PERSPECTIVES FROM PORTUGAL

BUSINESS COMBINATIONS UNDER COMMON CONTROL

8 July 2021

EFRAG
European Financial Reporting Advisory Group

Comissão de Normalização Contabilística

ORDEM DOS REVISORES OFICIAIS DE CONTAS
Integridade. Independência. Competência.

IFRS®

Disclaimer: The views expressed in this presentation are those of the presenter, except where indicated otherwise.

AGENDA

Time	Agenda item	Speakers
09:30 – 09:40	Opening and welcome	Lúcia Lima Rodrigues, Saskia Slomp
09:40 – 11:45	Overview of IASB proposals and EFRAG’s preliminary position	Tadeu Cendon, Chiara Del Prete, Filipe Alves
	Portuguese Perspectives on the possible reporting requirements for BCUCC • Topic 1 - Project scope and selecting the measurement method • Topic 2 – Applying the acquisition method, applying a book-value method and disclosures	Fernando Araújo Filipe Romão, Nuno Martins, Mário Freire
11:45 – 11:55	Main take aways	Luisa Anacoreta
11:55 – 12:00	Closing Remarks	Mário Freire

SPEAKERS

Welcome speakers

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

TOPIC 1 – SCOPE AND MEASUREMENT METHOD THE IASB PRESENTATION

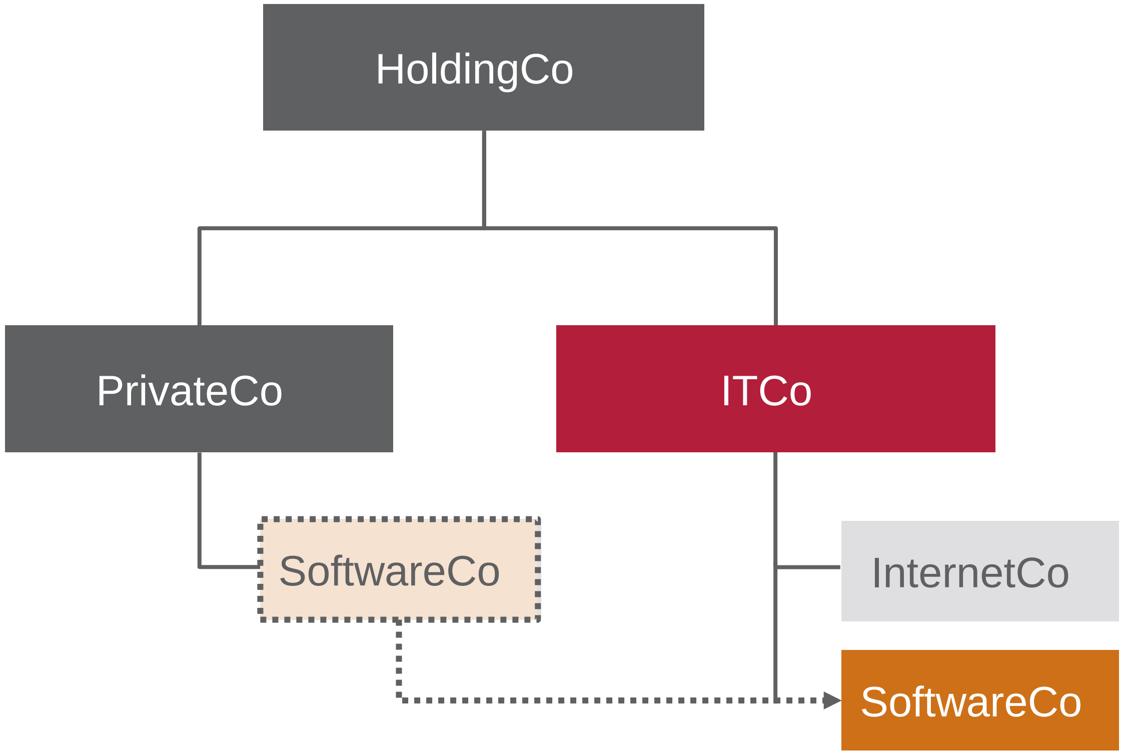
Introduction

Business combinations under common control
An illustration

ITCo buys SoftwareCo from PrivateCo.

ITCo and SoftwareCo are controlled by HoldingCo, both before and after the combination.

This is a business combination under common control.



We are considering the reporting by the receiving company, ITCo, and focus on information needs of users of its financial statements.

Why is the Board doing the project?

A gap in IFRS Standards results in diversity in practice and lack of transparency

Business combinations Addressed by IFRS 3 *Business Combinations*	The acquisition method is applied
Business combinations under common control NOT addressed by IFRS Standards	The acquisition method and a variety of book-value methods are applied

What information do those methods provide?

	Acquisition method as per IFRS 3	Book-value method is not defined
Assets and liabilities received	Measured at fair values	Measured at various book values
Intangibles and contingent liabilities	All identifiable assets and liabilities received are recognised	Only previously recognised assets and liabilities are recognised
Goodwill	Recognised	Not recognised
Pre-combination information	Excludes the transferred company	Diversity in practice
Disclosure	Comprehensive disclosure	Little disclosure

What improvements is the Board aiming for?

