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Stefano Coda

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ESCP Europe

Ecole Doctorale de Management Panthéon-Sorbonne
ED 559

**BUSINESS COMBINATIONS AND GROUP OF COMPANIES:
PERSPECTIVES FROM ACCOUNTING, LAW AND CORPORATE FINANCE**

THESE

En vue de l'obtention du
DOCTORAT ÈS SCIENCES DE GESTION

Par

Stefano CODA

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1. INTRODUCTION

1.1 Business combinations, enterprise groups and control

Business combinations are an important set of business transactions and events which feature the evolution of market economies. They can take a wide array of forms and relate to the organisation of enterprise groups. Generally, a business combination involves a reorganization of control within and across enterprise groups. The definition of control is then critical for the identification of the group of companies performing business combinations. Without knowing what “control” means and who controls whom or what, it would not be possible

“ νομίζω δὲ περὶ τοῦ μέλλοντος ἡμᾶς μᾶλλον βουλευέσθαι ἢ τοῦπαρόντος. ”

« *I consider that we are deliberating for the future more than for the present* »

Thucydides, History of the Peloponnesian War, Book 3, chapter 44 from the speech of Diodotus to the Athenians on the rebellion of Mytilenians.

to recognize a merger or an acquisition. Therefore, a definition of control should precede any characterization of a business combination. The first significant definition was probably the one proposed by Adolf Berle, an American legal scholar, in his groundbreaking volume co-authored with Gardiner Means published in 1932. Berle and Means define 5 types of corporate control¹: i) almost complete ownership; ii) majority ownership and control (both above 50%); iii) majority control through a legal device (e.g., a pyramidal structure) without majority ownership; iv) minority control (voting power between 20% and 50%); v) managerial control (voting power concentration below 20%). “Of these, the first three are forms of control resting on a legal base and revolve about the right to vote a majority of the voting stock. The last two, minority and management control are extra-legal, resting on a factual rather than a legal base” (Berle and Means, 1932 p. 70). The latter type of control is the one that was later considered as the basis for the separation of ownership and control in the corporate enterprise. Ultimately, according to Berle and Means, control is the power to

¹ See for an explanation Berle and Means, 1932, chapter V “The evolution of control” pp. 69-118. See also Weinstein, 2012 on Berle and Means’s comprehensive analysis of corporate power.

select directors. In most of the cases, if one can determine who does actually have the power to select directors, one has located the group of individuals who for practical purposes may be regarded as “the control”. However, they also recognize that occasionally control can be characterized not through the ability to select directors but through direct influence on management “as where a bank determines the policy of a corporation seriously indebted to it” (Berle and Means, 1932 p. 66). Already in 1926 Berle warned that control of a company by a minority of the owners granted them “power without responsibility” (Berle, 1926) allowing for nefarious behavior. Their concept of control was surprisingly modern and useful to tracing the delimitations of a group of companies including what would now be called related parties. Later in his life, Adolf Berle went even further than that. In keeping with his conception of the firm as an enterprise entity (Berle, 1947) he maintained that “the power going with «control » is an asset which belongs only to the corporation ; and that payment for that power, if it goes anywhere, must go into the corporate treasury ” (Berle and Means, 1932 p. 244). Moreover, also the context in which they proposed their definition adds to its novelty. In fact, two years after the publication of their book, the regulation S-X of the securities act of 1934 of the SEC (Securities and Exchange Commission) introduced the first consolidation requirements which were based on ownership to determine the companies to be consolidated, excluding from consolidation the entities which are not a majority-owned subsidiary of the parent (see article 4 of regulation S-X of 1934, Rule 4-02- “Consolidated statements of the registrants and its subsidiaries”).

Interestingly, the concept of control developed by the major Italian scholars of “Economia Aziendale” had many similarities with the one proposed by Berle and Means. Probably, one reason is that the conception of the firm as a system advanced by Gino Zappa, in substance the founder of the Italian *Economia Aziendale*, is somehow similar to the latter’s conception. On the top of that, Gino Zappa’s disciples’ conception of control and group of companies reflected itself in its accounting counterpart i.e. consolidated financial statements.

1.2 History of business combinations activity and landmark papers

In order to put business combinations into perspective, it is useful to have a look at the history of M&A. On that point the literature on business combinations appears to have reached a consensus that (i) mergers occur in waves, which means that is possible to identify periods of intense merger activity which are each homogeneous with respect to some distinct

characteristics and (ii) up to now six merger waves have occurred (see for example Lipton 2006, Martynova and Renneboog, 2008 and Golubov et al., 2013).

As to the first point, there are two theories which suggest possible drivers of the merger waves. According to the first, based on neoclassical theory, merger waves involve specific industries and are triggered by economic shocks, see Harford (2005) for empirical evidence. Instead, the second theory suggests that merger waves are caused by market valuations. Managers would then use overvalued stocks as currency for acquiring undervalued or relatively less overvalued firms (Shleifer and Vishny, 2003).

Concerning the second point, from the historical perspective, there is a consensus that six mergers waves occurred. Briefly, I synthesize hereafter the characterization of the six waves on the basis of the views expounded by the literature on business combinations. The emphasis will be put on the aspects of interest for the present thesis, in particular accounting standards (see chapter 4) and the method of payment and financing decisions (among the main ingredients of chapter 6).

- 1) **1893-1904.** The first merger wave was characterized by major horizontal mergers paid in cash which gave birth to the US business groups in the oil, mining, steel, telecom and railroad industries. These groups so formed had in general a monopolistic power. The enactment in 1904 of the antitrust laws coupled with the stock market crash in the same year is considered to have put an end to the wave by some. For others the wave continued beyond 1904 and ended when the First War World broke out.
- 2) **1919-1929.** The second period recorded a further consolidation in the industries involved in the first wave associated with a very significant increase in vertical integration. In contrast with the first wave, exchange of shares became the predominant payment instrument. The stock market crash in 1929 and the ensuing Great Depression put an end to this wave. In 1934 the SEC introduced Regulation S-X that is probably the first law at the national level regulating consolidated financial statements in general and the accounting for the consolidation difference².
- 3) **1955-1969.** In the third merger wave, the conglomerate concept took hold of corporate America. Their shareholders and managers were viewed as the heroes of the new organizational model. However, the stocks of the conglomerates plummeted substantially in 1969-1970 as the conglomerate companies failed to deliver the

² See Nelson (1959) for a meticulous study of the first and second merger wave.

benefits that they were supposed to generate. Share exchange continued to be the most used form of payment. In 1959 the AICPA (American Institute of Certified Public Accountants) issued ARB (Accounting Research Bulletin) 51 on consolidated financial statements entirely based on the equivalence of control and ownership, while a few years before the CAP (Committee of Accounting Procedure) first formally acknowledged the pooling-of-interest method for M&A accounting³. During this period of growth through diversification, relevant activity was also recorded in the UK and in other European states. It was in this period that Manne (1965) advanced his view of a “market for corporate control” and introduced the study thereof. *In nuce*, Manne (1965) posits that there exists a market for corporate control which acts as a monitor for managers in public corporations. The influence of his article went well beyond the antitrust debate for the desirability of the conglomerate mergers predominating at that time.

- 4) **1979-1989.** In the US and the UK, the merger wave of the 1980s saw the success of major hostile bids, generally made by the predominant investment banks on behalf of their clients-raiders which contributed to the unraveling of the conglomerates resulting from the previous wave. With hindsight, the former can be seen as a response to dissatisfaction with the performance of conglomerates. As a result, takeovers in the US marked at that time a “return to specialization” (see Shleifer and Vishny, 1990). New financial instruments such as the infamous “junk bonds” and new markets ignited debt financing for these acquisitions and leverage buyouts predominantly paid in cash which was not sourced from final investors but from debt leveraged by the takeover players. The latter acquisitions were also favored by the rise of the number and participations of institutional shareholders who were the lubricant which made hostile takeovers easier. The views of Henry Manne⁴, which implicitly made the case for a free market for corporate control and therefore justified hostile takeovers, were contrasted by the arguments set forth by Martin Lipton, one of Adolf Berle’s disciples, who in particular didn’t accept the efficient market hypothesis behind Manne’s theory of the functioning of the market for corporate control⁵. Lipton

³ See Rayburn and Powers 1991 for a detailed history of pooling-of-interest accounting in the US. See also Lys and Vincent (1995), Ayers et al. (2001) and Martinez (2008) for some evidence on the misuses and effects of that accounting method.

⁴ His convictions remained unscathed throughout the crepuscule of his life. See for instance Manne, Henry G. “Bring back the hostile takeover.” Wall Street Journal Jun 26, 2002.

⁵ Lynn Stout sees in Martin Lipton the true successor of Adolf Berle and probably the disciple of Berle who embodied his views most correctly.

(1979) set the basis for the “poison pill” mechanism introduced in 1982⁶ which made it possible for the board of directors of a target of a hostile takeover bid to simply “say no” and thereby prevent the consummation of the prospected acquisition. However, in the US and in the UK hostile takeover activity was high while it was absent in Asia and in Europe. In the latter, cross-border horizontal mergers paved the way to the common market. It was during this wave, in 1983, that IAS (International Accounting Standard) 22, the first international standards on accounting for business combinations was issued by the IASC (International Accounting Standards Committee). The wave was partially disrupted by the October 1987 stock market crash started on October 19, the so-called Black Monday which involved the entire world. However, what put an end to the wave were the ensuing decline of the junk bond market, the savings and loan banks crisis and the related relevant capital difficulties commercial banks had to face, which further reduced the possibilities of financing for prospective acquirers.

- 5) **1993-2000.** The eight years running from 1993 to 2000 could most correctly be labeled the time of the mega-deals. From a combined worldwide volume of \$342 billion worth deals in 1992, the volume reached \$3.3 trillion worldwide in 2000. The fifth merger wave was marked by the globalization of competition and bull markets putting pressure on managers to do deals. In the US deals were mostly amicable resulting from strategic negotiated deals paid generally in stock⁷. In particular Andrade et al. (2001) document that the share of acquisitions financed entirely by stock rose from 33% in the 1980s to 58% in the 1990s. In Europe hostile deals became predominant, suffice it to mention the hostile takeover of Mannesmann by Vodafone through an exchange offer i.e. stock payment for \$200 billion (in 1999 dollars, the deal consummation year). The wave found its end mainly as the tech bubble burst which greatly reduced the appetite for potential acquirers. On the top of that tighter lending standards reduced the possibilities of acquisition financing.⁸ On the

⁶ The Delaware Supreme Court’ 1985 decision officially supported the possibility of the board of directors to employ a mechanism such as the poison pill to decline a hostile takeover offer.

⁷ It’s revealing about the deals in this period what Martin Lipton notes: “The buzzwords for opening of merger discussions were, “would you be interested in discussing a merger of equals.” While few if any deals are true mergers of equals, the sobriquet goes a long way to soothe the egos of the management of the acquired company”. See Lipton 2001 and Lipton 2006.

⁸ See Holmstrom and Kaplan (2001) for a rationalization of the patterns of mergers in the fourth and fifth merger waves.

accounting front the FASB (Financial Accounting Standards Board) issued in 1995 the watershed exposure draft on consolidated financial statements.

- 6) **2003-2007.** What is now considered as the sixth merger wave started only three years after the end of the previous one. The volume of deals rose to \$3.4 trillions in 2006 surpassing the value recorded by the fifth wave. Globalization and the encouragement by the governments of certain countries (France, Italy and Russia being illustrative examples) to create strong national and global “champions” were the main drivers of the wave. Cross-borders deals reached levels never achieved before. However, the novel element that characterized this wave was the impressive rise of institutional investors⁹ and the new active role the latter played in M&A activity. In fact, institutional ownership in the US rose from about 52% in 2003 to over 74% in 2006 according to Gillan and Starks (2007). Deals by hedge funds and other shareholder activists rose significantly and the private equity buyers accounted for more than a quarter of the overall takeover activity. The latter was made easier by the availability of low interest rate credit, which also made debt financing more favourable. In part as a result of that, deals paid in cash mainly coming from debt largely predominated over this period. (For the financial sector see descriptive statistics in chapter 6 of the present work, for the rest see Alexandridis, Mavrovitis and Travlos, 2012). The wave was partially disrupted by the financial crisis which followed the US subprime crisis started in August 2007.

Concerning accounting for M&A, the sixth wave was the first after the introduction of the new rules set forth by the FASB in 2001 (Statement of Financial Accounting Standards No. 141 – Business Combinations and Statement of Financial Accounting Standards No. 142 – Goodwill and Other Intangible Assets issued by the Financial Accounting Standards Board, Norwalk, CT). All business combinations had to be considered as acquisitions for accounting purposes thereby disallowing the use of merger accounting (pooling-of-interest method), goodwill had to be capitalized and became subject to an annual impairment test, while goodwill amortization was eliminated. The impairment only approach is found to result in untimely write-downs and to go against the very principles of matching and verifiability stated in the FASB’s own original conceptual framework (see for instance evidence in Ramanna and Watts, 2012 and in Li and Sloan, 2017). In sum, according to the US standard

⁹ See the figure from Gillan and Starks (2007) reported at page 93 of the present work.

setter followed in 2004 by the IASB¹⁰ (International Accounting Standard Board) all business combinations are acquisitions and each premium is treated as if it were the result of future synergies stemming from the business combination¹¹.

As to consolidation, the rise of institutional investors observed in particular during the fourth and sixth merger waves rendered an already defective consolidation model based on ownership totally inadequate¹². The late response of the accounting standard setters seemed to address the issue adopting a consolidation model based on control. However, a proprietary model based on ownership lived on. In fact, it was not long before the FASB and later the IASB issued a rule in order to de facto maintain a consolidation model based on ownership for institutional investors (see chapters 4 and 5). And yet, already before 1959 Adolf Berle suggested that the rise of institutional investors¹³ would lead to the ultimate separation of ownership from control.

“Now this stock certificate, carrying a right to receive certain distributions and to vote, begins to split. Once it is bought by a fiduciary institution, be it pension trust, mutual fund or insurance company, that institution becomes the “stockholder,” holds legal title to the stock certificate and to its right to vote. But it has by contract dedicated the dividends or other benefits to distribution among beneficiaries under the pension contract, the fund arrangement, or the insurance policy. The one remaining power by which the recipient of corporate profits might have direct relation to corporate ownership has been divided from the benefit itself”. (Berle, 1959, p. 64).

