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Re: DP/2020/2 Business Combination under Common Control

Dear Jean-Paul,

We are pleased to have the opportunity to provide our comments on the EFRAG Draft Comment Letter on the Discussion Paper *Business Combination under Common Control* issued by the IASB on 30 November 2020 (the DP).

We welcome the DP and we really appreciate the IASB's efforts to address the current lack of guidance on the accounting for business combinations under common control (BCUCC). BCUCC are common in Italy and may have a significant impact on the financial statement of both the transferring and the receiving companies. We believe that the proposals in the DP represent a significant step forward that would reduce diversity in practice, improve comparability and consistency of reporting and provide more relevant information for users of financial statements. Consequently, we recommend the IASB to prioritize the finalization of this project.

We generally agree with the IASB proposals, however we have the following comments.

Scope

Investments in subsidiaries acquired in common control transactions

The focus of the DP is how to report BCUCC in the consolidated financial statements of the receiving company (the buyer). In Italy many subsidiaries of listed companies and banks prepare separate financial statements (SFS) according to IFRS Standards and these financial statements are statutory financial statements that are used for tax purposes, dividends and capital requirements.

The proposals in the DP apply to the SFS of the receiving company only if the BCUCC involves the transfer of an unincorporated business. However, the DP is not addressing how a receiving company should report in its SFS an investment in a subsidiary received in a BCUCC (i.e. a BCUCC that involves the transfer of a business incorporated in a legal entity is outside the scope of the DP). The DP states that this topic is addressed by IAS 27.

We do not support this approach, because we do not see a substantial difference between the transfer of an unincorporated business and the transfer of a business incorporated in a legal entity. Consequently, we strongly recommend the IASB to expand the scope of the project to include the accounting for BCUCC that involves the transfer of investments in subsidiaries in order to ensure consistency in the accounting for the acquisition of a business under common control regardless of whether it is incorporated into a legal entity or not.

If the IASB confirmed that this transaction must be accounted for in accordance with IAS 27, then it should clarify how the cost of the acquired investment should be measured when the consideration paid is different from the fair value of the investment acquired. Indeed:

- some believe that the cost of the investment acquired should be measured at fair value of the consideration paid;
- others believe that the cost of the investment acquired is its fair value and the difference between the consideration paid and the fair value of the acquired subsidiary is recognised as an equity contribution or an equity distribution.

Legal mergers
Another common control transaction that is frequent in Italy is the legal merger between a parent company and one of its existing subsidiaries (i.e. a subsidiary acquired before the legal merger). In our understanding, the DP does not address how the parent company should report this transaction in its separate financial statements.
The predominant practice in Italy is to recognise this transaction applying the book-value method (using the parent's consolidated book values). We suggest the IASB to include these transactions in the scope of the project to avoid divergence in practice (i.e. some could argue that if the parent has non-controlling shareholders the acquisition method should be applied).

Transferring company
The proposals in the DP does not address the reporting by the transferring company. We recommend the IASB to include within the scope of the project the reporting by the transferring company. Although in current standards there is not a scope exemption of the UCC for the transferor, in our view it should be included in the project in order to investigate whether symmetrical accounting for both the transferring and receiving companies is needed. Indeed, existing IFRS Standards do not provide guidance on how the transferring company should recognise the difference between the consideration received and the book value of assets and liabilities transferred. From a conceptual point of view some believe that the difference between the consideration received and the book value of assets and liabilities transferred should be recognised in profit or loss (similarly to a loss of control of a business), whilst others would recognise this difference against equity (as a sort of distribution / contribution).

Selecting the measurement method
We agree that a single measurement approach is not appropriate for all BCUCC. We also agree that the acquisition method should apply to BCUCC that affect non-controlling shareholders (NCS), subject to the cost benefit trade-off, and that a book-value method should apply in all other cases.
However, we observe that the expression 'affecting non-controlling shareholders' used by the IASB in the DP to select a measurement method may be subject to different interpretations. For example, some could argue that "affects" means "a change in the ownership interest of the NCS in the receiving company". Thus, we suggest the IASB to clarify that when the receiving company has non-controlling shareholders the acquisition method is applied (subject to cost benefit trade-off). In other words, the driver for selecting the measurement method should be the presence of NCS in the receiving company.

In addition, we suggest the IASB to consider the introduction of "a materiality criterion" on the presence of NCS in the receiving company. This, in our view, would avoid structuring opportunities, for example the acquisition method is applied only because a NCS (that is not a related party) holds an immaterial interest in the receiving entity for a limited time period.

We agree that the acquisition method should be applied if the receiving company's shares are traded in a public market. However, we observe that the definition of public market used in the DP (i.e. a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) include over the counter market, which are markets where the participants trade bilaterally. Thus, we suggest the IASB to consider whether the definition of a public market is robust enough for selecting the measurement method.

Finally, we observe that the optional exemption proposed by the IASB introduces a "governance rule" that could be difficult to apply in practice (e.g. how and when the company should notify its non-controlling

shareholders or how long those shareholders should be given to raise any objections) and would impair comparability.

Applying the acquisition method

According to the DP, if the fair value of consideration paid is lower than fair value of the acquired assets and liabilities the receiving entity recognise a contribution to equity instead of a gain in the statement of profit or loss (as currently required by IFRS 3). We suggest the IASB to reconsider this proposal, because it seems not consistent with the assumption that BCUCC affecting NCS are similar to business combinations covered by IFRS 3.

We also suggest the IASB to provide guidance on how to identify the receiving entity (i.e. the acquirer) in situations involving a NewCo, because in this case applying the existing guidance in IFRS 3 might challenging.

Applying the book value method

The IASB in his preliminary view considers that, when applying a book-value method to a BCUCC, the receiving company should measure the assets and liabilities received using the transferred company's book values.

We believe that using the book values in the consolidated financial statements of the controlling party would be more appropriate, for the following reasons:

- in this way the same assets and liabilities would be recorded at the same carrying amount in the different financial statements of the group;
- the financial statements of the transferred company might be prepared in accordance with national accounting principles different from IFRS standards, and thus the DP proposal might be difficult to implement;
- the book values in the consolidated financial statements of the controlling party may provide a more recent valuation of the assets and liabilities acquired in a previous business combination;
- the DP proposal would create an unnecessary difference with US GAAP.

Disclosure requirements

In general, we support the IASB proposals on the disclosure requirements, however:

- when applying the acquisition method, we suggest the IASB to consider whether additional disclosures on how the transaction price has been determined are needed, because BCUCC may not be priced at arm's length.
- when applying the book value method, we suggest the IASB to consider whether some pre-combination information might be useful to investors, for example the revenue and profit or loss of the combined company for the current reporting period, as if the combination had occurred at the beginning of the reporting period as already required by paragraph B64(q)(ii) of IFRS 3.

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,
Angelo Casò
(Chairman)