Better information for investors without imposing unnecessary costs on preparers

Relevance	Accounting method used provides useful information
Comparability	Similar transactions are reported in a similar way
Transparency	Disclosures are improved

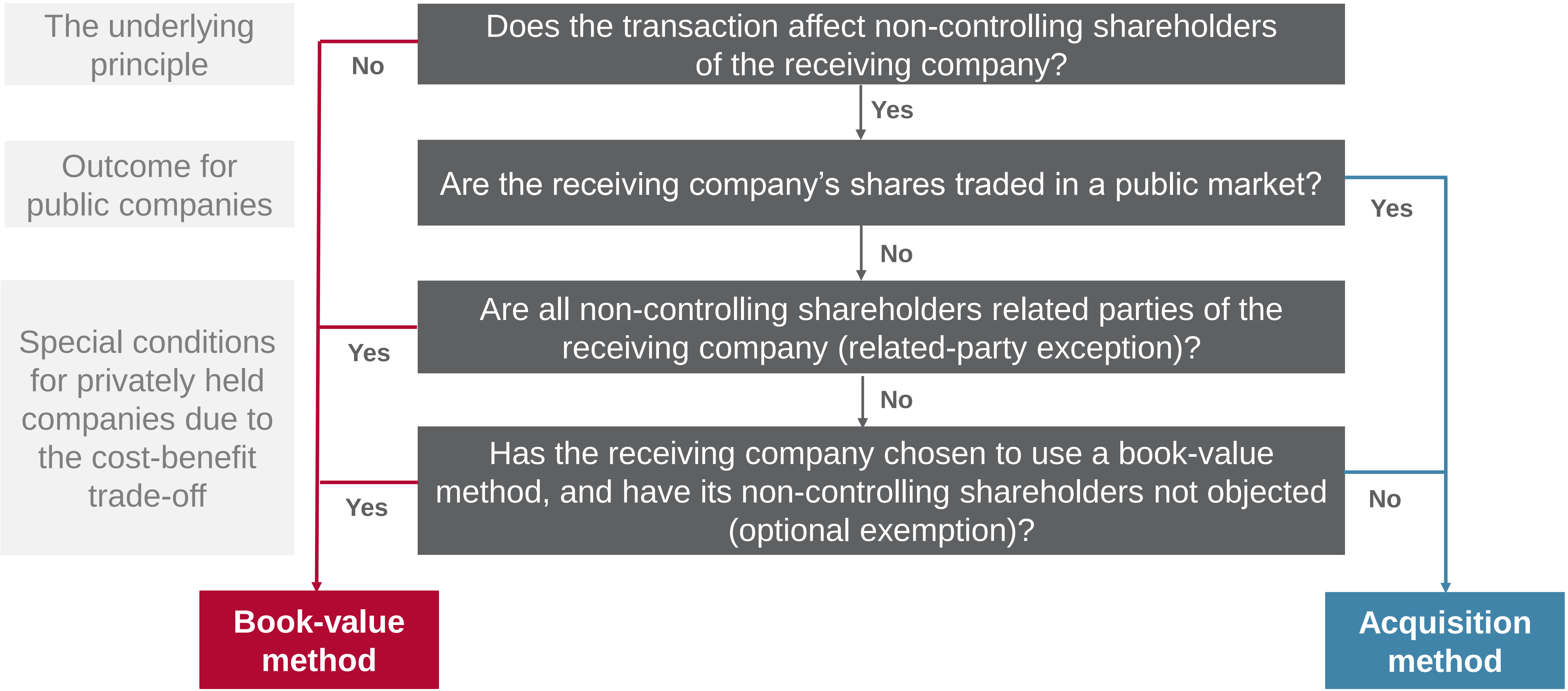
The acquisition method or a book-value method?

What are the Board's views?

One size does not fit all

A single method in all cases?	Neither the acquisition method nor a book-value method should apply in all cases
How to 'draw the line'?	In principle, the acquisition method should apply when non-controlling shareholders are affected
What about the cost-benefit trade-off?	There is an exception to and an exemption from the acquisition method for privately held companies
When to apply a book-value method?	A book-value method should apply in all other cases

