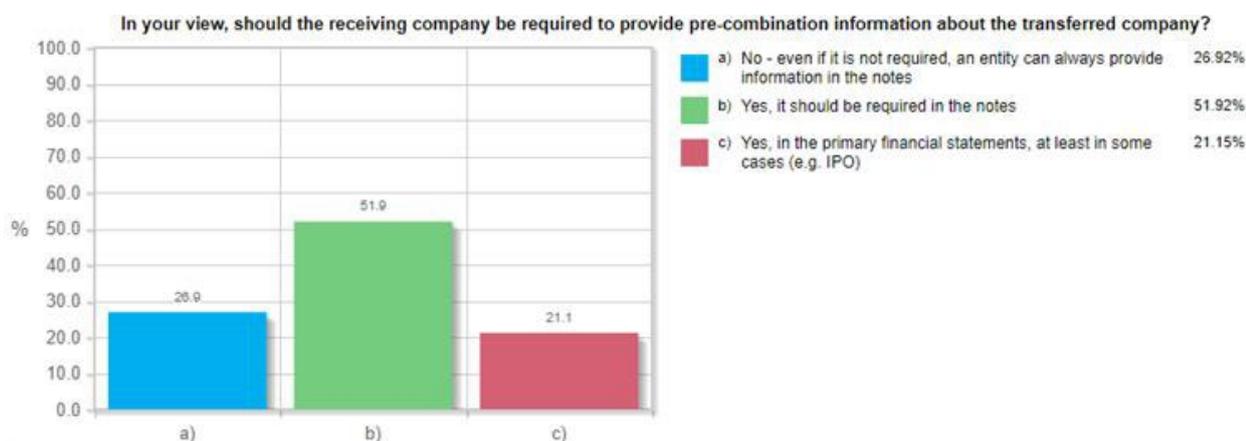
Panellists were generally in favour of a prospective approach, however in some specific circumstances pre-combination information could be useful (e.g., legal mergers).

Nuno Martins considered that the receiving company should include the transferred book values in its financial statements prospectively from the date of the combination, without restating pre-combination information. Otherwise, retrospective restatement of pre-combination information would depict a

combined company that in fact did not exist before the combination, would be judgemental and not be aligned with IFRS 3.

Fernando Araújo agreed and added that the prospective approach was easier and less costly to implement.

Pedro Aleixo Dias introduced the polling question to the audience regarding pre-combination information.



Fernando Araújo was surprised that the audience had showed a preference for requiring pre-combination information to be disclosed in the notes as it would be very costly for preparers. He would have agreed with providing limited pre-combination information about the transferred company but he would disagree with a complete retrospective approach.

Mário Freire considered that the usefulness of pre-combination about the transferred company would depend on the type of business combination. For example, for legal mergers, providing some information in the primary financial statements for the current period as though the acquisition had occurred at the beginning of the annual reporting period could be useful for users of financial statements.

How to apply a book-value method to BCUCC?

In general, panellists agreed with the IASB's preliminary views on how to apply a book-value method to BCUCC. However, it was noted that for tax purposes, the consideration paid in assets must be measured at fair value. An alternative approach was proposed where the difference between the consideration paid and assets and liabilities received would be recognised as an asset (e.g. synergies) that is amortised.

Fernando Araújo agreed with the IASB's preliminary views that the receiving company should use the transferred company's book values to measure the assets and liabilities received. This is because the book values recorded by the controlling party have no relation to the transaction because the controlling party is not a party of the business combination. He acknowledged that some favoured using the controlling party's book values because in some cases those values may be more up to date. However, if the objective was to have more up-to-date values, then the acquisition method would be the best approach.

