COMITÊ DE PRONUNCIAMENTOS CONTÁBEIS
SAS Quadra 05. Bloco J. CFC
Brasília, Distrito Federal – Brazil
http://www.cpc.org.br

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commentletters@ifrs.org

IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD

Reference: Discussion Paper 2020/2 – Business combination under common control

The Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee)[1] welcomes the opportunity to respond to the Discussion Paper 2020/2 – Business combination under common control.

We are a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies.

If you have any questions about our comments, please do not hesitate to contact us at operacoes@cpc.org.br.

Yours sincerely,

Rogério Lopes Mota
Chair of International Affairs
Comitê de Pronunciamentos Contábeis (CPC)

[1]The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), B3 (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).

Question 1

Paragraphs 1.10–1.23 discuss the Board's preliminary view that it should develop proposals that cover reporting by the receiving company for all transfers of a business under common control in the Discussion Paper, collectively called business combinations under common control) even if the transfer:

a) is preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies to an external party (that is, a party outside the group); or

b) is conditional on a sale of the combining companies to an external party, such as in an initial public offering.

Do you agree with the Board's preliminary view on the scope of the proposals it should develop? Why or why not? If you disagree, what transactions do you suggest that the Board consider and why?

CPC's response:

CPC agrees with the Board's preliminary view in the meaning that it is necessary to provide disclosure information in the financial statements of the acquirer company.

CPC also considers that some guidance should be given to the separate (individual) statements of an acquirer firm. This topic is an issue for Brazilian entities since the local legislations adopted IFRS for both set of financial statements (individual and consolidated ones).

Question 2

Paragraphs 2.15–2.34 discuss the Board's preliminary views that:

a) Neither the acquisition method nor a book-value method should be applied to all business combinations under common control.

Do you agree? Why or why not? If you disagree, which method do you think should be applied to all such combinations and why?

b) In principle, the acquisition method should be applied if the business combination under common control affects non-controlling shareholders of the receiving company, subject to the cost–benefit trade-off and other practical considerations discussed in paragraphs 2.35–2.47 (see Question 3).

Do you agree? Why or why not? If you disagree, in your view, when should the acquisition method be applied and why?

c) A book-value method should be applied to all other business combinations under common control, including all combinations between wholly-owned companies.

Do you agree? Why or why not? If you disagree, in your view, when should a book-value method be applied and why?
and why?

CPC's response:

CPC agrees with the statement that neither the acquisition method nor the book value method should be applied to all BCUU because there are factors or circumstances that would determine that one or the other method is more relevant to reflect the economic substance of the transaction.

However, establish a method based on specific parameters and limited almost exclusively to the existence or not of a non-controlling interest in the receiving party, subject to the evaluation of the balance between costs and benefits and other practical considerations (such as those mentioned in paragraphs 2.35 to 2.47), can generate difficulties in capturing the substance of the transaction and even more, the balance between costs and benefits mentioned, even when it helps with the objective of reducing the diversity of observed practices

In the Brazilian capital market, for example, the accounting choices are entitled to companies' management, and it is not clear if the local legislation allows the Brazilian entities to provide to the non-controlling shareholders the option to select the accounting method to be applied in a BCUCC transaction.

Furthermore, the Brazilian corporate law establishes that in transactions involving corporate restructuring (e.g. BCUCC), must to be used the market value as a reference of securities especially aiming to protect the non-controlling interests (for more details please see Law 6.404, articles 254-A, 257 e 264).

Question 3

Paragraphs 2.35–2.47 discuss the cost–benefit trade-off and other practical considerations for business combinations under common control that affect non-controlling shareholders of the receiving company.

a) In the Board's preliminary view, the acquisition method should be required if the receiving company's shares are traded in a public market. Do you agree? Why or why not?

b) In the Board's preliminary view, if the receiving company's shares are privately held:

i) the receiving company should be permitted to use a book-value method if it has informed all of its non-controlling shareholders that it proposes to use a book-value method and they have not objected (the optional exemption from the acquisition method).