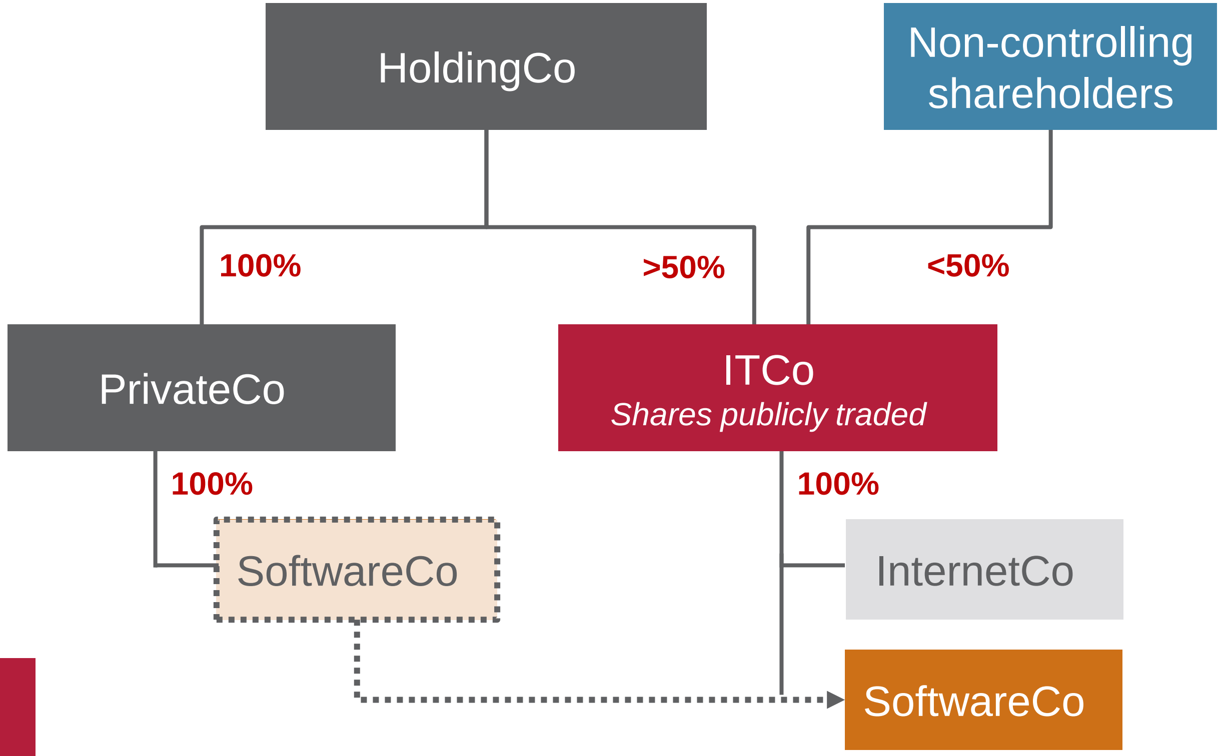
The Board's decision tree



Illustrating the Board's views
Non-controlling shareholders

Receiving company with a majority shareholder

- HoldingCo wishes to seek funding against its successful SoftwareCo, and decides to move SoftwareCo into the ITCo group.
- ITCo shares are publicly traded. It is controlled by HoldingCo but has non-controlling shareholders.
- ITCo buys SoftwareCo from PrivateCo for cash.



The Board's view is that the receiving company, ITCo, should use the acquisition method.

Why use the acquisition method?

Reporting by the receiving company, ITCo

	Acquisition method	Book-value method
Cash consideration paid	**CU 500**	**CU 500**
Software	CU 380	CU 20
Brand name	CU 50	-
Other net assets	CU 40	CU 40
Goodwill	CU 30	-
Total net assets recognised	**CU 500**	**CU 60**
Difference (recognised in equity)	**n/a**	**CU 440**

Provides information about fair values of SoftwareCo identifiable assets and liabilities, including:

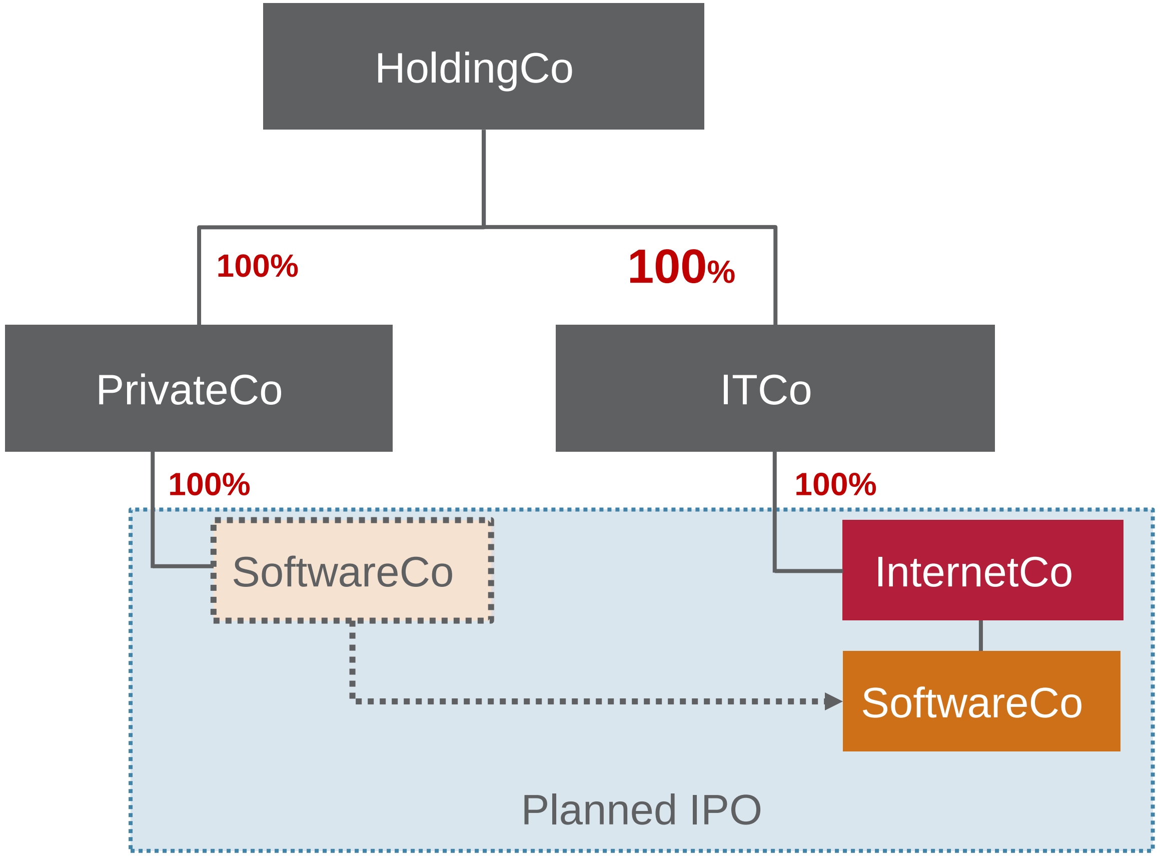
- brand name (previously unrecognised);
- software (previously measured at book value).