¹⁰ See Baker et al. (2009), for a comparative study with the different approach of Chinese GAAP on accounting for business combinations.

¹¹ Clearly, outside the classical efficient markets framework, takeover premiums may be “natural market phenomena rather than evidence of efficiency gains from acquisitions” as Lynn Stout already pointed out in 1990. See also Stout 2005.

¹² That model may have had a sort of heuristic content in certain countries and epochs corresponding in particular to the first stages of the development of a capitalist system economy. However, it showed its total inadequacy in other realities. In the Italian context for example also the concept of control introduced by the IASB ultimately based upon a proprietary view appears defective (see chapter 4). See also how in the Italian context the “community analysis” developed by Carlo Piccardi et al. (2010) allowed them to spot larger areas of influence than those identified by a narrow definition of business groups.

Faced with the obsolescence of the model based on ownership two different perspectives emerge:

- One by FASB and IASB, arguing for a capital market perspective on business combinations (as summarized in the previous paragraph, with goodwill being evidence of value)
- Another one by extending the principle of the enterprise as a whole and a going concern. This is the institutional perspective by Berle and others. See also Baker et al. (2009) and Haslam et al. (2016).

¹³ Gilson and Gordon (2013) refer to this trend as “the rise of the U.S. system of agency capitalism”.

1.3 Research perimeter and thesis structure

In the broad context of business combinations and group of companies, my research selects some illustrative matters of interest at the crossroad between accounting, law (including/especially legal provisions and accounting regulation) and corporate finance.

Concerning accounting theory, I analyse the perspective of accounting under the historical profile of Italian business economics (*dottrina aziendale*). In particular, I compare how Italian scholars of “Economia Aziendale” of the classical period intended the consolidation difference – that might coincide with goodwill - which is one of the major aspects of accounting for business combinations. Then, I reconstruct the political and legislative process that brought about the birth of the concept of group of companies in the Italian legal corpus.

Concerning law and accounting policy, I broaden the scope diachronically comparing how the notion of control and its use in consolidated financial statements and business combinations accounting evolved in European law (*i*), under international accounting standards as issued by the IASB –International Accounting Standards Board (*ii*) and in US GAAP (Generally Accepted Accounting Principles) (*iii*). Moreover, I analyze the responses of constituents to the adoption of the latest international standard on accounting for business combinations IFRS 3 focusing on an aspect of business combinations accounting particularly relevant to the purchase price, i.e. goodwill.

Concerning corporate finance, I here study the implications of different financing decisions in a large and comprehensive sample of cases of mergers and acquisitions across and between financial institutions (banks and insurances) consummated worldwide around almost the last two decades. In particular, I investigate the relationship between the method of payment choice (i.e. if the price is paid in cash, stock or a mixture of the two) and the choice regarding the mode of financing a business combination.

After this necessary prelude on the research perimeter, hereafter I present the summaries, findings and contributions of my dissertation.

Chapter 2 - In the second chapter I examine how the concept of group of companies and its financial reporting counterpart i.e. consolidated financial statements was developed in Italy throughout the XX century and evolved under two different angles, the one of Italian

business economics scholars on one side and the one of Italian legal scholars and law-makers on the other. The founder of the Italian “*economia aziendale*” tradition, Gino Zappa, was in a good position to tackle the subject himself. In fact his understanding of the firm through the concept of system would have lent itself naturally to the study of groups. However, the Maestro never took that step personally. The job was instead profusely carried out by some of his major disciples active during 1939-1982, be they direct students of him like Onida, Saraceno and Azzini or indirect like Cassandro. Firstly, I review and analyze their work related to how they understood and intended the group accounts and the process for their preparation. In particular, I focus on their views on (i) control, (ii) goodwill, (iii) non-controlling interests and (iv) the consolidation area. In section 2.2 I study and present the relevant text by author in chronological order on the basis of the first edition, whereas in section 2.3 I expound the views of the main Italian legal scholars on those issues starting from Tullio Ascarelli. Then, in the concluding section I provide a critical assessment of the texts reviewed comparing the authors’ writings across the four points mentioned before coupled with a comparison between the approaches of business scholars and jurists. The former are found in my view to adopt a kind of holistic approach whereby the group is considered as a unit (*azienda*). In contrast, the latter maintain the formal autonomy of the company also when it is part of a group. This dualism will be recomposed to some extent by the Italian legislator thanks to the introduction of the group of companies concept in the Italian legal corpus, which I discuss in chapter three.

Chapter 3 - In chapter three I assess the political process which led the Italian legislator to set bounds to the group of companies’ concept. The definition of group of companies was proposed in a situation of emergency which prompted the Italian government to prepare a decree-law on the default administration procedures for large insolvent companies issued in 1979. Article 3 of the adopted law enacting the related decree-law proposed the following four types of relationships which allow to identify a unique economic enterprise subsuming the plurality of companies the latter is composed of from a juridical point of view. According to the first paragraph of that article a company is related to the company under default administration if it meets one of the following requirements:

- It directly or indirectly controls the company under extraordinary administration
- It is controlled by the company under extraordinary administration.

- The composition of the board of directors (*organo amministrativo*) suggests that the company is under the same direction as the company under extraordinary administration.
- It issued loans or guarantees to the company under extraordinary administration or to the companies referred to in the previous points for a value which is, according to the last available annual report, higher than one third of the value of its assets.

The first relationship can be referred to as active control or upstream control, the second as passive control or downstream control, the third as non-financial shareholder rights-related criterion or substantial uniqueness of management and the last as financial non-shareholder rights-related criterion. The objective of the chapter is to critically reconstruct the parliamentary debate which ultimately led to the enactment of the law. That reconstruction is made possible thanks to the stenographic transcripts of the relevant parliamentary sittings which I managed to gain access to. The richness of the debate which developed around the thorny problem of liability (*responsabilità*) allows me to track down the forces at play, not only political, which at the end came in my assessment to the compromise leading to the enactment of the law. It is also interesting to read between the lines of the debate having in mind the confrontation on the subject between Italian legal scholars and business economics scholars analyzed in the second chapter.

Chapter 4 - Chapter four diachronically compares how the notion of control and its use in consolidated financial statements and business combinations accounting evolved in European law (i), under international accounting standards as issued by the IASB (ii) and in US GAAP (iii).

In particular, I study the evolution of the notion of control and consolidation according to the international accounting standard setter and the related standard-making. As a preliminary step, I collect all the relevant material produced by the international standard setter on the matter *ab origine*, standards as issued, the related exposure drafts, the basis for conclusions and other preparatory materials. Superseded standards and documents which pertained to them are not freely publicly available and that contributes to their passage into oblivion. The group is defined in terms of “control” from the first standard on consolidated financial statements IAS 3 issued by the IASC, the precursor of the IASB, in 1976. A group is in fact defined as a parent company and all its subsidiaries which are the companies controlled by the former. This definition will remain unchanged to the latest standard. However, the definition of control would be on the contrary subject to many modifications which would

ultimately change the identification of the group area required to be traced for consolidation purposes. Also the identification and reporting of the consolidation difference i.e. goodwill, is found to undergo important modifications from the original codification in IAS 22.

Chapter 5 - Chapter 5 studies how the single consolidation model based on control was influenced by lobbying activities of constituents. In particular, in chapter 5 I review the comment letters on the Exposure draft of IFRS 10 on consolidated financial statements and the related amendment on the scope exception of investment entities in order to assess to what extent the accounting regulation on consolidation was shaped by respondents' comments. The review suggests that other constituents besides financial institutions and their associations contributed to lobbying in favour of the scope exception of investment entity. In particular, the review of the comment letters on the scope exception of investment entities indicates that investment funds whose nature is characterized by long-term responsible investments or are controlled by a family are opposed to the prohibition of reporting consolidated financial statements for groups controlled by investment entities and are against being required to measure those interests at fair value.

Chapter 6 - In chapter six I focus on the reaction of stakeholders to the introduction of the latest standard regulating merger and goodwill accounting. In particular, I analyze the comment letters received by the IASB in the ambit of the post implementation review of that standard. It doesn't take advanced statistical method to bring out an accentuated resistance to goodwill recognition and its annual impairment test, the compromise the FASB got to after the abolition of pooling of interests accounting and the subsequent alignment of the IASB. That resistance is particularly relevant for preparers which appears to me more justifiable on the basis of my findings expounded in the last chapter. The latter imply that the abolition of pooling of interests accounting in the US contributed to the reduction of equity issuances and to the increase of the premium with negative consequences on debt.

Chapter 7 - Advanced econometrics methods are instead proficuously employed in chapter seven. Recent research established a link between the modification in 2001 to the GAAP (by FASB 141 and 142) regulating the recognition of the consolidation difference and the method of payment choice. More specifically, it showed that the abolition of pooling of interests accounting resulted in a drastic reduction in the number of M&A transactions paid in equity. I extend that link from the method of payment choice to the related financing decisions impacting the capital structure. In particular, chapter 6 investigates the relationship between the method of payment choice and the mode of financing using a novel dataset of № 5,669

business combinations consummated in the period 1999-2017 involving firms in the financial sector. Previous literature makes the equivalence between all-cash offers and all-equity offers on one side and debt-financed offers and equity financed-offers respectively on the other side. I relax that implicit assumption and I find that the mode of financing matters both for (i) the payment method choice and (ii) investors' reaction at the combination announcement. As to the first point, the amount of equity issued by the acquirer during the year before the acquisition announcement is found to be significant in explaining the payment method choice between cash, equity or a mix of the two. Moreover, as to the second point, the evidence provided using two nonparametric tests suggests that acquiring firm's shareholders reward debt-financed acquisitions whereas they penalize those deteriorating the financial slack of the acquirer.

1.4 Why are chapters 2 and 3 rooted into Italian accounting and parliamentary debate?

Chapter 2 and 3 develop themselves mainly within an Italian setting. A justification for this important choice has to be made explicit. In other words, why Italy and its theoretical and parliamentary *querelles*? What makes them so interesting and differential?

From the historical point of view, the significance of Italy in the development of accounting thought and practice has been largely recognized and established by a relevant consensus (Zambon, 2002 and Zan, 1994). In this respect, the emergence of double entry bookkeeping and the early systematization in a chapter of Luca Pacioli's *Summa* has become a topic of interest beyond the small circle of accounting historians and new interpretations and reconstructions continue to be proposed (Sangster, 2015, 2017). Therefore, the forces which made Italy the cradle of accounting might justify scholarly attention in Italian accounting also after the early genetic moments. However, the developments of Italian accounting after its illustrious beginnings have not spurred the same interest. On the contrary, the former were portrayed as "enigma" (Lafferty, 1973) and "undeveloped" (Stillwell, 1976 and Oldham, 1981). In particular, the conception of accounting enshrined within the Italian business economics tradition flourishing in the twentieth century has not found adepts in that approach abroad. This lack of attention in the international arena might have been influenced by accounting chauvinism (Oldham, 1981). More likely, the former may be the result of a misunderstanding about Italian accounting (Zambon, 2002). In fact, according to the Italian business economics approach, accounting theory is embedded in a theory of the firm, institution or entity within which it finds its meaning and significance. In this light management theory and organization theory could not be separated from accounting theory. This is why the structure of the first treatises on business groups by authors belonging to the tradition of *Economia Aziendale* studied in chapter 2 follow a precise pattern whereby group accounting and the techniques for preparing group financial statements are covered at the end of the work, after a throughout exposition of the economic structure, morphology of firms' coming together coupled with the study of their organization, operations and management. In other words, Italian business economics scholars conceived (group) accounting as deeply rooted into their theory of the firm (business group) to the point that it would have appeared a

sterile exercise to think the former disconnected from the latter¹⁴. In this respect, Chapter 2 will effectively attempt to dispel the misunderstandings about Italian group accounting in the twentieth century by correctly relating the former to the other interconnected subsystems which lie behind the conception of the entity according to the Italian business economics tradition.

Another reason lies behind the choice of Italy in chapter 2 and 3 besides the historical importance of that country in the birth of accounting and the exigency of a correct representation of the developments proposed by the Italian business economics tradition. In particular, the decision to examine the theory of corporate control, consolidated statements and business combinations with reference to the Italian tradition of *Economia aziendale* allows a comparison with the positions of Italian legal scholars on that matter and the following debate between these two traditions. On the top of that, the practical problem of the frequent and vast crises that hit Italian companies during the seventies prompted the Italian legislator to issue an innovative law which allowed to effectively identify the ramifications of large business groups. In this respect, the legislative response set off by the practice problem of important companies crises coupled with a strong tradition of thought both in the legal disciplines and business economics make the Italian setting an interesting *unicum* meriting further study.

Moreover, Chapter 2 and 3 set the case for the rest of the work. In fact, their examination the theory of corporate control, consolidated statements and business combinations with reference to the Italian tradition of *Economia aziendale* as well as the forces and pressures underlying the political and regulatory debate in this country can be used as a relevant benchmark for the international comparison detailed in chapter 4 and the lobbying activities analyzed in chapters 5 and 6. In this regard, the implications of the focus on the entity in *Economia Aziendale* including what would now be called its “business model” can be contrasted to the presence or lack of the same focus in an international setting both with respect to regulators and other interested parties.

¹⁴ The disconnection between a conception of the firm and accounting can result in serious shortcomings in the latter. In this respect, the superimpositions of foreign standards in a different local context can lead to inadequate or meaningless reporting as documented for example by McKinnon, 1984 regarding the failure of “Anglo-American methods of consolidation to reflect adequately the nature of corporate group associations in Japan”.

1.5 Thesis overview

Table 1.1 hereafter brings to light the relationships between the chapters, how they are grouped and the methodology employed in each chapter grouping. In particular, reading the table from the left, the pyramid denotes how the chapters are built one on the other with the fundamentals and the top of the pyramid. Then, the first column indicates the chapter titles and how they are related to each other, the second details the chapter groupings and the third column the methodology employed and the nature of the data used.