Do you agree with this exemption? Why or why not? Do you believe that the exemption will be workable in practice? If not, in your view, how should such an exemption be designed so that it is workable in practice?

ii) the receiving company should be required to use a book-value method if all of its non-controlling shareholders are related parties of the company (the related-party exception to the acquisition method).

Do you agree with this exception? Why or why not?

c) If you disagree with the optional exemption (Question 3(b)(i)) or the related-party exception (Question 3(b)(ii)), in your view, how should the benefits of applying the acquisition method be balanced against the costs of applying that method for privately held companies?

CPC's response:

CPC believes that, firstly, the economic substance of the transaction should be analyzed. In some capital markets, like in the Brazilian one, there is a massive presence of controlling shareholders in public companies, that could be an indication that the simple fact of both companies (acquired and acquirer) being publicly traded is not necessarily an indication of arm's length principle.

CPC agrees with the exemption for private entities once all the non-controlling shareholders agree with that accounting policy, and there is no local legal rule that forbids this exemption.

Question 4

Paragraphs 2.48–2.54 discuss suggestions from some stakeholders that the optional exemption from and the related-party exception to the acquisition method should also apply to publicly traded companies. However, in the Board's preliminary view, publicly traded receiving companies should always apply the acquisition method.

a) Do you agree that the optional exemption from the acquisition method should not be available for publicly traded receiving companies? Why or why not? If you disagree, in your view, how should such an exemption be designed so that it is workable in practice?

b) Do you agree that the related-party exception to the acquisition method should not apply to publicly traded receiving companies? Why or why not?

CPC's response:

CPC does not agree that to enforce all public companies to employ the acquisition method in a BCUCC is reasonable in terms of the economic substance. This disagreement is aligned with the prior concerns related to the fact that in the Brazilian capital market the non-controlling shareholders does not play a relevant role in the capital structure of public companies.

Furthermore, not providing an option for acquisition method for public companies could motivate some firms to apply push-down accounting by using the acquisition method for example.

Question 5

Paragraphs 3.11–3.20 discuss how to apply the acquisition method to business combinations under common control.

a) In the Board's preliminary view, it should not develop a requirement for the receiving company to identify, measure and recognise a distribution from equity when applying the acquisition method to a business combination under common control.

Do you agree? Why or why not? If you disagree, what approach for identifying and measuring a distribution from equity do you recommend and why? In particular, do you recommend either of the two approaches discussed in Appendix C or do you have a different recommendation?

b) In the Board's preliminary view, it should develop a requirement for the receiving company to recognise any excess fair value of the identifiable acquired assets and liabilities over the consideration paid as a contribution to equity, not as a bargain purchase gain in the statement of profit or loss, when applying the acquisition method to a business combination under common control.

Do you agree? Why or why not? If you disagree, what approach do you recommend and why?

c) Do you recommend that the Board develop any other special requirements for the receiving company on how to apply the acquisition method to business combinations under common control? If so, what requirements should be developed and why are any such requirements needed?

CPC's response:

CPC believes that the explanations about the acquisition method, as provided by the IFRS 3, is enough to also be employed in BCUCC transactions.

Related part B of this question, CPC agrees that the differences between the fair value must be recognized in the acquirer's equity.

CPC would like to request more guidance about how to disclose such transactions in the explanatory notes.

Question 6

Paragraphs 4.10–4.19 discuss the Board's preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should measure the assets and liabilities received using the transferred company's book values.

Do you agree with the Board's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

CPC's response:

CPC agrees when applying a book-value method to a business combination under common control, the receiving company should measure the assets and liabilities received using the transferred company's book values.

Question 7

Paragraphs 4.20–4.43 discuss the Board's preliminary views that:

a) the Board should not prescribe how the receiving company should measure the consideration paid in its own shares when applying a book-value method to a business combination under common control; and

b) when applying that method, the receiving company should measure the consideration paid as follows:

i) consideration paid in assets—at the receiving company's book values of those assets at the combination date; and
ii) consideration paid by incurring or assuming liabilities—at the amount determined on initial recognition of the liability at the combination date applying IFRS Standards.

Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

CPC's response:

CPC agrees that the Board should not prescribe how the receiving company should measure the consideration paid in its own shares when applying a book-value method to a business combination under common control.

Question 8

Paragraphs 4.44–4.50 discuss the Board's preliminary views that:

a) when applying a book-value method to a business combination under common control, the receiving company should recognise within equity any difference between the consideration paid and the book value of the assets and liabilities received; and

b) the Board should not prescribe in which component, or components, of equity the receiving company should present that difference.

Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

CPC's response:

CPC agrees that when applying a book-value method to a business combination under common control, the receiving company should recognize within equity any difference between the consideration paid and the book value of the assets and liabilities received.

CPC agrees that the Board should not prescribe in which component(s), of equity the receiving company should present that difference. Otherwise, it will be necessary more developments about the unit of accounts, which is not provided by the Conceptual Framework.

Question 9

Paragraphs 4.51–4.56 discuss the Board's preliminary view that, when applying a book-value method to a business combination under common control, the receiving company should recognise transaction costs as an expense in the period in which they are incurred, except that the costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS Standards.

Do you agree with the Board's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

CPC's response:

CPC agrees with the recommendation that all transaction costs of a business combination under common control be recognized in the income statement.

Question 10

Paragraphs 4.57–4.65 discuss the Board's preliminary view that, when applying a book-value method to a business combination under common control, 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.

Do you agree with the Board's preliminary view? Why or why not? If you disagree, what approach do you suggest and why?

CPC's response:

CPC agrees that the assets and liabilities should be included prospectively in the financial statements of the receiving company, without restating the information prior to the business combination.

Question 11

Paragraphs 5.5–5.12 discuss the Board's preliminary views that for business combinations under common control to which the acquisition method applies:

a) the receiving company should be required to comply with the disclosure requirements in IFRS 3 Business Combinations, including any improvements to those requirements resulting from the Discussion Paper Business Combinations—Disclosures, Goodwill and Impairment; and

b) the Board should provide application guidance on how to apply those disclosure requirements together with the disclosure requirements in IAS 24 Related Party Disclosures when providing information about these combinations, particularly information about the terms of the combination.

Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

CPC's response:

CPC agrees that the disclosure requirements of IFRS 3, including improvements, are required if the entity applies the acquisition method.

CPC also agrees that application guidance on how to apply those disclosure requirements should be provided in conjunction with the disclosure requirements of IAS 24 Related Party Disclosures, when providing information about these combinations, in particular information about the terms of the combination.

However, CPC has concerns on whether the proposed disclosures from the Discussion Paper Business Combinations—Disclosures, Goodwill and Impairment would be applicable to certain BCUCC, e.g. metrics that management will use to monitor whether the objectives of the acquisition are being met.

Question 12

Paragraphs 5.13–5.28 discuss the Board's preliminary views that for business combinations under common control to which a book-value method applies:

a) some, but not all, of the disclosure requirements in IFRS 3 Business Combinations, including any improvements to those requirements resulting from the Discussion Paper Business Combinations—Disclosures, Goodwill and Impairment, are appropriate (as summarised in paragraphs 5.17 and 5.19);

b) the Board should not require the disclosure of pre-combination information; and

c) the receiving company should disclose:

i) the amount recognised in equity for any difference between the consideration paid and the book value of the assets and liabilities received; and

ii) the component, or components, of equity that includes this difference.

Do you agree with the Board's preliminary views? Why or why not? If you disagree, what approach do you suggest and why?

CPC's response:

CPC agrees with the proposal, in the sense that some, but not all, the disclosure requirements of IFRS 3 would be applicable.

The idea is also shared that the receiving company must disclose information about the amounts recognized in equity, and the components in which such items are accounted for.