Does not provide information about fair values of SoftwareCo identifiable assets and liabilities; instead, reports a reduction in equity.

Illustrating the Board's views
Wholly-owned receiving company

Preparing for an IPO

- HoldingCo wishes to sell its wholly-owned businesses, SoftwareCo and InternetCo, together in an IPO.
- To organise its businesses into a single sub-group in preparation for an IPO, HoldingCo could, for example, transfer SoftwareCo to InternetCo…

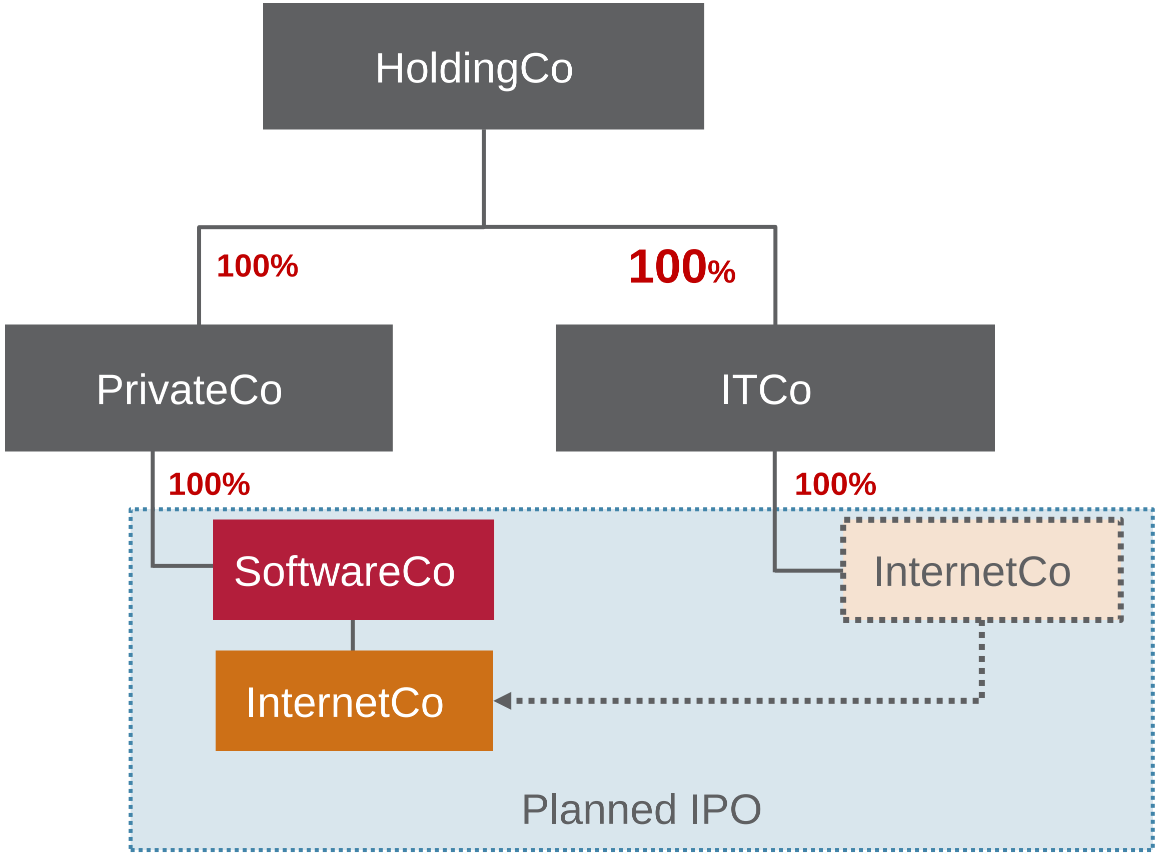


Illustrating the Board's views
Wholly-owned receiving company (continued)

Preparing for an IPO (continued)

- Alternatively, to organise its businesses into a single sub-group in preparation for an IPO, HoldingCo could transfer InternetCo to SoftwareCo.
- HoldingCo could also introduce a new holding company (NewCo) to acquire both businesses or legally merge the combining businesses into a single company.

The Board's view is that the receiving company should apply a book-value method so consistent information is provided regardless of how the combination is structured.



What about lenders and other creditors?

Information lenders and other creditors need is largely unaffected by whether the acquisition method or a book-value method is used

Economic interest	Payments of principal and interest
Credit analysis	Company's ability to service and raise debt
Information needs	Cash flows and debt commitments

Information about fair values of particular assets is useful but the outcome of credit analysis does not depend greatly on that information

TOPIC 1 – SCOPE AND MEASUREMENT METHOD
EFRAG PRESENTATION

SCOPE OF THE PROJECT

EFRAG TENTATIVE POSITION

- EFRAG agrees with the scope proposed by the IASB and welcomes that both BCUCC and group restructurings are in the scope
- The IASB should avoid labelling group restructurings that are not business combinations as BCUCC and better define ‘group restructurings’
- The IASB should consider whether there is a need to improve the description of ‘combination of entities or businesses under common control’ in IFRS 3 (e.g., clarify the meaning of ‘transitory control’) and/or align it with the definition used in this project
- Other common control transactions (e.g., transfer of a group of assets that does not meet the definition of a business) are an important and comprehensive topic that needs to be discussed in the future