Table 1-1 Thesis overview

Chapter title	Rephrased-chapter-titles groupings	Methodology
7. PAYMENT METHOD AND FINANCING CHOICE IN FINANCIAL INSTITUTIONS' BUSINESS COMBINATIONS: DOES IT MATTER HOW AN ACQUISITION IS FINANCED?	Does the acquisition financing mode matter for the payment method choice and for acquirer's shareholders?	Quantitative based on different data providers
6. AN ANALYSIS OF THE COMMENTS RECEIVED BY THE IASB IN THE POST IMPLEMENTATION REVIEW OF IFRS 3 BUSINESS COMBINATIONS	How did constituents respond to the post-implementation review of IFRS 3 business combinations?	Mixed methods based on publicly available comment letters
5. LOBBYING ON ACCOUNTING STANDARDS ON CONSOLIDATION: A REVIEW OF THE COMMENT LETTERS SUBMITTED TO THE IASB IN THE AMBIT OF THE EXPOSURE DRAFTS OF IFRS 10 AND THE AMENDMENT ON INVESTMENT ENTITIES.	Did constituents inform IFRS 10 on consolidation and its amendment?	
4. CONTROL AND CONSOLIDATION: ITS EVOLUTION WITHIN THE EUROPEAN LAW AND THE INTERNATIONAL ACCOUNTING STANDARDS VS THE US GAAP DYNAMICS	How did the notion of control and its use in consolidated financial statements and business combinations accounting evolve in European law (i), under international accounting standards as issued by the IASB (ii) and in US GAAP (iii)?	Qualitative based on original sources
3. A CRITICAL RECONSTRUCTION OF THE POLITICAL PROCESS WHICH BROUGHT ABOUT THE BIRTH OF THE CONCEPT OF GROUP OF ENTERPRISES IN ITALY	How did political forces shape the concept of group of enterprises in Italy?	
2. CONSOLIDATION AND CONTROL: A REVIEW AND A CRITICAL ASSESSMENT OF THE ITALIAN <i>ECONOMIA AZIENDALE</i> TRADITION	How did business economics scholars understand the group accounts and the process for their preparation in particular compared to Italian legal scholars?	

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2. CONSOLIDATION AND CONTROL: A REVIEW AND A CRITICAL ASSESSMENT OF THE ITALIAN *ECONOMIA AZIENDALE* TRADITION

2.1 Introduction

Zappa's understanding of the firm through the concept of system lends itself smoothly to the study of group of firms.¹⁵ However, the Maestro never took that step personally. The job was instead profusely carried out by some of his major disciples, be they direct like Onida, Saraceno and Azzini or indirect like Cassandro. The objective of the present chapter is to review and analyze their work related to how they understood and intended the group accounts and the process for their preparation. In particular, I'll focus on their views on control, goodwill, non-controlling interests and the consolidation area.

“È nostro fermo avviso che anche le teoriche contabili non debbono far apparire dissolto in isolati momenti ed in elementi separati un divenire coordinato, una struttura necessariamente solidale. (omissis). Tutti i fenomeni aziendali, anzi, e non alcuni soli tra essi, si rilevano ad attenta osservazione come costituiti in unica coordinazione di azioni economiche, volte ad un determinato intento. Forse tale nozione non si può raffigurare più vivamente che ricorrendo al concetto di sistema anche per designare il complesso aziendale, uno pur nella più diversa molteplicità.”
G. Zappa, *Il reddito di impresa*, 1937, p.14

The present review¹⁶ is the result of the study of the texts listed hereafter. In section 2.2 and 2.3 I will review the relevant text by author in chronological order on the basis of the first edition, whereas in section 2.4, I will provide a critical assessment of the texts reviewed comparing the authors' views across the four points mentioned in the previous paragraph coupled with a comparison with the views of the main Italian legal scholars on those issues.

¹⁵ See also Biondi, Yuri. “The Firm as an Entity: Management, Organization, Accounting.” SSRN Scholarly Paper. Rochester, NY: Social Science Research Network, August 2, 2005.
<https://papers.ssrn.com/abstract=774764>.

¹⁶ The present chapter has been made possible thanks to fruitful conversations with Professors Arnaldo Canziani and Stefano Zambon. I'm also grateful to librarians at Bocconi University in Milan.

I compared all the editions hereafter in order to make sure that relevant modifications have not been introduced over the years. The edition, the quotations refer to, is indicated in table 2.1.

Table 2-1 Compared Editions

Thesis section	Compared Editions	Edition	Year
2.2.1	Onida, Pietro. <i>Le Dimensioni Del Capitale Di Impresa: Concentrazioni, Trasformazioni, Variazioni Di Capitale</i> . 2. ed. Biblioteca Di Economia Aziendale. Serie 1 1. Milano: Giuffrè, 1951.	Serie 1.1	1951
	Onida, Pietro. <i>Le Dimensioni Del Capitale Di Impresa: Concentrazioni, Trasformazioni, Variazioni Di Capitale</i> . Biblioteca Di Economia Aziendale. Serie 1 1. Milano: Giuffrè, 1939.	Serie 1.1	1939
2.2.2	Cassandro, Paolo Emilio. <i>I Gruppi Aziendali</i> . Bari: Francesco Cacucci, 1954.	Ed 1	1954
	Cassandro, Paolo Emilio. <i>I Gruppi Aziendali</i> . 3. Ed. Bari: Cacucci, 1959	Ed 3	1959
	Cassandro, Paolo Emilio. <i>I Gruppi Aziendali</i> . 7. Ed. Bari: Cacucci, 1982.	Ed 7	1982
2.2.3	Saraceno, Pasquale. <i>La Produzione Industriale</i> . Venezia: Libreria universitaria, 1963.		1963
	Saraceno, Pasquale. <i>La Produzione Industriale</i> . 5. Ed. Venezia: Libreria universitaria, 1967.	Ed 5	1967
2.2.4	Azzini, Lino. <i>I Gruppi: Lineamenti Economico-Aziendali</i> . Istituto Di Economia Aziendale dell'Università commerciale L. Bocconi. Serie 6 2. Milano: A. Giuffrè, 1968	Serie 6 2	1968
	Azzini, Lino. <i>I Gruppi Aziendali</i> . Università Degli Studi Di Parma, Istituto Di Ricerche Aziendali Gino Zappa 3. Milano: Giuffrè, 1975	Ed 3	1975
2.2.5	Tessitore, Antonio. <i>Alcune riflessioni sui concetti di capitale e reddito di gruppo</i> in Various authors <i>Finanza Aziendale E Mercato Finanziario: Scritti in Onore Di Giorgio Pivato</i> . Milano: Giuffrè, 1982.		1982

2.2 Review of the understanding of the group of companies concept and consolidated financial statements through the lens of major proponents of *Economia Aziendale* during 1939-1982

The works studied to prepare the present review have been written in order to satisfy different needs. Cassandro's and Azzini's books are devoted to groups of companies whereas Onida's and Saraceno' have a much broader scope. In particular, the two former explain how groups arise, how they are structured, organized, managed. Moreover, they provide a conceptual framework for framing the notion of group income and group capital and finally the principle informing the setup of the consolidated accounts. I try to show how their views on consolidation items and group accounts are rooted in their broader framework which allows them to understand the economics of groups.

2.2.1 Onida 1951

In Onida 1951¹⁷ group companies i.e. under control of the same main economic actor (*soggetto economico*) lose their economic autonomy. The latter can be only apparent from an external perspective. However, the economic unity represented by the group doesn't make it equivalent-not even economically- to a consolidated company or to the company that would result from the merger of the companies belonging to the group (pp.104-105 and p.109).

The cement which keeps the group unified is the control relationship which is the main criterion adopted for the determination of the consolidation perimeter. In practice, a company is controlled by another company when the latter owns more than 50% of the former. In general, however, it is possible to obtain control with a minority equity investment for example in the presence of shareholder agreements (p.106 and p.124).

As to the purposes of the consolidated balance sheet and income statement he makes clear that they don't include the determination of the economic value of the participations of the parent in the controlled companies. Among the many factors that influence that value he mentions the control premium associated with the controlling participations. By the same token, it wouldn't be correct to justify the recognition of an asset representing the future income expected to be generated by the controlled companies¹⁸. Therefore, "*if the book value of the investment is greater than the net assets [of the controlled company], the decrease in*

¹⁷ Onida, Pietro. *Le Dimensioni Del Capitale Di Impresa: Concentrazioni, Trasformazioni, Variazioni Di Capitale*. Biblioteca Di *Economia Aziendale*. Serie I 1. Milano: Giuffrè, first edition 1939

¹⁸ The main reason is clearly that Onida favors the historical cost approach.

reserve funds could be highlighted in the consolidated balance sheet as a “consolidation write-down” - “ In particolare , se il valore di bilancio della partecipazione supera quello del capitale netto da eliminare, la diminuzione delle riserve si potrebbe porre in rilievo, nel bilancio consolidato, sotto il titolo “svalutazione di consolidamento” (p.133). Similarly, a negative difference would give rise to a consolidation reserve fund - riserva di consolidamento - in the consolidated balance sheet (p.135). Another reason which justifies this treatment of goodwill is linked to the determination of the distributable income:”In quanto questo bilancio venga precipuamente composto per la determinazione del reddito distribuibile, è di solito da escludere-a parte ogni altra osservazione-la sopravvalutazione del capitale per rilevare presunti valori di avviamento. Il bilancio di esercizio non ha e neanche potrebbe avere il compito di valutare l’azienda, come complesso, in funzione della sua presunta redditività” (p.134). The overvaluation of the capital as a result of accounting for an alleged goodwill must be normally avoided in that this balance sheet is drawn up primarily for the determination of distributable income. Financial statements don’t have and could in no case have the objective of valuing the business in its unity on the basis of its alleged profitability and also a goodwill coinciding with synergies wouldn’t change the approach: “D’altronde, a giustificare la sopravvalutazione del capitale della società controllata, nel bilancio consolidato, non varrebbe neppure la circostanza che il valore attribuito alla partecipazione nel bilancio della società madre, si possa ritenere adeguato ai frutti diretti e indiretti che questa trae o spera di trarre dalla partecipazione. (...) Il consolidamento dei bilanci ,anzi, mira proprio a sostituire i valori del bilancio di funzionamento o esercizio della società controllata, ai valori di scambio-effettivi o presunti, passati, attuali o futuri-della partecipazione posseduta dalla società controllante”. (p.134) “After all, the overvaluation of the capital (-i.e. equity-) of the controlled company could not even be justified by the case where the corresponding value of the participation in the balance sheet of the parent company is supported by the fruits, be they direct or indirect, that the latter derives or hopes to derive by the participation (i.e. the equity investment in the controlled company). (...) On the contrary, the financial statement consolidation aims at having the exchange values of the participation of the controlling company-be they conjectural, past, present or future- replaced by the book values of the controlled company”.

Table 2.2 sums-up Onida’s position with respect to the treatment of the consolidation difference, assuming that B is a company whose control is acquired by a new parent company. The consolidation write-down (svalutazione di consolidamento) should not be

interpreted in Onida’s mind as a loss that the controlling company has to recognize in its own financial statements.

Table 2-2 Onida’s position regarding the consolidation difference.

Book value of the equity investment in B >	Equity Capital of B	Consolidation write-down decrease in reserves
Book value of the equity investment in B <	Equity Capital of B	Consolidation write-up increase in reserves

Moreover, Onida specifies that if hidden reserves (*riserve occulte*) are attributable to the controlled company, then they should be recognized in the ambit of the consolidation process. In practice, the recognition of hidden reserves which results in an increase of equity of the controlled company is made either revaluing the assets or decreasing the liabilities but not through the recognition of a “supposed and indeterminable goodwill value”.

In the same vein recognising goodwill in a merger is seen as “irrational”: *“Le considerazioni fatte lasciano intendere come sarebbe irrazionale far figurare, nelle scritture delle società incorporante o della nuova società formata con la fusione, i valori attivi e passivi esposti nei bilanci delle società disciolte e rilevare sotto il nome di “avviamento” l’eventuale eccedenza del valore di apporto delle aziende fuse sulla somma algebrica di quei valori attivi e passivi”* p.217 What explained makes it clear that it would be irrational for the acquiring company or the one resulting from the merger to recognize the values of the assets and liabilities as recorded in their balance sheets and account for the possible difference between the consideration (the contribution values) and the algebraic sum of those values as “goodwill”.