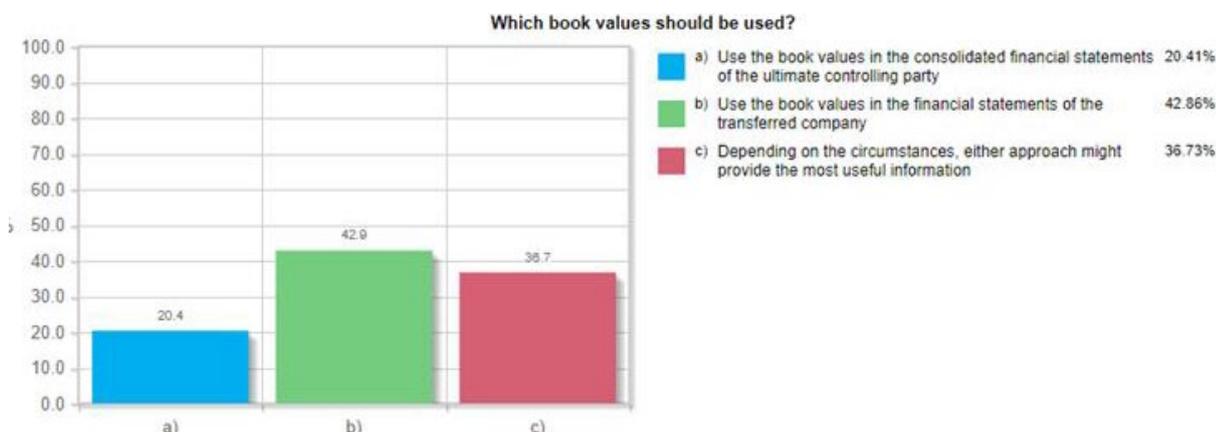
Fernando Araújo also agreed with the IASB's preliminary views regarding transaction costs. He also agreed with the IASB's preliminary views that consideration paid in assets should be measured at the receiving company's book values of those assets at the combination date. He disagreed with the use of the fair value to measure the consideration paid in assets as it would be inconsistent with the measuring of the assets and liabilities received at their book values.

Filipe Romão noted that for tax purposes, the consideration paid in assets must be measured at fair value.

Mário Freire agreed with the IASB's preliminary view that an approach that would require the difference between the consideration paid and assets and liabilities received into different components (contribution, distribution, unrecognised goodwill, etc) would be costly and complex to apply. This is because it would, for example, require a company to determine what would have been paid to an unrelated party in an arm's length transaction. An alternative approach would be to recognise the difference between the consideration paid and assets and liabilities received as an asset (e.g., synergies) that is amortised. This would avoid a significant impact directly in equity.

Filipe Romão highlighted the importance of recognising any pre-existing goodwill in the acquired business. This should be clear in any future IFRS Standard on BCUCC.

Pedro Aleixo Dias introduced the polling question to the audience on what book values of the transferred company should be used.



Fernando Araújo was surprised by the mixed views received from the audience. The use of the book values in the financial statements of the transferred company, his favourite approach, was supported by 43% of the respondents. However, 37% of the respondents seemed to prefer an accounting option.

Main take aways

Luisa Anacoreta recalled that the lack of a specifically applicable IFRS Standard had resulted in diversity in practice in preparing IFRS financial statements. As noted by some panel members, companies in Portugal tended to use the acquisition method, therefore, the IASB's preliminary views would represent a significant change to current practice in Portugal.

She highlighted that the IASB's project was going to have an impact on the individual and separate financial statements, in particular it would have an impact on tax and corporate law. Therefore, it was important to have this topic discussed by auditors, preparers and tax lawyers, which would provide different but complementary perspectives.

She pointed out that the cost argument against the use of the acquisition method was not so significant as companies already had to calculate the fair values of the assets and liabilities for tax purposes.

Another important point mentioned by the panellists was that the IASB's preliminary views might not eliminate completely the diversity in practice as both the acquisition method and the book-value method were being applied differently.

Luisa Anacoreta also recalled that some panellists had questioned the IASB's preliminary views to focus on non-controlling shareholders when selecting a measurement method for BCUCCs. For example, some panellists suggested that the IASB should focus instead on the substance of the transactions or define a threshold for minority shareholders.

There had been also many questions on whether the IASB's preliminary views were, in some cases, too theoretical and not aligned with practice.

Luisa Anacoreta also observed that the audience had provided mixed views, showing that there are different perspectives on BCUCC and that it will be difficult to reach a consensus.

Finally, she noticed that preparers had highlighted the importance of having cost-benefit considerations when developing a future IFRS Standard on BCUCC.

Closing remarks

Mário Freire welcomed the IASB's DP and highlighted the importance of debating BCUCC, as such transactions are very common and relevant in Portugal and there was lack of guidance on how to account for them. He also welcomed EFRAG for raising the debate, promoting European views and ensuring that these views were properly considered by the IASB. Finally, Mário Freire explained that OROC was happy to contribute and help the debate with the objective of reducing diversity in practice and having more consistency in the future on BCUCC.