EFRAG IS SEEKING STAKEHOLDERS’ VIEWS ON:

- EFRAG is asking its constituents whether it is important to clarify the meaning of ‘transitory control’ and whether the IASB has reached the right scope

SELECTING THE MEASUREMENT METHOD

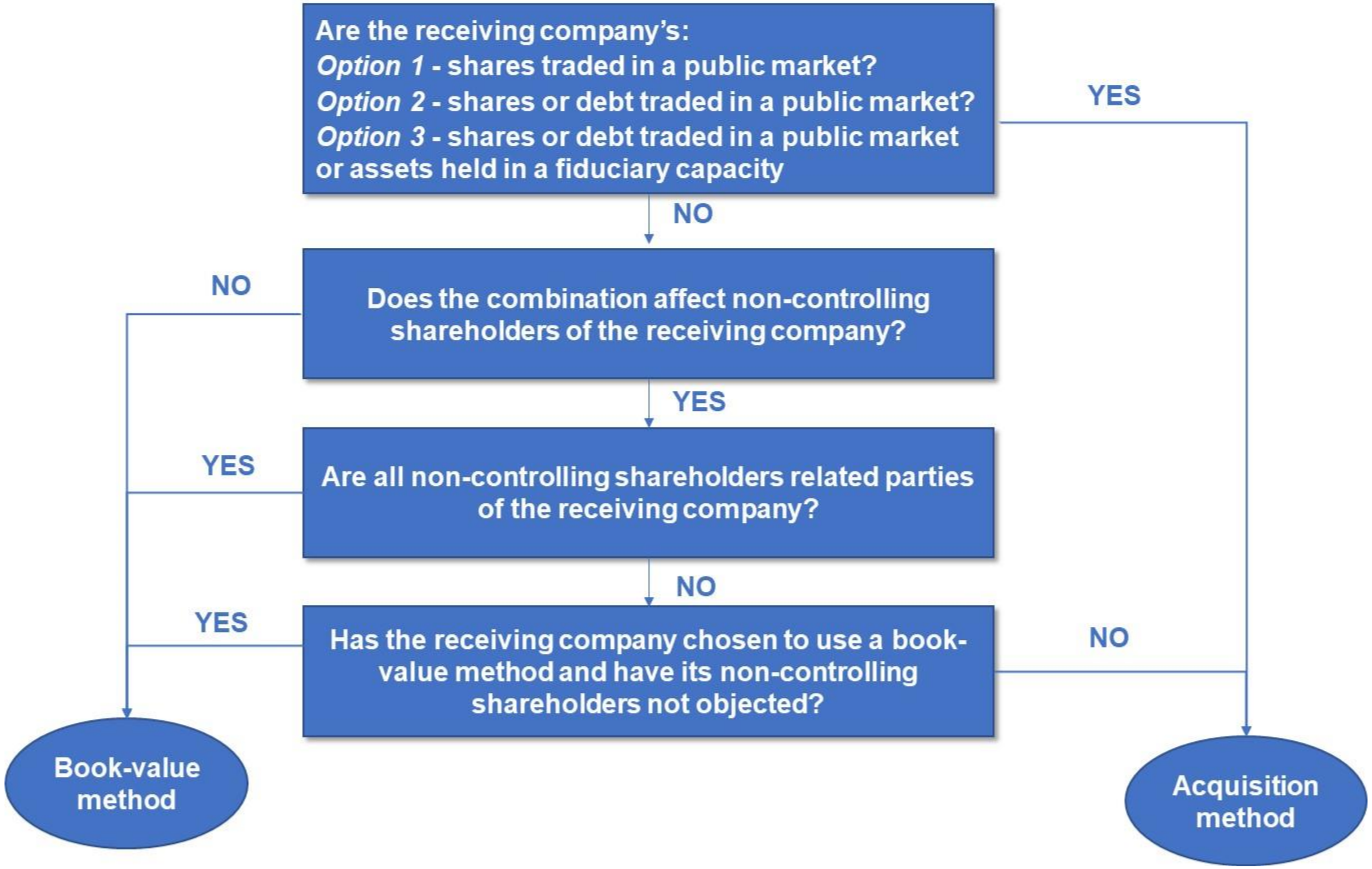
EFRAG TENTATIVE POSITION

- EFRAG agrees that the acquisition method or a book-value method should be used, as BCUCC are not a homogeneous population
- EFRAG agrees that when the receiving company has non-controlling shareholders, it should use the acquisition method (with limited exceptions)
- EFRAG cautions that selecting the measurement method will rely on the definition of a ‘public market’ which may not be robust enough. EFRAG also suggests that the IASB clarifies the meaning of the term ‘traded’

EFRAG IS SEEKING STAKEHOLDERS’ VIEWS ON:

- EFRAG is consulting constituents on possible modifications to the IASB’s decision tree
    - reversing Step 1 and Step 2 of the IASB’s decision tree; and
    - expanding the scope of entities included in the proposed new Step 1

EFRAG's DECISION TREE



SELECTING THE MEASUREMENT METHOD

EFRAG TENTATIVE POSITION ON EXCEPTIONS AND EXEMPTIONS

- EFRAG supports the **optional exemption** and the **related-party exception** to the acquisition method for privately-held entities with non-controlling shareholders
- EFRAG agrees with the IASB that:
  - the **optional exemption** from the acquisition method should not be extended to publicly traded companies because it will be difficult to operationalise the exemption
  - the **related-party exception** to the acquisition method should not be extended to publicly traded receiving companies as the exception will have limited application in practice