Interestingly, Onida compares his position with that of Newlove¹⁹, his main source concerning consolidation issues. Not only is Onida not ready to accept the recognition of goodwill as instead Newlove does but he also takes a different approach as to the time the values used to draw up the consolidated financial statement should refer to. In fact, he suggests that the elimination of the value of equity investment of the parent against the corresponding value of equity of the subsidiary should be carried out using the values at

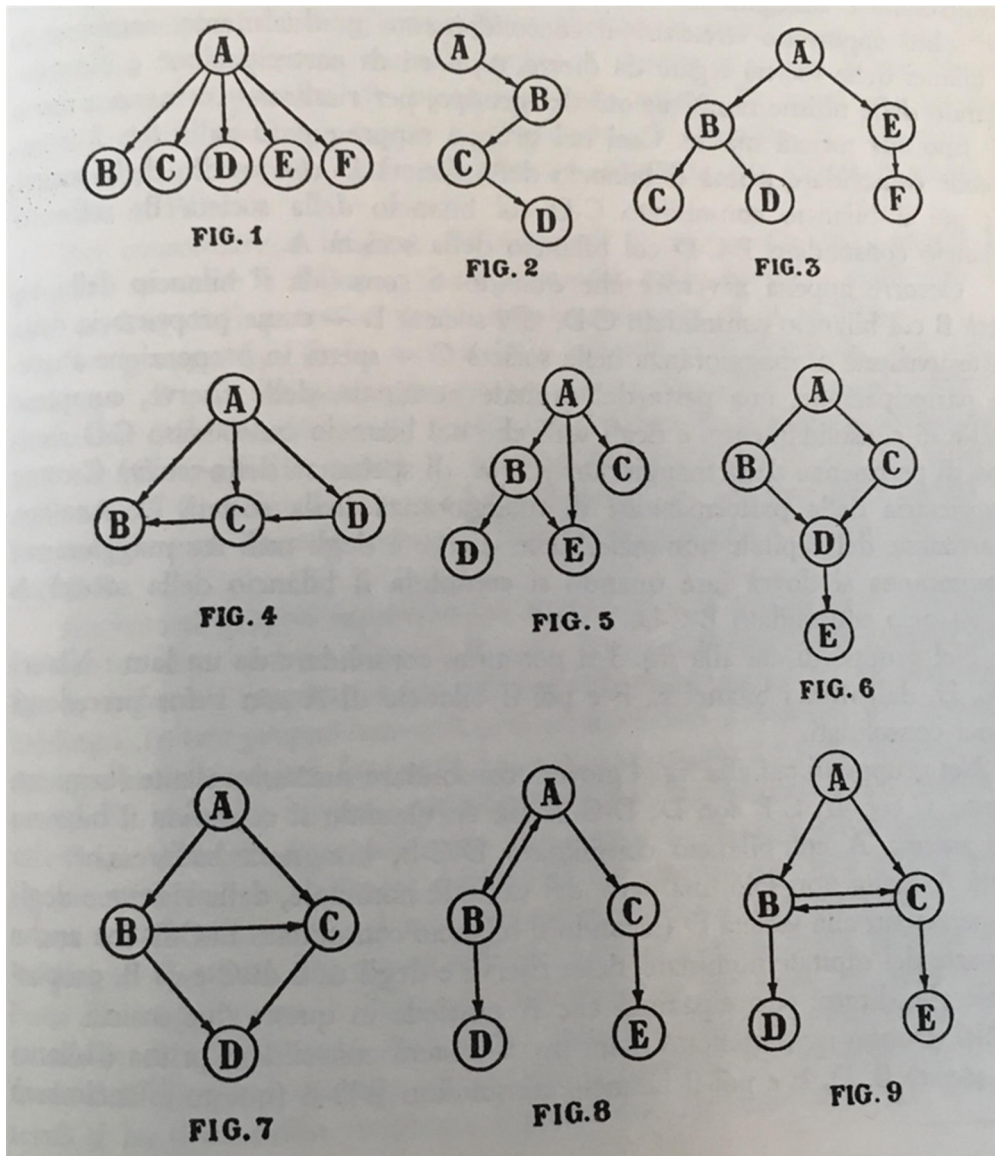
¹⁹ George Hillis Newlove is to my knowledge the first author of a fully-fledged volume on consolidated balance sheet published in New York in 1926. The volume is a working manual on consolidated balance sheet technique. There is no theory, just 41 rules accompanied by a short discussion and 136 cases given as an example of the application of the rules. The author, an associate professor of accounting at Johns Hopkins University in 1926, worked for more than three years as a full-time instructor of consolidated balance sheet technique in the Income Tax Unit, U.S. Treasury Department. That experience largely contributed to the preparation of the volume. Perhaps, it is not a surprise that the volume was born in the ambit of the U.S. Income Tax Unit, given the tax-avoidance purpose of some groups and legal set-ups.

consolidation date and not at the time when control was acquired. As a support to his approach, he argues that in that way the resulting “consolidation reserves or write-downs” would let know the relationship²⁰ at consolidation date between the value of the equity investment of the controlling entity and the corresponding book value of equity related to the controlled entity. In particular, he argues that the former relationship may be much more relevant for the user of consolidated financial statements than the relationship between the original cost of the equity investment and the book value of equity of the controlled entity prevailing at acquisition time. That approach is in my opinion in line with Onida’s refusal of goodwill recognition no matter the origin of the latter and also with his approach to consolidation impacting exclusively the consolidation reserves i.e. the equity capital and not the consolidated assets.

What expounded above concerns the set-up of the consolidated balance sheet and income statement distinguishing between the case where the parent owns the nominal capital of the subsidiary in its entirety and which is discussed by Onida 1951 §26-§27, the case where the parent owns the subsidiary in its majority §28 and the case of group composed of companies connected in different ways §29. The second case, i.e. where the parent owns the subsidiary in its majority but not in its entirety is analogous to the previous one. In particular, the elimination of the equity investment of the parent in the subsidiary has to be eliminated against the percentage of the subsidiary equity proportional to the equity investment. The difference should then impact the consolidation reserve as seen before. As to the case of companies connected in different ways, Onida consider the configurations reported in appendix 1 hereafter. He just specifies the order of consolidation. For example in the group represented in figure 2.1 (figure 3) he notes that at first the balance sheets of B,C,D are consolidated and those of E and F and in a second moment the balance sheet of A with the two previous ones.

²⁰ See pp. 137 and 138. Onida uses the expression “*rapporto esistente*” i.e. existing relationship in order to emphasise his point. However, that expression is not precise and might be misleading.

Figure 2-1 Groups composed of companies connected in different ways in Onida 1951



Finally, also the case of what nowadays would be called joint venture is mentioned in §30 “*Il controllo in comune di una società da parte di due o più altre fra loro indipendenti*” i.e. “Common control of a company between two or more reciprocally independent companies”. However, this part is underdeveloped. In fact, Onida mentions the possible rationale for such a configuration which can ease the financing of the controlled society thanks to the issuance of debt or privileged share solidarily guaranteed by the controlling companies and the reduction of unused capacity resulting from the asset shared by the controlling companies, but doesn’t touch upon consolidation issues.

2.2.2. Cassandro 1959 third edition *Fondo Dell'Amore*

Cassandro –p.56 and following- understands the group as an aggregation of companies (*imprese societarie a struttura azionaria*) having each a distinct legal status (*soggetto giuridico*) and a common main economic actor²¹ (*soggetto economico*) i.e. generally the same parent company. The companies belonging to the group keep both their legal and their economic autonomy. In line with Zappa 1952 economic autonomy is a necessary characteristic for an entity or unit (*azienda*), in other words it is not possible for an entity to lose its economic autonomy and continuing being considered as such and the same continues to be valid for each group entity. However, he explains that the economic autonomy of each company belonging to the group is limited by the fact that the latter shares the MEA with the other companies belonging to the group (*comunanza del soggetto economico*). And he specifies that “losing the economic autonomy” can be applied to the group companies only if it is interpreted as equivalent to “sharing the same MEA”.

As to the distinct legal status, it is not a mere formal fact. On the contrary, it has relevant consequences also from the economic point of view and separate out groups from big consolidated companies (*grande impresa divisa*) p.99. Consistently with his conception of autonomy, the distinct legal status distinguishes the case of a parent company which owns the totality of the capital of the subsidiaries from a consolidated unique company²².

Finally, from the functional point of view, a distinctive feature prevailing in groups of companies is reshuffling or leveling (*perequazione*-literally equalization-) whose main purpose is to increase the overall productivity of the group as a whole. It can take several forms and it can be related to the degree of exploitation of the productive capacity across group companies p.141, or to the selling and procurement activities within the group, to stocks and productive inputs and most notably to income smoothing p.143 see also §49 on intra-group operations and within group market.

Control

Equity participation is the most common kind of financial cement which keeps together the companies of the group when it gives rise to control. Cassandro follows Paton 1949 and recognizes that in many cases even an equity interest between 20% and 30%-or less in some

²¹ I translate “*Soggetto economico*” as “Main Economic Actor” as in Zambon, Stefano, and Luca Zan. “Accounting Relativism: The Unstable Relationship between Income Measurement and Theories of the Firm.” *Accounting, Organizations and Society* 25, no. 8 (November 2000): 799–822.

²² This seems to refer to a variety of functional forms, like in Chandler and Williamson.

cases- can be sufficient for granting control to the parent. And he explains how this can be the case, be it for a dispersed shareholder structure, the shareholders' absenteeism, the use of proxy voting or the creation of intermediate companies p.87, see also p.56 note 63.

Control must be actually exerted -see pp.328-329- appointing members of the boards of directors ready to follow the group's directives. In line with Moonitz, whom he quotes, majority participation may not result in actual control and conversely the latter can be present with no share participation as the quoted Bethlehem Steel Company-Cambria Iron Company case in Moonitz shows.

In chapter 2 he builds a morphology of groups of companies. He distinguishes between two broad classes of groups:

- groups which constitute an economic unity
- groups which do not constitute an economic unity

Groups belonging to the first class, called economic groups are similar to a company and he mentions Fiat as an example. On the contrary, an archetype of the second class is IRI (Institute for Industrial Reconstruction). In any case these groups can also be the result of the desire of economic or political influence of financiers.

The distinction plays a central role in the construction and interpretation of the group's financial statement. In particular, what matters is then to determine whether the group constitutes an economic unity. The determination has to be done case by case considering the nature of operations and activities carried out by the group's companies and the degree of control exerted by the parent over the latter. *“Sono stati, specialmente in America-he quotes Moonitz here, The entity theory ecc p.20-, suggeriti vari criteri o, come usano dire quegli autori, vari “standards” che dovrebbero servire ad accertare la sussistenza della “economic entity” e a legittimare il procedimento dell’integrazione. La verità è che nessuno degli indici esteriori suggeriti può da solo essere bastevole ad accertare il fatto sostanziale dell’esistenza di una unità economica, che possa dar significato alla integrazione dei bilanci. Tale accertamento va fatto caso per caso in relazione ai vari elementi concreti da cui risulta la struttura del gruppo e alle varie altre circostanze inerenti al suo funzionamento”* p.328.

Consolidated capital and consolidated income – *Capitale e Reddito di gruppo*

Those two classes are then used to represent the group gross capital according to suitable templates. In particular, for the financial groups the consolidated assets are split between

those pertaining to the individual companies which can be grouped under homogeneous classes and those which cannot p.272.

As to the group net assets (*capitale netto di gruppo*) he notes that it is possible to determine their value with respect to either the majority or all shareholders. He calls the first case subjective determination in that it is referred to the group's MEA and objective determination in the second in that it would be determined what he calls *capitale "proprio"* –inverted commas in the original text- see p.274. He notes that usually the determination is carried out with respect to the majority and minority interests (*partecipazioni di minoranza*) are considered as a debt.

The group capital has three main characterizing elements: legal and material rights to use (*disponibilità giuridica e materiale* p.268-269)²³, productive instrumentality and complementarity. Cassandro specifies that it is only possible to refer the first element, in its full meaning, to the legal statuses (*soggetto giuridico*) of the individual companies belonging to the group and only partially and indirectly to the MEA of the group (*soggetto del gruppo*). The distinction between economic and financial group is also used to structure the income statement and interpret group income p.281-284.

Consolidation area

The nature of the group, i.e. the distinction between economic and financial group coupled with actual control (*effettivo dominio*) inform the definition of the consolidation area.p.346-*amplius*. Companies over which the parent does not exert a controlling influence (*effettivo controllo*) see note 467-should be excluded from the consolidation area. He mentions the financial unit theory –only majority participated companies are included in the consolidation area-and the operational unit theory-the inclusion pertains companies directed by the parent with or without owning the majority of their capital- as in Childs W.H. Consolidated. Consistent with his view on control, Cassandro notes that the ownership of a majority participation is in itself not sufficient for inclusion without being coupled with effective control.

²³ Here the word “capital” is to be intended as “assets”. In Cassandro’s view the legal and material rights to use the group’s assets pertains only to the individual companies which constitute the group. In other words, from the juridical point of view, the MEA of the group has no legal and material rights to use the assets of the subsidiaries. See also Tessitore, *infra*.

Goodwill and minority interests

Cassandro's vision of consolidation goodwill is essentially contained in §76 -*I valori delle partecipazioni e la loro sostituzione con le attività e passività delle società controllate*- p.370-381. The first step consists of measuring the investments of the parent in the subsidiaries in the former's balance sheet. The favoured method is recognizing those investments at acquisition cost. The other two methods i.e. equity method also called adjusted cost method and the book value method are considered "unacceptable"²⁴ in particular the latter supported by Moonitz see note 517.

Once that value has been determined it is possible to account in the consolidated balance sheet for the difference between the investment in the subsidiary in the parent balance sheet and the net asset of the subsidiary. He maintains that, assuming a positive difference between the acquisition price and the net assets of the subsidiary, such value cannot be considered as a goodwill ("*differenza tra un capital di cession e un capital di funzionamento, e cioè in sostanza un valor di avviamento*") in that many and varied are the influencing factors see p 377-378 for a list. Instead that value should be simply called "Excess of the carrying value over book value of subsidiary stock". Similarly, for a negative difference²⁵-which in any case is a part of the net assets as in Lewis note 531. As to the case for the fiscal years after acquisition the dividends received by the parent are deducted from the cost of the investment of the respective subsidiary in line with all the other relevant authors considered by Cassandro.

Minority interests (*partecipazioni di minoranza*) are seen as a limitation on group capital and are recognized as liabilities. He acknowledges that they are not a debt from the legal point of view, and can be correctly included in liabilities which as common in a going concern balance sheet are not the same as legal debt²⁶ pp.384-385. The different views of Childs, Kester and Moonitz who all consider minorities as shareholders of the group thereby including their interests in group equity, are mentioned but explicitly not shared by Cassandro.

²⁴ The first is deemed unsuitable in that it ignores the legal diaphragm between the parent and the subsidiary and would implicitly recognize profit of the subsidiary before being possessed by the parent.

²⁵ See Group's balance sheet model Figure p.275 -badwill (*differenze negative tra I valori delle partecipazioni quali risultano nel capitale delle società controllanti e il capitale netto, o le frazioni di netto proporzionali, delle società controllate*).

²⁶ "Liabilities do not coincide with legal debt in particular in a going concern balance sheet i.e. not a liquidation balance sheet" "*Il concetto di passività non coincide, specie in bilanci di funzionamento, con quello giuridico di debito*".

2.2.3 Saraceno 1967

Saraceno was in a privileged position to understand the functioning of group of companies. In fact, he was involved with IRI, the institute for industrial reconstruction, from the very beginning and informed the course of its industrial and financial policies²⁷.

His definition of the group employs the usual terms of legal status (*soggetto giuridico*) and MEA (*soggetto economico*) i.e. “a set of companies under control of the same MEA but with a distinct legal status” –“*un gruppo è un complesso economico costituito da più imprese che, pur dotate ciascuna di un proprio soggetto giuridico, hanno in comune il soggetto economico*”-Saraceno 1967 p.87. However, differently from Cassandro’s view, belonging to a group coincides with the complete loss of economic autonomy p.91. That’s what matters when it comes to gauge whether a company belongs to a group, irrespectively of what kind of cement keeps the companies together, be it an equity controlling participation-which can be a minority one see note 2 p.88-long-term credit financing, or contracts like a long-term leasehold.

In terms of classification, besides the financial and industrial group, the historical importance of the banking group- whose MEA is a bank- is recognized. Irrespectively of the group type, a very clear example is illustrated showing that the greater the number of group layers the smaller the required entity of the capital granting control of the group to the MEA, assuming the total invested capital equal.

The description of the consolidated financial statement setup is presented as articulated into the two phases of retreatment of the individual financial statements and the consolidation process itself. Among the first phase the fourth operation concerns the treatment of the equity investment of group companies in other group companies. And here it is also possible to find Saraceno’s approach to consolidation goodwill see pp.644-645. Implicitly, he distinguishes between two cases divided into two subcases each. If the equity investment value of a company is greater than the corresponding equity in the investee company-case 1- then it is possible to recognize a goodwill in the investor company balance sheet and a consolidation reserve fund-*riserva di consolidamento* by the same amount in the investee balance sheet only if that goodwill can be justified in terms of the income generating potential of the investee-subcase 1-. On the contrary if the latter cannot be justified that positive difference will be adjusted on the basis of the actual income generating potential of the investee whose

²⁷ See Saraceno’s detailed contribution on the subject in Ristagno 1955 *L’Istituto per la ricostruzione industriale, IRI. III Origini, ordinamenti e attività svolta. Rapporto di Pasquale Saraceno*. See also Saraceno’s preface to Mosconi and Rullani 1978.

equity will be reduced accordingly –*perdita di consolidamento*-subcase 2-. The reasoning in the case of a negative difference-case 2-mirrors completely those for case 1. In particular, if the value of the equity investment is lower than the corresponding amount of equity recognized in the investee’s balance sheet, then, if justified by the economic situation of the latter, a consolidation reserve has to be recognized corresponding to the reevaluation of the value of the equity investment-case 2, subcase1. On the contrary, if the economic situation of the investee does not justify such a revaluation, then the equity capital of the latter has to be reduced recognizing a consolidation loss and a corresponding write-down has to be recognized in the assets of the same entity (i.e. the investee)-case 2, subcase 2.

Table 2-3 Saraceno’s position regarding the consolidation difference

Book value of the equity investment in B >	Equity Capital of B	Can goodwill be justified in terms of the income generating potential of the investee?	(i) YES	Recognise a goodwill in the asset side and a corresponding reserve
			(ii) NO	Adjust the value of the equity investment in B and recognize a corresponding consolidation loss
Book value of the equity investment in B <	Equity Capital of B	Can goodwill be justified in terms of the income generating potential of the investee?	(i) YES	Recognise a consolidation reserve and a corresponding increase of the equity investment in B
			(ii) NO	Recognise a consolidation loss and a corresponding write-down

2.2.4 Azzini 1968 Fondo Dell’Amore

According to Azzini a group of companies is “a business whose relative economic units have an independent legal status”- “*Il gruppo aziendale è [quindi] un’impresa le cui unità economiche relative sono dotate di indipendenza giuridica*”. Differently from Cassandro each economic unit belonging to the group loses its economic autonomy which is only an attribute of the group itself- “*Nel gruppo aziendale ogni unità perde la propria autonomia economica e si manifesta come unità economica relativa*” pp.26-27 and “*solo il gruppo ha autonomia economica*” p.29. This way of looking at the group would “allow for a more throughout investigation of the problems connected to management, organization and accounting related

to the former” p.31-“*Noi crediamo che il concetto da noi accolto consenta una più feconda investigazione dei problemi propri dell’economia del nostro istituto, siano essi di gestione, di organizzazione, di rilevazione*”. However, he recognizes that the formal element embodied in the independence conferred by the autonomous legal status plays a relevant role on the business substantial structure, thereby acquiring an economic significance.

The definition of income and units is uniformly determined and its repartition across the different economic units is in the best interest of the group as a whole -amplius p.38-

Control and consolidation area

Control over a company is obtained through equity investments and the possibility of obtaining the latter through debt financing is considered but it is excluded that it would give rise to a group p.56. As a result, the question is then what percentage of equity is sufficient for the obtention of control. In agreement with Cassandro and Moonitz and even more explicitly, Azzini notes that it is not possible to state general rules for determining that percentage. As an example he mentions some of the circumstances which influence that percentage and can durably make organized minorities the controlling agents of a company p59-60.

In any case when it comes to the determination of the consolidation area he gives a 75% participation threshold to discriminate between companies included and those excluded, pointing out at the same time that participation percentages are insufficient to determine control pp.299-300.

Group capital and income

His notion of group income is founded on his notion of the group as an autonomous economic institute. It’s in line with Masini’s views pp.195-197. See p.197 for a definition of group income consistent with Masini’s definition of income²⁸.

Goodwill and minorities interests

The difference between the carrying value over book value of subsidiary stock may be considered as goodwill only at acquisition and is seen from a technical point of view p.234.

²⁸ He refers to Edelkott, Childs, Moonitz and Kaefer for the different notions of income related to the different approaches to the group understanding-*Interesstheorie-Einheitstheorie* and their American counterpart Financial unit-operational unit and economic or business entity.

As to minority interests, they are included in equity in all the examples without a justification of this choice (probably in line with his understanding of the economics of the group).

2.2.5 Antonio Tessitore -1982 Alcune riflessioni sui concetti di capitale e reddito di gruppo in Finanza aziendale e mercato finanziario-Scritti in onore di Giorgio Pivato- vol. 2 pp. 581-592

Tessitore's contribution is contained in the collected papers in honor of Giorgio Pivato. Its objective is to provide the reader with some considerations about group capital and income which could favor a correct interpretation of these items covered by the -at that time- newly issued VII directive.

In line with Cassandro he attaches to group capital the attributes of instrumentality, complementarity and material rights of use (*disponibilità*- literally: availability i.e. to what extent can the group capital be disposed of). The latter attribute in particular is brought to its extreme consequences. To the point of not recognizing the autonomous existence of group capital:

“A first consideration results from the fact that group capital does not exist *per se* as an autonomous entity, but is allocated to the different companies the group is composed of”

-“*Una prima considerazione muove dalla circostanza che il capitale di gruppo non esiste di per sé come entità autonoma, ma risulta allocato presso le imprese che formano il gruppo* p.584”. His conception of the group appears therefore somehow limited and goes against the notion of common control and the idea of the group as a system, one in its multiplicity.

2.3 The approach of legal scholars on consolidation and control in an historical and comparative perspective

The specificities of the Italian business economics scholar approach to consolidation and control may somehow appear more clearly when contrasted with a different but related approach such as that of Italian legal scholars. In this paragraph I'll focus on the relationships between the former and the latter with respect to consolidation and control. As I will show in what follows, in the Italian context “control” was originally a genuinely economic concept dissected by accounting and business economics scholars. The transition to entering into the realm of commercial law was definitive in 1991.

Traditionally, legal scholars, whatever their country, make the form prevail over the substance. Italian legal scholars are no exception in that respect as the following excerpt from Angelo Sraffa (1911) suggests. He is denouncing the attempt made by the Italian state to consider as taxable²⁹ also the income generated by foreign subsidiaries of Italian groups.

“L’errore giuridico in cui cade la Finanza italiana è quello di disconoscere che l’autonomia formale di una società produca l’effetto di separarla nettamente e sostanzialmente da ogni altro ente e da ogni altra persona. Il parlare di una società madre e di una società figlia per confonderne poi i patrimoni e i redditi, è disconoscere la natura delle società anonime e lo stesso sviluppo storico delle medesime, che si caratterizza appunto col distinguere sostanzialmente il patrimonio che, distaccandosi da nuclei diversi e separati, si unifica formalmente nell’ente società.”

“The legal error the Italian ministry of economy and finance is falling into is denying that the formal autonomy of a company sets the latter distinctly and substantially apart from other entities. Talking about a parent company and a subsidiary and then confounding their incomes amounts to disavowing the nature itself of companies and their historical development which is characterized by the insulation of the capital which separates out from different entities and is formally unified through the incorporation of a company.”

The legal scholars’ preference for the formal autonomy of the companies composing a substantially unique business group entity will be partly overcome by the introduction of an Italian regulation in 1979 which is studied in the next chapter. In any case, that preference coupled with the refusal to admit that certain companies belonging to groups may not be independent might also have had a bearing on the absence of an organic discipline regulating group of companies whose reasons are enucleated in the section 2.3.2. Instead, the next section will set the tone detailing the views on corporate groups of Cesare Vivante, an early relevant Italian legal scholar often referred to by his peers.

2.3.1 Cesare Vivante’s approach to regulating groups of companies

The concerns raised by business groups in general and pyramidal groups in particular are already under the scrutiny of the early legal scholars. In this regard, Cesare Vivante can be considered as the most relevant among the Italian legal scholars who were the first to propose a regulation on groups of companies. Among other things, he was at the head of a commission established by the government in 1919 in order to prepare a possible reform of the 1882 Commercial Code. As a result, a preliminary project was issued in 1922 with the clear imprint of Vivante. The former contained the famous prohibition of all agreements

²⁹ In the ambit of the first income tax introduced after the unification of Italy by the then finance minister Quintino Sella and into force from 1864 to 1973.

which would limit the freedom to vote and in particular voting trusts. That proposal met the fierce opposition of banking leagues, associations of entrepreneurs (Confindustria) and business corporations (Assonime) who favor voting trusts as a legitimate means to effectively counter speculation and takeovers (Sandrelli and Ventoruzzo, 2018). Resisting these pressures witnesses Vivante's independence *vis à vis* the establishment.

Concerning groups of companies, Vivante's proposal appears to be quite liberal, especially when compared with other positions voiced at that time. In fact, he was in favour of a free formation of business groups as long as it was compatible with the business purpose of the parent company. The latter is defined as the company which "owns as many shares of the subsidiaries (*Società affiliate*) as they are sufficient to make up the majority of their shareholders' meeting (*"quante sono sufficienti per formare la maggioranza della loro assemblea"*), which is different from the narrow view requiring the ownership of the majority of equity of the participated company in order to qualify for the creation of a group. In Vivante's view, once the group is formed within the ambit of the corporate purpose of the parent company, it has to meet only the following three conditions. Firstly, subsidiaries and affiliates are forbidden to purchase the shares of the parent company. Secondly, the latter must disclose the progressive formation of the group to its shareholders' meeting and, thirdly, directors that the parent and an affiliate company have in common shall not cumulate the related remuneration. Besides these points, Vivante explicitly notes that no further restrictions shall be applied to business groups as he defines them (*"si combattono altre limitazioni"* p. 154 in Vivante, 1931).

However, his approach to groups of companies adopted a more restrictive stance just a few years later as it is clear from a reform proposal concerning public companies (*società anonime*), industrial groups and financial companies published in 1935 (Vivante, *Gruppi industriali e società finanziarie (holdings)*, 1935). In that proposal, he distinguishes between industrial and financial groups i.e. "industrial chains" and "speculative chains" in his jargon. In his view, the latter cannot belong to the category of companies *tout court* let alone "*società anonime*". Their inclusion would instead undermine the discipline of public companies. In this regard, he proposes some restrictions which in his mind would prevent "the risk that the chains would have no end without technical and economic reasons" and that controlled companies would "lose any independence". In particular³⁰, he proposes that

"a)l'industria dominante deve essere esercitata direttamente dalla società madre con i propri capitali.

³⁰ For a detail of his seven proposed articles see Vivante 1935 p. 5-6

b)la società madre deve avere un capitale non inferiore alla somma complessiva dei capitali investiti nelle società affiliate

c)l'industria delle società affiliate deve essere coordinate con quella della società-madre entro lo stesso programma, in modo da impedire il raggruppamento di società eterogenee.” (Vivante, 1935, p.3-4)

“a)the main business activities shall be carried out by the parent company,

b) the latter shall have equity for an amount not lower than the total sum of the participations in the invested companies

c)controlled companies shall have the same industrial plan as the parent company”

These restrictions are clearly meant to separate out industrial business groups from financial groups. On the top of that Vivante also put forward a strong limitation for the latter. In fact, financial groups which do not meet the previous restrictions would be prevented from being public companies (*società anonime*) and “issuing shares backed by the capital invested in controlled companies” “*emettere azioni in rappresentanza del capital coperto dalle azioni delle società affiliate*”. These developments in Vivante’s approach towards business groups has no univocal reason. One conjecture is that they are also influenced by the changing attitude of the Facist government *vis à vis* financial institutions. That interpretation may be supported by a quote of the fascist leader concerning the pernicious effect for the state of financial groups’ bankruptcies.

Concerning financial reporting, Vivante proposes to make parent companies disclose in their annual report the detail of the participations in subsidiaries coupled with their estimated return. In particular, when the group size exceeds a certain threshold, an auditor shall prepare a report which delineates the relationships between the different companies belonging to the group and if necessary the auditor shall also inform the government³¹ regarding his observations. According to Vivante, these measures would contribute to prevent surprise crises leading to financial distress and ultimately bankruptcy.

2.3.2 Why is there no organic discipline regulating groups of companies?

Conventional wisdom maintains that the dearth of a regulatory framework for groups of companies is due to a missed opportunity of the Italian legislator who proved to be unable to provide the Italian legal system with such a regulation. The careful examination of the

³¹ Vivante specifies that he shall inform “the Ministry of Corporations” which existed during the fascist period.

original sources shows that this is not the case. It is instead, as I will show hereafter, a precise well-reasoned choice of the Italian legislator. The intended decision is due primarily to a conceptual rationale. Simplifying, the latter stems from the need to maintain the distinction between the economic function versus the legal structure of the contracts or legal principle (*istituto giuridico*). The clearest proponent of this view during the debate in the thirties was Tullio Ascarelli. He was one of the foremost legal scholars of the 20th century, full professor of company law in the University of Bologna at the age of 27, he would cast his long intellectual shadow well beyond the realm of Law in that many of his pupils would take relevant positions in the Italian political institutions. Ascarelli maintained that recognizing a purported legal concept of group or control would lead to meddling up the economic outcome which can be achieved through different legal devices with the latter. In fact also a given legal device can lead to new economic functions but in Ascarelli's views is primordial to keep the two distinct. Moreover, the legal characteristics of the various contracts have to be kept distinct from their respective economic outcomes also in case where the latter are equivalent due to particular circumstances.