EFRAG IS SEEKING STAKEHOLDERS' VIEWS ON:

- EFRAG is consulting its constituents on whether the **related-party exception** should be optional rather than required as it is possible that the non-controlling shareholders (e.g., when having significant influence) will not have the information they need about the transaction

PERSPECTIVES FROM PORTUGAL: ROUND TABLE ON TOPIC 1





PANELLISTS

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

Mário Freire, Board Member at OROC

TOPIC 2 – ACQUISITION METHOD, BOOK-VALUE METHOD AND DISCLOSURES – IASB PRESENTATION

How to apply the acquisition method

IFRS®

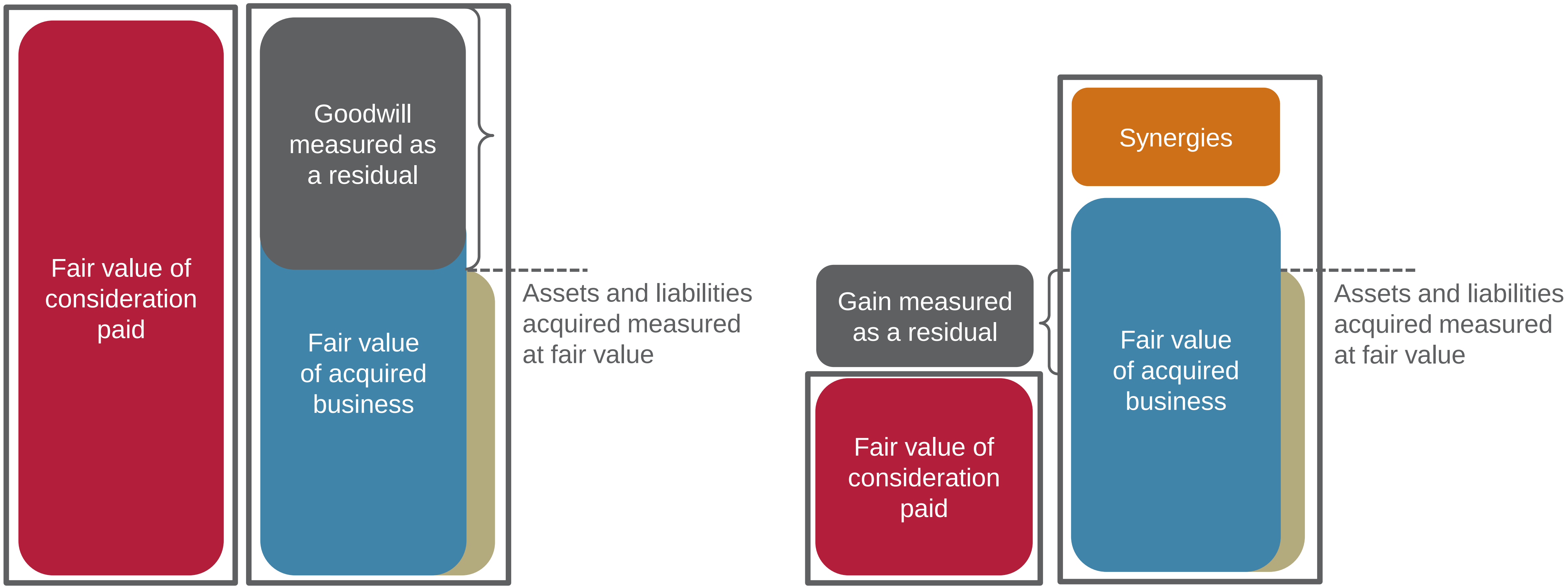
What are the Board's views?

The acquisition method is specified in IFRS 3 *Business Combinations*

General principle	Apply the acquisition method as set out in IFRS 3, including all disclosure requirements
Special feature	In rare cases of a 'bargain purchase', recognise a contribution to equity instead of recognising a gain
Additional disclosure	Disclose information about how the transaction price was determined