In other words, there must correctly be a distinction between the juridical attributes related to the different contracts from the economic outcome borne out of the former. That's why it is not possible not only to come up with a general legal concept of group of companies but also with the legal concept of control.

“Per la stessa ragione non è possibile far capo a un concetto giuridico di dominio e controllo, seppure sotto qualche aspetto sia necessario tener presenti tutte le ipotesi nelle quali, grazie a vari negozi giuridici che rimangono però tra loro distinti e soggetti a distinte discipline, un imprenditore esercita economicamente un controllo su un altro.-Passim-

Il concetto generale di gruppo economico, quello più ampio ancora di unione di impresa, quello di controllo, sono tutti concetti economici, indubbiamente utili nell'interpretazione di particolari disposizioni di legge e nella soluzione di particolari problemi, ma che stanno ad indicare un risultato economico che può essere raggiunto con negozi casualmente distinti e soggetti a distinte discipline; sì che non possono essere assunti come caratteristici di particolari categorie giuridiche.” Ascarelli (1937).

“By the same token, it is not possible to refer to a legal concept of control (*dominio e controllo*) even if it is necessary to keep in mind all the hypothesis, related to legal contracts which remain distinct among each other and subject to distinct law disciplines, through which an entrepreneur economically controls another entrepreneur.

The general concept of economic group, the more encompassing concept of union of companies, the one of control, are all economic concept, which are for sure useful for the interpretation of the law and for the solution

of particular problems. However, they refer to an economic outcome which can be obtained through causally distinct contracts subject to different aspects of the law and which, therefore, cannot be considered as characterizing attributes of particular legal categories.”

I find Ascarelli’s imprint in the “*Relazione del Ministro Guardasigilli Grandi al Codice Civile del 1942 -Libro V Del Lavoro*”³².

“*Per quanto attiene ai “gruppi di società”, espressione di un fenomeno economico non riconducibile sul piano giuridico a unità, il codice si è essenzialmente preoccupato di arginare quelle combinazioni che possono sorprendere la buona fede dei soci che rimangono estranei, e soprattutto dei creditori e rappresentare un pericolo per l’economia nazionale.*” “*Dei gruppi di società e delle partecipazioni*” art. 963 first paragraph see also art. 964 and art. 965.

“As to the “groups of companies”³³, the resultant of an economic phenomenon which *cannot be brought to unity on a juridical basis (-italics mine-)*, the Italian Civil Code just ensured to prevent those combinations which can go against the good faith of the partners who are not directly involved and of the creditors, thereby representing a danger for the national economy.”

That “*cannot be brought to unity on a juridical basis*” may be most correctly interpreted in Ascarelli’s terms illustrated above, even if I didn’t find any evident proof of his involvement, be it indirect, in the preparation of that document.

The fact that the Civil Code just ensured to prevent possible abuses may be seen under an anti-dirigist light, which appear, however, secondary to the original conceptual reason exposed. Moreover, as mentioned by Canziani (2013), the highly concentrated shareholder structure of Italian business groups, in the hands of families or the State linked by a network of reciprocal connections, obnubilated the exigence of protecting outside shareholders. In sum, conceptual reasons, which at the end of the day took a political patina, are at the origin of a case of apparent regulatory void.

2.3.3 Control as a legal basis for consolidation

The term “control” was introduced in the Italian legal system in 1931 by art. 6 of a law issued that year. Enrico Finzi (1932) comments about the meaning of that word newly introduced in

³² Relazione del Ministro Guardasigilli Grandi al Codice Civile del 1942 -Libro V Del Lavoro <http://www.consiglionazionaleforense.it/documents/20182/174648/Libro+V+++--+Del+Lavoro/585f22db-a0da-4c19-a701-b75e7d9148e9> accessed 4/06/2017

³³ The inverted commas in the original Italian text are clearly due to the fact that “group of companies” is nowhere defined in the Italian legal corpus at that time.

the Italian legal system by that law. In particular, the law established penal sanctions for the director (*amministratore*) who would take out a loan from the company he manages or from the company which the latter *controls* or is *controlled* by. In this respect, Finzi recognizes that the Italian legislator intends control as the power to elect directors deriving from the ownership of the majority of the voting shares. However, control doesn't require the majority of votes to exist (§10 p. 466)-i.e. it might appear that he embraces "de facto control". This does not mean that he disregards the form of the control relationship³⁴. In fact, he excludes the interpretation of control as dominance or mastery of another company. The latter would then not be subordinated to the controlling company to the point of neglecting its own interests to the benefit of a not better precised dominant group interest. In this regard, it is already clear to Finzi that "control" does not rest upon a determined legal basis:

"E' affatto indifferente per il controllo quale ne sia il fondamento legale. Normalmente esso sarà la partecipazione alla società controllata con la maggioranza del capitale.

Ma non mancano numerosi artifice per garantire il controllo a chi rappresenta una minoranza, anche esigua, del capitale stesso: dalle azioni a voto plurimo ai sindacati di maggioranza³⁵, dai "voting trusts", alle società a catena." (Finzi, 1932)

"It doesn't matter what the legal basis of control is. Normally it would be a participation in the majority of the controlled company capital.

However, there are numerous devices which grant control to those who represent a minority of the capital such as multiple voting shares, voting trusts, shareholder agreements and pyramidal groups."

Concerning the notion of "controlled companies", it is mentioned for the first time in the Italian legal system in the Civil Code in 1942, the year of its introduction in art. 2359 at the time entitled "the purchase of shares by controlled companies" "*l'acquisto di azioni da parte di società controllate*". As the title indicates, the objective of the article is to define controlled societies in order to prevent possible abuses, most notably the purchase of shares of the

³⁴ "*L'economista vede la sostanza del rapporto, e, prescindendo dalla forma giuridica, considera la cosa in sé, indipendentemente dalla norma che la regola.*" (Finzi, 1932) "The economist looks at the substance of the relationship and considers the thing in itself abstracting from the norm by which it is regulated"

³⁵ For possible factors behind the documented relative decline in the use of pyramidal chains and shareholders' agreements among listed Italian companies see (Marchetti, 2016) "*Ma gli investitori, ci racconta ormai una significativa casistica, agiscono di concerto senza formalizzare patti parasociali. ...Viene allora da pensare che ogni tempo ha le sue forme di coalizione. Al tempo, per mutuare la terminologia antitrust, delle intese è subentrato quello, appunto, del conscious parallelism.*"

"Several cases suggested that investors act in unison without having previously formalized shareholders' agreements. ...Each time has its own forms of coalitions. In this respect, the time of agreements has been followed by the time of conscious parallelism as intended by the antitrust literature."

parent company, at the time forbidden. That requirement was adjusted in the ambit of the reform introduced in 1974 which modified also art. 2359. However, the spirit of the article remained substantially the same, still in line with Ascarelli's approach. Things changed in 1991. That was the year of the adoption of the 7th directive by the Italian system and art. 2359 was rewritten to accommodate for the conversion of art 1 of the directive. The apparently seamless inoculation of a foreign principle into the Italian legal corpus brought about change somehow surreptitiously. Without going into the details of the modifications to article 2359, suffice it to observe that the article's former negative purpose-to prevent abuses in terms of purchase of shares of the controlling company by the controlled ones- now was changed into a positive purpose-define the consolidation area.

“La scelta ipotetica di maggiore rilevanza è stata compiuta relativamente all’area di consolidamento e precisamente in ordine alla definizione delle imprese da considerare “collegate” ai fini del consolidamento- preparatory work of the commission chaired by Floriano D’Alessandro in charge of the “relazione allo schema di legge delegata”. “The most relevant conjecturally-based choice was taken with respect to the consolidation area and in particular with respect to the definition of companies considered as “related” for consolidation purposes”.

As a result the notion of “control of companies” assumed a proper legal vest and it's the basis for the identification of the consolidation area.

“Pertanto la nozione giuridica rilevante, ai fini della individuazione dell’area di consolidamento, non è quella di “gruppo”, ma di “controllo di società” e ciò si spiega perché la communis opinio, confortata anche dalla giurisprudenza consolidata della Corte di Cassazione³⁶, ritenga che il gruppo come autonomo soggetto di diritto o autonomo centro di imputazione giuridica non esista, nel senso che è privo di rilievo reale, perché sono le società che compongono l’insieme ad avere autonoma e distinta personalità giuridica anche e soprattutto in caso di insolvenza.” Bocchini p.497.

“Therefore, in order to identify the consolidation area what matters is not the notion of “group” but the legal notion of “control of companies”, which is why common wisdom, supported by the jurisprudence elaborated by the Italian Supreme Court of Cassation,

³⁶ Bocchini makes reference to 11 different rulings of the *Corte di Cassazione* from 1988 to 2003.

maintains that the group doesn't exist as an autonomous legal subject in the sense that it lacks a legal status which is instead maintained by the companies the former is composed of³⁷.

Jurisprudence clarified that control does not need to be effective but may be potential or possible³⁸ and that it does not have to be also economic i.e. the activities of the controlled company may well be heterogeneous with respect to those of the parent.

Another approach for the delineation of the links connecting the companies belonging to a business group rests upon the notion of "unitary direction" as opposed to that of "control". In this regard, the next section presents the view of a major proponent of that approach.

2.3.4 Unitary direction as a basis for business group identification and consolidation

The shortcomings of the Italian legislator's attempts to found the identification of business groups on the basis of control relationships were pointed out by a group of Italian legal scholars. Among the latter, Guido Rossi made an introductory keynote lecture in a conference on groups of companies held in Venice in 1995. The conference resulted in three volumes collecting the contributions of the speakers, mostly Italian legal scholars, economists³⁹, business economics scholars and some relevant foreign academics. In his contribution he voiced the fundamental weakness of the conceptions behind the laws hinging on control pertaining to corporate law (*diritto societario*) as the central element for the identification of the groups. The different definitions of control both the Italian⁴⁰ and U.S. legislator came up with reflect the shortcomings of that approach. Instead, an approach focusing on "unitary direction or management" (*direzione unitaria*) pertaining to business disciplines (*disciplina dell'impresa*) {literally discipline of the undertaking} is the one which shall be adopted. It would point to detect influence acting beyond the channels of the general shareholders' meeting. This extra-shareholder-meeting power can manifest itself in different forms which goes beyond sharing a common strategic orientation like for instance unique cash management for the entire group or unified internal and fiscal procedures. Moreover, the multifarious aspects and concretizations of unitary direction do not lend themselves to a

³⁷ In any case, autonomous legal status is not an attribute of the group also in countries where the latter is organically disciplined-see Colombo in Colombo, Portale vol. 7 p.585 "*Va peraltro ricordato che anche nei Paesi ove esiste una disciplina organica del fenomeno , come ad esempio la Germania, l'ordinamento non attribuisce mai al gruppo personalità giuridica autonoma, poiché ciò equivarrebbe a negare le ragioni stesse di tale forma di organizzazione di impresa*". Busse von Colbe and Ordelheide refer to the consolidated balance sheet as a "*Fiktion der rechtlichen Einheit des Konzerns*" p.19 ss. The expression of "*ipotesi finzione*" is also recurring in Carlo Masini writings although not in this context.

³⁸ Bocchini p.499, Campobasso p.292 and quotations therein.

³⁹ Including the important empirical contribution by Fabrizio Barca.

⁴⁰ For a clear table see Bank of Italy (1994) p. 228

unified general framework. Therefore, it is not adequate to embark on a lawmaking activity aiming to form a general discipline of business groups. In Rossi's view, the attempts to bridling the discipline of group under a unified general framework are vain and would lead to contradictions.

“Il gruppo come impresa fondata sulla direzione unitaria, ora sicura, ora incerta, ora palese, ora occulta, non può essere ridotto ad unità di struttura negoziale, poiché la sua vitalità si sprigiona liberamente secondo comportamenti puramente imprenditoriali.” (Rossi, 1995 p.36)

“Business groups as an undertaking founded upon unitary direction, be it clear or uncertain, hidden or manifest, cannot be reduced to a unique legal transaction in that its genesis and development is the result of purely entrepreneurial behavior.”

In this respect, annual financial reports should reflect not links based on control but those hinging on a unitary direction. Furthermore, accounting information should be complemented by a *“prospetto di gruppo”* containing information allowing to identify unitary direction including a detailed list of intragroup operations.

Concerning listed companies, they should be prohibited from being part of a business group in that their sovereignty would be limited by other interests. In other words, the former might be controlled by another company but it should not be allowed to let their interests overtaken by a “superior group interest” or the one of a parent which might not be subject to the same regulation as the one prevailing for listed companies. This would, in Rossi's view, resolve concerns normally raised by pyramidal business groups.

2.4 Italian business economics scholars *vis à vis* legal scholars

The relationship between Italian business economics scholars and jurists was described as having been characterized either by a complete independence or open hostility. Paola Balzarini writes about a “Religious war” between the two *““guerra di religione” tra giuristi e aziendalisti”*⁴¹. The relationship was not made easier by the absence of a fully-fledged *“droit comptable”* in the Italian legal system.⁴²

⁴¹ Provasoli, Viganò, 1995 p.15 - la natura giuridica dei principi contabili in Italia -

⁴² Bocchini p.41 *“Il primo problema è dato dalla stratificazione delle leggi in materia contabile, perché manca, nel nostro paese, un vero e proprio “diritto contabile”, degno di questo nome e, cioè, organico e coerente. La*

Consolidation and control are issues where the clash between the two approaches is evident. Olivieri-in Colombo, Portale Vol VII p.665- for example mentions that the shortcomings of the approach of “*economia aziendale*” scholars are among the reason for the silence of the Italian law about the phenomenon of the groups. They were unable, in his words, “to formalize the integration degree between companies which is necessary and sufficient for their consolidation”, “*incertezze che la dottrina aziendalistica tuttora incontra nel formalizzare il grado di integrazione fra imprese necessario e sufficiente a procedere al loro consolidamento*”.

Equity theories, developed by accounting scholars, are considered as not relevant. What matters from the juridical point of view is to find a subject to whom it is possible to refer the juridical relationship pertaining to the companies to be consolidated.