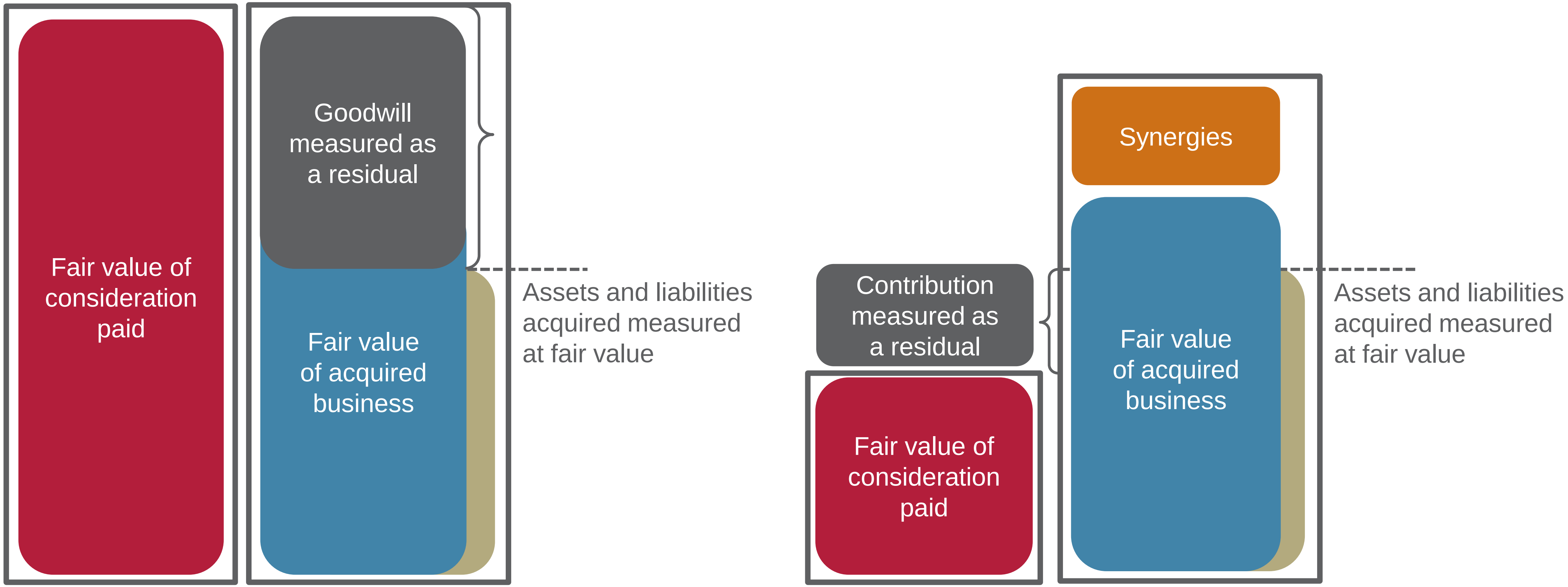
Illustrating the Board's views

Applying the acquisition method to business combinations…



Illustrating the Board's views

…and to business combinations under common control



How to apply a book-value method

What are the Board's views?

A single book-value method to be specified in IFRS Standards

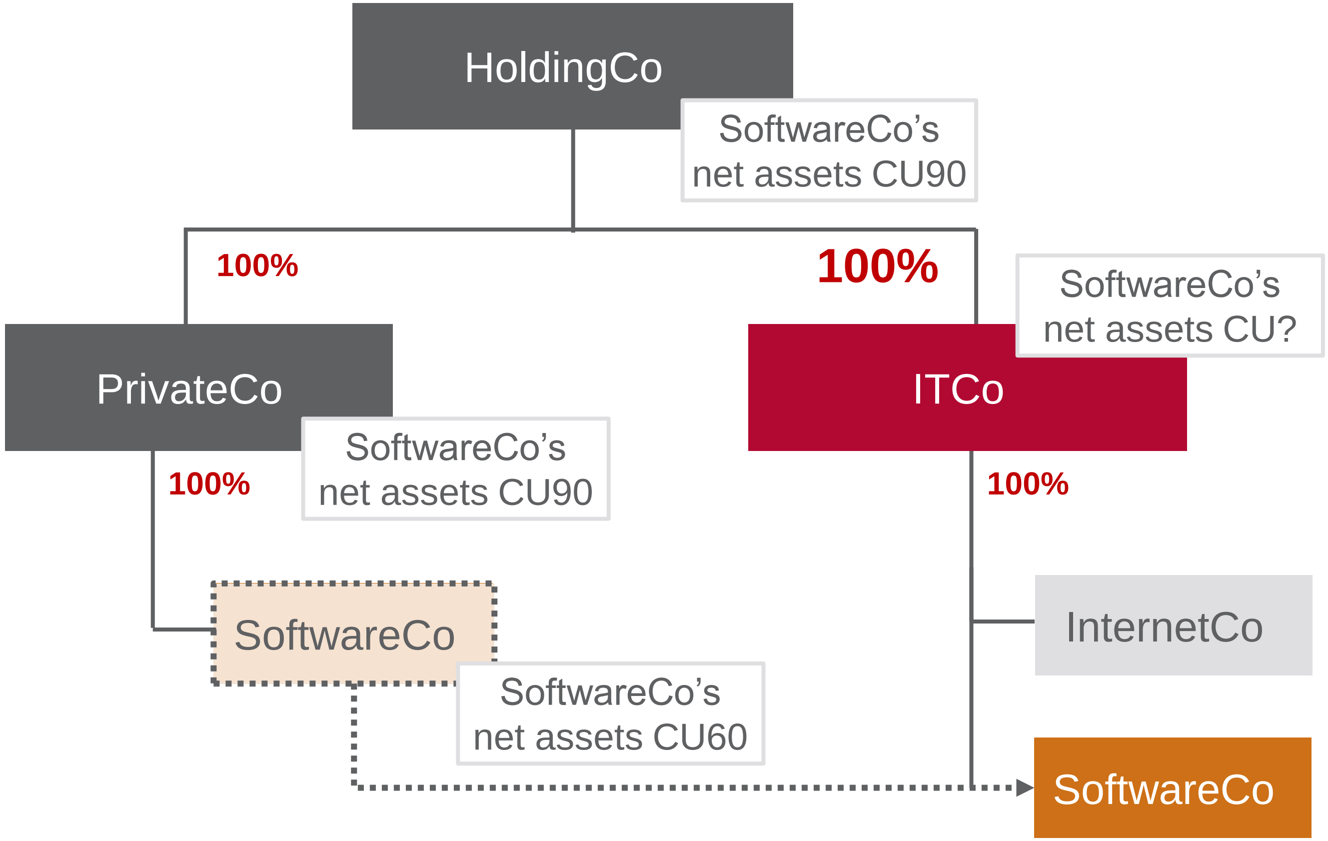
Assets and liabilities received	Measure at transferred company's book values
Consideration paid	Generally measure at book value
Transaction costs	Generally recognised as an expense
Difference	Recognise as an increase or decrease in equity
Pre-combination information	Include the transferred company prospectively, without restatement
Disclosure	A subset of IFRS 3 disclosure requirements and the difference in equity

Illustrating the Board's views

Which book values to use?