“Poco importa poi stabilire, in questa sede, se il processo delineato nel testo sia coerente con la teoria dell’unità⁴³ -sic- (entity theory) di origine tedesca, ovvero con la “teoria della proprietà” (proprietary theory) o, piuttosto, con quella anglosassone nota come Parent company theory, una volta accertato che tutte e ciascuna presuppongono l’identificazione di un soggetto (il gruppo nella prima, la “proprietà” del capitale di comando, nella seconda, la capogruppo, in quella da ultimo menzionata) al quale riferire la situazione patrimoniale, quella finanziaria ed il risultato economico su base consolidata.” Colombo in Colombo, Portale Vol VII p.586.

Bocchini, for his part, mentions that Italian laws and principles employ the parent company theory which is on one hand related to entity theory in that it requires full consolidation (*consolidamento integrale dei conti*) and on the other hand to proprietary theory in that what matters is “potential controlling power and a possible economic integration whereas the pure entity theory would require a controlling power of the parent company concretely and actually exerted”.

“A differenza della teoria dell’entità che dà rilievo al potere di controllo della capogruppo solo se concretamente ed effettivamente esercitato, la teoria della capogruppo, accolta, in via

normativa è sparsa all’interno del codice civile e in una serie di leggi speciali”. Ermanno Bocchini is in fact the would-be creator of the Italian “*droit comptable*”. See the Bibliography hereafter for a list of his works on the topic.

⁴³ He probably intends Entity as “*Einheit*” which is the German for unity. In any case, the word “Unit” was used to denote an entity in the fifties and sixties.

di principio, dal nostro legislatore, dà rilievo al controllo giuridico anche se solo potenziale e alla integrazione economica anche solo se possibile". Bocchini p.507

2.5 Chapter Conclusions - Sum-up and critical assessment

Table 2.4 presents a global overview of the four main Italian classic business economics scholars who wrote on consolidation and control across five different issues. As to the first point on the conception of group there are substantially two views. The most followed one maintains that the companies belonging to the group lose their "economic autonomy" in that their decisions are ultimately determined by the MEA. In the extreme case it is just possible to speak about the "economic units" the group is composed of and not companies-Azzini-. According to the opposite view-Cassandro-the economic autonomy is still an attribute of the companies controlled by the parent but it may be somehow limited by the latter's will. In general, there is an awareness that there can be a spectrum of degree of integration resulting in the autonomy or heteronomy of the companies or economic units constituting the group. However, that degree is never precisely identified, let alone quantified, and it not clearly stated what would be its relationship with the consolidation area. There is the intuition that in some cases such as the financial group extending the consolidation area to all controlled companies would result in non-meaningful consolidated statements, but that intuition is not developed to its consequences.

By the same token, that cement which keeps the group together which is the hypostasis of control can take different forms. All the authors recognize that a majority equity investment is neither a necessary nor sufficient condition for control. They are also unanimous in considering effective control as the criterion for the delimitation of the consolidation area in line with entity theory. That wasn't the choice of the Italian legislator, though, at least according to the interpretation of the Italian jurisprudence. The same happened with uniform management as an indicator for considering the set of controlled companies as a group with its consequence on the consolidated financial statement. The "*aziendalisti*" didn't provide a way to measure or infer that characteristic and that, coupled with the juridical principle of the autonomy of a company as a distinct legal status, is probably the reason why the law didn't include it as an indicator suggesting control. Moreover, it can be noted that a control which is just possible but not effective can occur only in cases where there is no uniform management

across the companies in the group. If the management is uniform control cannot be but effective in line with the four authors.

As to goodwill it is clear that they are concordant to avoid its recognition in its entirety like in Onida or to recognize only a justifiable quota of it as in Saraceno. Their influence on this topic was relevant also for legal scholars. Suffice it to note that art 33 co 3⁴⁴ of decr.legisl. 127/1991 in its first version appears very similar to Saraceno's wordings for the item. That changed, however, after the introduction of IFRS⁴⁵.

Finally, the choice of Cassandro to recognize non-controlling interests as liabilities versus equity as in Azzini can be clearly associated to their conception of group and group companies' economic autonomy. However, this relationship is never made explicit in their texts.

In sum, their intuitions were good but they were not able to carry them forward in an effective way. And that's a missed opportunity of Italian business economics scholars vis à vis legal scholars. Their conception of the group could have been explicitly and more concretely linked to their approach to consolidated financial statement and the morphology of groups of companies proposed by some authors could have borne out by a serious empirical analysis. Like the one that was carried out by the Minister of Economy in order to inform the first definition of "group" proposed in the decree law on the extraordinary administration procedures for large insolvent companies issued in 1979. Which I will analyze in the next chapter.

⁴⁴ "3. *L'eventuale residuo, se negativo, è iscritto in una voce del patrimonio netto denominata "riserva di consolidamento", ovvero, quando sia dovuto a previsione di risultati economici sfavorevoli, in una voce denominata "fondo di consolidamento per rischi ed oneri futuri"; se positivo, è iscritto in una voce dell'attivo denominata "differenza da consolidamento" o è portato esplicitamente in detrazione della riserva da consolidamento fino a concorrenza della medesima. L'importo iscritto nell'attivo è ammortizzato nel periodo previsto dall'art. 2426, n. 6 del codice civile.*"

⁴⁵ See chapter 4.

Table 2-4 Comparison across the authors' positions.

	Onida	Cassandro	Saraceno	Azzini
Group companies' economic autonomy	Excluded	Maintained but limited	Excluded	Excluded
Control	A majority equity investment is neither a necessary nor sufficient condition for control			
Consolidation difference-Goodwill	Excluded	It cannot be called "goodwill"	Only the justifiable quota is recognized	At acquisition
Non-controlling interests		In liabilities		In equity
Consolidation area	Delimited by effective control			
JV	Mentioned	-	-	-

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3. A CRITICAL RECONSTRUCTION OF THE POLITICAL PROCESS WHICH BROUGHT ABOUT THE BIRTH OF THE CONCEPT OF GROUP OF ENTERPRISES IN ITALY

3.1 Introduction

The irreducibility of the concept of control to a paradigm resting upon ownership shared by the views of Italian scholars of *Economia Aziendale*

“ Comunque il tema più tormentato di questa normativa è quello che attiene al gruppo di imprese ”.

Parliamentary debate, 7 March 1979

found its natural continuation in the definition of group of enterprises the Italian legislator came up with. The objective of the present chapter is to reconstruct and analyse the political process which led to the conception of group of enterprises behind the definition contained in the law as issued. To that end, I proceed as follows. Firstly, I briefly mention the special circumstances which urged the government to act in this regard. Secondly, I present the relevant article of the draft-law introducing the conditions allowing an identification of a business group. Thirdly, the parliamentary debate which led to the law is critically reconstructed. Finally, I report the most significant excerpts from the latter and the comparative evolution of the legal text which ultimately led to the relevant law.

It is a situation of emergency which prompts the Italian legislator to give birth to the concept of group of companies in the Italian legal corpus. In the late 70ties many groups relevant for the economy of the country were facing serious financial difficulties which, given the legal possibilities available at the time would ultimately lead to the declaration of bankruptcy and the consequent extinction of the former. In order to avoid this outcome the government issued a decree-law on the 30th of January 1979 effective from the 6th February of the same year. The decree-law introduced a new legal device whose main objective was to ensure the continuity of the companies as going concerns in the interest of labour and the national economy as a whole. The means to reach that end was to appoint a commissioner in lieu of the entrepreneur, who would prune the branches for which a recovery was deemed impossible

but save the entire tree. That would entail not only identifying the companies entitled to be put under extraordinary administration-that's the name of the new legal device introduced by the decree-law- according to the requirements defined by the new law but also those somehow related "*variamente collegate*" to the former. Hence the concept of group.

3.2 Overview of art 1 and 3 of the decree-law 30 January 1979, number 26 concerning the extraordinary administration of large enterprises in crises, turned into law 3 April 1979, n.95

The decree-law consists of 6 articles. I only focus on the articles which pertain to the definition and identification of a "group of companies" art 3 and art 1 which defines what companies are entitled to the new procedure.

According to article 1 of the draft law-*disegno di legge*-, the procedure applies to enterprises that have been declared insolvent by the court and have a medium-long debt exposure to banks (*aziende o istituti di credito*) which is higher than five times the paid-in capital, twenty billion Italian liras and which is composed of State-subsidized credit (*credito agevolato*) by at least fifteen percent. Article 3 prescribes that the companies related to the company subject to the extraordinary administration shall be subject to the same procedure provided they are declared insolvent by the court and they will be run by the same commissioner or commissioners in charge of the company under extraordinary administration. According to the first paragraph of the same article a company is related to the company under extraordinary administration if it meets one of the following requirements:

- It directly or indirectly controls the company under extraordinary administration
- It is controlled by the company under extraordinary administration.
- The composition of the board of directors (*organo amministrativo*) suggests that the company is under the same direction as the company under extraordinary administration.
- It issued loans or guarantees to the company under extraordinary administration or to the companies referred to in the previous letters for a value which is, according to the last available annual report, higher than one third of the value of its assets.

The first relationship can be referred to as active control or upstream control, the second as passive control or downstream control, the third as non-financial shareholder rights-related

criterion or substantial uniqueness of management and the last as financial non-shareholder rights-related criterion.

The previous four types of relationships allow to identify a unique economic enterprise subsuming the plurality of companies the latter is composed of from a juridical point of view. However, the information which would allow to trace those links is generally not publicly available. That's why paragraph 3 of article 3 entitles the Ministry of Industry trade and craft and the commissioners in charge of the extraordinary administration to ask the required information to the Italian stock exchange regulator and other public institutions which have to disclose the information within 15 days. By the same token the trust societies involved may be required to disclose the actual owners of the shares they administer. The extraordinary administration is then extended to the other companies of the group provided they are declared insolvent by the law and the Italian Ministry of Industry trade and craft has issued a decree authorizing the procedure.

The four letters above that define the group are the result of an extensive inquiry carried out by the Ministry of Industry Trade and Craft under the direction of the Minister Romano Prodi who proposed the law. According to their analysis the four letters would allow the identification of all Italian groups. I couldn't access the preparatory materials that led to the four letters but I could access the stenographic transcript of the relevant parliamentary sittings kindly made available by the Italian parliament. In the next paragraph I present and comment the views emerging from the parliamentary debate which pertain article 3 of the law.

3.3 Views from the parliamentary debate

In the Italian legal system a law proposal and its subsequent modifications-amendments- have to be approved by both the Senate and the Chamber of Deputies-perfect bicameralism. I focus on the debate in the Chamber of Deputies at first in that it is more relevant for my ends and then briefly on the debate in the Senate. The number of pages referred to are those of the stenographic transcript quoted above from the Parliamentary sitting 7 March 1979 of the Chamber of Deputies.

The four letters above which define the group have never been called into question during the parliamentary debate, on the contrary the task carried out by the experts of the Ministry under the direction of Romano Prodi was praised see p. 16849. Instead it is the use of those four letters-i.e. the definition of group of companies" which happened to be strongly debated and

controversial. To say that article 3 with its definition of group of companies and the use that shall be made of it is a crucial point in the parliamentary debate is an understatement as the following quotations across the political spectrum show. “The most debated topic of the present law is the one related to the group of companies” *il tema più tormentato di questa normativa è quello che attiene al gruppo di imprese* p. 27981 Mannuzzu far left PCI, “it wasn’t possible to reach unanimous consent on only one article: article 3” *su un solo articolo non si è potuto raggiungere l’accordo unanime: l’articolo 3* Citaristi center –democrazia cristiana- p. 27985. “Article 3 represents the focus of the issue” *l’articolo 3 rappresenta il nodo di tutta la questione* Valensise left PSI Italian socialist party p. 27992, “an issue we deem central in the present decree-law, that is the identification of a “group” *una questione che riteniamo centrale in questo decreto-legge, e cioè sull’individuazione del “gruppo”*. Macciotta PCI communist party p. 28001.

The discussion turns around the thorny problem of liability (*responsabilità*), i.e. should the companies belonging to the group as defined in the four letters be liable or at least held accountable for the financial state of the company under extraordinary administration or instead the corporate veil should screen them off from any responsibility they may have toward that company? The most debated amendment presented to the law, the so called Felisetti law modification or amendment 3.1, worked in the direction of the first part of the question. In particular, the objective of the amendment was to include in the restructuring made possible by the extraordinary administration procedure also those companies in the group which, albeit profitable, have contributed to the insolvency of the company under extraordinary administration. “The companies [among those belonging to the group identified as above] which took part in money or other-types transfers to the detriment of the company under extraordinary administration or which are involved in acts of patrimonial or managerial confusion shall be considered as if they were insolvent and therefore jointly-liable (*solidarietà passiva*) with the latter.”

The views of those in favour-mainly from the far left parties- point to the fact that without that amendment the formal diaphragms shielding the companies belonging to the group would act as an actual barrier thereby making it impossible to pierce the corporate veil of the relevant companies. The group itself would not be involved in the extraordinary administration procedure. What could then be called consolidated position of the group would just exist as a mere representation of something not ontologically real.

From a political point of view it is clear that if the artificial separation of companies the group consist of is also substantial the entrepreneur will be left with the healthy societies

while at the same time the burden related to the restructuring of the societies involved in the procedure will fall on the State's finances. The issue is even stronger when considering cases where the financial soundness of some companies of the group is the result of the insolvency of other companies according to a cause and effect relationship. According to the politicians aligned with this view-see for example the pages with the intervention of S. Mannuzzu, a magistrate-, the failure to approve the amendment would lead to the "privatization of profits and the sharing of losses".

Instead, the inclusion of the companies belonging to the group in the extraordinary administration procedure would safeguard the interests of the employees and the national economy, which have to be privileged compared to those of creditors, investors and minority shareholders of the profitable societies included.

The opposing view, backed by the government, was against the amendment. According to the Christian democracy, extending the procedure to all companies in the group to which the society under extraordinary administration belongs would be unconstitutional, i.e. against article 3 first paragraph⁴⁶ and 42 third paragraph⁴⁷ -sic- of the Italian constitution. Which is to say that the limited liability principle in its twofold meaning would be overridden by the amendment and each company has the right to this limitation and cannot be deemed liable for the debts of another company. Under the Italian legal system it is therefore not possible to make the parent accountable for the obligation of its subsidiaries in case of insolvency of the latter.