- SoftwareCo's assets and liabilities might be recognised at different book values by different companies.
- For example, PrivateCo could have acquired SoftwareCo in a business combination, recognising SoftwareCo identifiable assets and liabilities at fair value, and recognising goodwill.

The Board's view is that the transferred company's book values should be used.



Illustrating the Board’s views

If a retrospective approach is applied, pre-combination information is restated.

Combination date

	30 June 20X1 profit (CU)	31 December 20X1 profit (CU)	30 June 20X2 profit (CU)	31 December 20X2 profit (CU)
InternetCo	5	4	3	6
SoftwareCo	16	20	24	30
ITCo	21	24	27	36

$\underbrace{\text{30 June 20X1 – 30 June 20X2}}$

Receiving company’s consolidated financial statements for previous periods include the transferred company and so present a group that did not exist at that time.

Illustrating the Board's views

The Board's view is that the receiving company should use a prospective approach.

Combination date

	30 June 20X1 profit (CU)	31 December 20X1 profit (CU)	30 June 20X2 profit (CU)	31 December 20X2 profit (CU)
InternetCo	5	4	3	6
SoftwareCo				30
ITCo	5	4	3	36

Receiving company's consolidated financial statements for previous periods do not include the transferred company and so present the group that existed at that time.

TOPIC 2 – ACQUISITION METHOD, BOOK-VALUE METHOD AND DISCLOSURES – EFRAG PRESENTATION

HOW TO APPLY THE ACQUISITION METHOD

EFRAG TENTATIVE POSITION ON DISTRIBUTION FROM EQUITY

- EFRAG supports the IASB proposal to not develop a requirement to identify, measure and recognise a **distribution** from equity.
- EFRAG agrees that any difference between the consideration paid and what would have been paid to an unrelated party in an arm's length transaction is recognised in goodwill

EFRAG IS SEEKING STAKEHOLDERS' VIEWS ON CONTRIBUTION TO EQUITY

- EFRAG has not formed a final view on the notion of **contribution** to equity
- EFRAG is seeking views from its constituents on 2 alternative views. Either support:
  - **IASB proposals in the DP** – difference to be recognised in equity; or
  - **Consistency with IFRS 3 requirements** – difference to be recognised in profit or loss

HOW TO APPLY A BOOK-VALUE METHOD

MEASURING ASSETS AND LIABILITIES RECEIVED

- EFRAG considers that both of the following provide useful information:
  - Carrying amounts included in the financial statements of the transferred company (as suggested by the DP)
  - Carrying amounts included in the consolidated financial statements of the transferred company's controlling party (or ultimate controlling parties)

EFRAG IS SEEKING STAKEHOLDERS' VIEWS ON:

- EFRAG is seeking views from constituents on:
  - current practice
  - which approach do they agree with

HOW TO APPLY A BOOK-VALUE METHOD

MEASURING CONSIDERATION PAID AT COMBINATION DATE

- EFRAG **agrees with the DP proposals** on amounts paid
  - *In assets* – at receiving company's book values of those assets
  - *By incurring a liability* - at the amount determined on recognition of that liability applying IFRS Standards
  - *In own shares* – to not prescribe measurement
- EFRAG suggests that the IASB considers allowing the use of fair value measurement for consideration paid in assets as the information may be relevant for creditors and other lenders

EFRAG IS SEEKING STAKEHOLDERS' VIEWS ON:

- EFRAG is seeking views from constituents on if there are other forms of consideration paid apart from those identified in the DP and how common they are

HOW TO APPLY A BOOK-VALUE METHOD

EFRAG TENTATIVE POSITION ON REMAINING TOPICS

- EFRAG **agrees** with recognising within equity any difference between the consideration paid and the book value of the assets and liabilities received
- EFRAG **agrees** with not specifying presentation within equity
- EFRAG **agrees** that transaction costs should be recognised as an expense when incurred and costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS Standards
- EFRAG **agrees** that the receiving company 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

EFRAG IS SEEKING STAKEHOLDERS' VIEWS ON:

- EFRAG is consulting constituents on whether the IASB proposal on providing pre-combination information creates tension with current reporting requirements in some jurisdictions or be costly and difficult to apply in practice

DISCLOSURE REQUIREMENTS

- EFRAG supports the proposed disclosure requirements for BCUCC accounted for under the acquisition method
- EFRAG also agrees with the proposed disclosure requirements for BCUCC to which a book-value method is applied

PERSPECTIVES FROM PORTUGAL: ROUND TABLE ON TOPIC 2





PANELLISTS

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

Mário Freire, Board Member at OROC

TAKE AWAYS AND CLOSING REMARKS


Speakers

Luísa Anacoreta, CNC Portugal

Mário Freire, Board Member at OROC

EFRAG receives financial support of the European Union - DG Financial Stability, Financial Services and Capital Markets Union. The content of this presentation is the sole responsibility of EFRAG and can under no circumstances be regarded as reflecting the position of the European Union.

THANK YOU

EFRAG
Aisbl - ivzw
35 Square de Meeüs
B-1000 Brussel
Tel. +32 (0)2 210 44 00
www.efrag.org