Notwithstanding that view, the chamber of deputies approved the amendment 3.1 and the possible inclusion of the societies belonging to the group in the extraordinary administration procedure. However, the Senate didn't approve the amendment which therefore was not included in the law as issued. Instead, the Senate as a compromise added the possibility for the commissioners of the society under extraordinary administration to exercise the revocation claim against the societies of the group art 3 third paragraph, legitimized the commissioners to sue the directors and management of the related companies according to art 2409 of the Italian civil code 5th paragraph and made the directors of those societies jointly

⁴⁶ Article 3 first paragraph: "all citizens have equal social dignity and are equal before the law, without distinction of sex, race, language, religion, political opinions, personal and social conditions".

⁴⁷ Art 42: "Property is public or private. Economic goods belong to the State, to entities or to private persons. Private property is recognized and guaranteed by law, which determines the ways it is acquired, enjoyed and its limits in order to ensure its social function and to make it accessible to all.

Private property may be expropriated, in cases provided for by law and with provisions for compensation, for reasons of general interest. The law establishes the rules and limits of legitimate and testamentary inheritance and the rights of the State in [matters] of inheritance." Most likely the member of the parliament intended to refer to Art 42 second paragraph and not to Art 42 third paragraph as he did.

liable with the directors of the company under extraordinary administration in case of a uniform management with the parent company, last paragraph. From the debate in the Senate sitting of 21 March 1979⁴⁸ see pp. 16858, 16864 it is evident that the compromise is the result of the will of the government which couldn't accept the conversion into law of its decree-law with the modification described above –which, as approved by the Chamber of deputies, makes the related societies jointly-liable with the society under extraordinary administration.

3.4 Further developments of the concept of group of enterprises introduced by Italian law n.95/1979

The law n. 95/1979 about default administration procedures for large insolvent companies lived on as issued for two decades till 1999 when it had to be abrogated under increasing pressures of the European Commission. In fact, it was decided that the law was incompatible with the EU regulations on state aids. The European Commission also came to the decision that all the state aids unduly granted to companies in the ambit of the implementation of law n.95/1979 had not to be returned⁴⁹. In order to comply with the deliberations of the EU, the Italian government issued the legislative decree 270/1999 (so called Prodi *bis*) which besides abrogating the law n. 95/1979 (art. 109, a) reformed the discipline regulating default administration procedures for large insolvent companies. In particular, the new law strengthened and enlarged the concept of group of companies. The latter allowed to identify the entities belonging to the same “group” as that the entity under extraordinary administration belongs to and include them in the reorganization procedures.

It is art. 80 which allows for such identification. According to art. 80 first paragraph b) the undertakings belonging to the group (“*imprese del gruppo*”) are those which directly or indirectly control the company under default administration (“*società sottoposta alla procedura madre*”) (n.1), the companies directly or indirectly controlled by the undertaking under extraordinary administration or by the undertaking which controls the latter (n.2), the undertakings which, on the basis of the composition of the governing bodies or on the basis of other concurrent elements (“*altri elementi concordanti*”), prove to be subject to a common direction with the one of the undertaking under default administration (n.3). Finally, art. 80

⁴⁸ In the debate in the Senate it is also mentioned that the juridical concept of “group” and holding was first treated by Tullio Ascarelli and his school p. 16857.

⁴⁹ http://europa.eu/rapid/press-release_IP-00-483_it.htm

second paragraph specifies that control relationship can also be present referring to entities different from companies.

Art. 80 enlarged the concept of business group compared with what was prescribed by the previous law (art. 3 law n.95/1979). In fact, the former concerns also undertakings (“*imprese*”) while the latter was limited to companies (“*società*”). Moreover, according to art. 80 first paragraph b) n.3, the web of relationships leading to the identification of entities belonging to the group can be identified on the basis of “other concurrent elements”. The expression is deliberately large and subsumes letter d) of art. 3 of the law n.95/1979 which used the loans or guarantees granted to the company under extraordinary administration or to the companies referred to in the previous letters as the basis for identifying the related companies belonging to the same group. Besides financing or guarantee-guarantor relationships the new expression would include relationships based on the existence of a common brand, different types of shareholder agreements which inform the decision of the related entity or a unique directional center⁵⁰.

In sum, legislative decree 270/1999 confirmed the concept of business group introduced by law n. 95/1979 and made it more encompassing and flexible. The law which came after (law n. 39/2004, so called “*Legge Marzano*”) was adopted in order to effectively counter the serious financial distress of an Italian strategically important firm such as Parmalat and it made reference to the previous law “*Prodi-bis*” for identifying the companies belonging to the group whose definition was thus unchanged. However, further developments are expected to be introduced by the Italian government in response to the law n. 155/2017 issued on the 30th October 2017 calling the government to study a definition of “group of undertakings” modeled also on the basis of the concepts of coordination and common direction. That innovation would be part of a major overhaul of insolvency and other financial reorganization procedures (*procedure concorsuali/ legge fallimentare*) that the Italian Government has been called to make.

3.5 Chapter Conclusions

The present chapter reconstructed the conception and gestation of a law which allowed to go beyond the traditional juridical principle of the legal form of a company as a distinct legal entity (*soggetto giuridico*) also when the latter is a part of a group or controlled by a superior

⁵⁰ See: various authors, *La riforma dell'amministrazione straordinaria*, Roma, 2000 and various authors *Crisi di impresa e procedure concorsuali in Italia e in Europa*, Padova, 2002.

main economic actor. However, that law didn't go as far as to fully pierce the corporate veil in that a controlling company is not automatically liable for the controlled companies' liabilities in case of their bankruptcy. In any case, the four conditions examined above didn't leave the corporate veil intact, either. In fact, the former allow the identification of the unique enterprise entity subsuming the pluralism of legal companies. In so doing, they de facto provided an original definition of group of enterprises. The analysis of the parliamentary debate showed how the latter was shaped by the different political forces and the Italian economic and juridical context.

3.6 Chapter References

Camera dei Deputati. Disegno di legge- Conversione in legge del decreto-legge 30 gennaio 1979, n. 26 concernente provvedimenti urgenti per l'amministrazione straordinaria delle grandi imprese in crisi-presentato il 6 febbraio 1979.

Camera dei Deputati VII LEGISLATURA - DISCUSSIONI - SEDUTA n 408 DEL 7 MARZO 1979.

DECRETO-LEGGE 30 GENNAIO 1979, N. 26, ART. 3.

LEGGE 3 aprile 1979, n. 95 Conversione in legge, con modificazioni, del decreto-legge 30 gennaio 1979, n. 26, concernente provvedimenti urgenti per l'amministrazione straordinaria delle grandi imprese in crisi. (GU Serie Generale n.94 del 04-04-1979).

Senato della Repubblica-VII Legislatura-Discussioni-382° Seduta pubblica del 21 Marzo 1979.

3.7 Chapter Appendix 1 - Transcript of some relevant excerpts from the parliamentary debate-(in the original Italian).

Felisetti Luigi Dino

Ma il tema sul quale chiedo l'attenzione dei colleghi che si interessano della materia è quello dell' articolo 3, che rappresenta il nodo di tutta la questione. Ora, volendo esaminare in termini storici il problema, possiamo dire che esistono le società dal gruppo. A questo riguardo probabilmente varrebbe la pena di coordinare l'attività legislativa, perché vi è la definizione delle caratteristiche in forza delle quali le società sono in gruppo, quale è espressa in questo decreto, e vi è un'altra legge - se non sbaglio quella sulla riorganizzazione finanziaria - nella quale pure viene data una definizione, leggermente diversa, del gruppo di società. Ritengo doveroso che una soltanto sia la nozione da considerare, affinché non sussistano dubbi interpretativi di fronte a tipi diversi di istituto: il concetto di gruppo e le condizioni necessarie affinché le società possano considerarsi gruppo devono essere identici, qualunque sia la situazione legislativa che si prende in considerazione.

Veniamo comunque al discorso concernente il gruppo. La sentenza dichiarativa dello stato di insolvenza può riguardare (o riguarda nella specie) una sola società. Secondo una prima tesi, tutte le volte che una società sia colpita dalla dichiarazione dello stato di insolvenza, automaticamente tutte le società, del gruppo devono essere coinvolte in una sorta di chiamata in solidarietà. Secondo un'altra tesi, se in un grappolo d'uva c'è un acino marcio, perché condannare l'intero grappolo e non salvare, viceversa, tutti gli altri acini che sono sani? Ne consegue che la società in decozione deve essere posta in amministrazione straordinaria, sotto gestione commissariale, mentre tutte le altre non devono esserlo, anche perché a ciò osterebbe - e questo è un richiamo sotterraneo a questioni di costituzionalità, anche se da parte di alcuno è stato espresso apertamente - il fatto che le altre imprese sono autonome, sono persone giuridiche diverse, e perciò non possono essere sottoposte allo stesso trattamento riservato alla società in difficoltà. A nostro giudizio queste due posizioni sono troppo drastiche e fuori della realtà, anche per le complicazioni che deriverebbero dalla probabile paralisi dell'intero settore. Parliamoci chiaro: un discorso del genere, specie se spinto alle estreme conseguenze, comporta una modificazione radicale dell'impostazione economica del nostro paese, con riferimenti di carattere costituzionale e quant'altro.

Vivaddio: se queste cose s'han da fare, si facciano alla luce del sole, si facciano apertamente, si facciano adottando in modo organico provvedimenti idonei a modificare un certo tipo di impostazione economica! Io non credo sia un buon risultato per nessuno aver rovesciato, attraverso una sorta di incidente qual è quello costituito dal decreto-legge di cui ci stiamo occupando, i canoni di fondo di un certo ordinamento che, sia esso il ,migliore o il peggiore, ha rilievo costituzionale. E finché così è, così sia: se lo vogliamo modificare, modifichiamo pure; ma non accettiamo, nel modo più assoluto, il distinguo in base al quale, per un discorso veramente formalistico di autonomia dei singoli soggetti giuridici, quali sono le società, una società del gruppo non possa essere attratta nell'ambito dell'amministrazione straordinaria soltanto perché formalmente- si denomina in modo diverso, ha un organo amministrativo diverso (magari soltanto per qualche persona e non per tutte), ha un azionariato diverso - al limite solo per il cinque per cento - dall'altra società. Parliamoci chiaro: tutte le volte che è successo o succede che un imprenditore, che è la mente organizzativa di tutto il complesso che ruota attorno al cosiddetto gruppo, si muove in modo tale - per malizia od anche per genuina scelta economica ed imprenditoriale - da spolpare di fatto (non mi interessa se artatamente o meno) una delle società per rimpinguarne un'altra delle proprie, mandando allo sbaraglio quella che meno gli preme o che crede essere la più facilmente condannabile, ed ha distratto ed ha trasferito, ha commissionato il patrimonio di questa con il patrimonio di quella, perché dovremmo arrenderci, di fronte ad un formalismo in base al quale il giudice o il commissario trova questa società che è in decozione e le altre per le quali si presenta un bilancio attivo, e dice: Queste qui non le tocchiamo !? Tutto ciò significa veramente, secondo il detto che corre nella piazza (e si ha ragione di ripeterlo), privatizzare gli utili e socializzare le perdite. A questo punto, non solo per ragioni tecnico-giuridiche, ma per ragioni sociali e morali, una cosa del genere non può, a mio giudizio, essere consentita. E il motivo per il quale siamo lieti di aver registrato - e ci auguriamo si estenda ancora di più - la confluenza delle forze politiche di sinistra e di altri settori su una proposta di emendamento all'articolo 3 del decreto-legge che tende a realizzare, in termini di equilibrio, di equità, di moralità, di scelta sociale e con il conforto di una sua validità sul piano tecnico e giuridico, una modifica che ci auguriamo possa essere fatta propria da questa Assemblea o, quanto meno, dalla maggioranza di essa. Signor Presidente, tocco ancora brevemente due argomenti e quindi concludo rapidamente. Innanzitutto, quello che fa riferimento all'articolo 6 del decreto-legge, relativo alla competenza. Mi pare vi sia una disponibilità del Governo in una determinata direzione, ed io ne prendo atto. Comunque,

l'aver accentrato l'intera competenza in questa materia nel tribunale di Roma, come avviene secondo l'articolo 6 nell'originario testo governativo, non credo giovi ad alcuno.

Mannuzzu

Comunque il tema più tormentato di questa normativa è quello che attiene al gruppo di imprese, strumento normale dell'economia moderna, nella quale operano soggetti economici unitari, divisi, però in segmenti con propria identità formale e giuridica. Al riguardo, vorrei ancora una volta, richiamare la elaborazione straniera, specie quella della Germania federale. (Ma esistono anche precedenti legislativi nazionali: lo stesso articolo 2359 del codice civile, già nel testo del 1942 e con 1,e successive, penetranti modifiche del 1974; lo stesso articolo 2362 del codice civile, che prevede l'ipotesi dell'unico azionista responsabile anche in proprio per i debiti societari, con il superamento dunque del diaframma formale tra soggetto economico e soggetto giuridico. Ed ancora, la legge 24 giugno 1974, n. 268, sul rifinanziamento del piano di rinascita della Sardegna; la legge 2 maggio 1976, n. 183, sull'intervento straordinario nel Mezzogiorno; la legge 12 agosto 1977, n. 675, sulla ristrutturazione industriale; la legge 5 dicembre 1978, n. 787, sul risanamento finanziario delle imprese). - Si può concludere che la più importante legislazione economica del paese - comunque quella degli ultimi anni - si fa carico di questo problema. Nel decreto legge al nostro esame la nozione di gruppo è data sulla base di ipotesi di controllo diretto o indiretto tra le società; sulla base di ipotesi di unicità di direzione, secondo la composizione degli organi amministrativi, cioè per la identità delle persone che fanno parte degli organi sociali o per la qualità dei rapporti fra queste persone; infine, sulla base di ipotesi di concessione di crediti o garanzie, per un certo importo, fra le società. Si prevede il coinvolgimento nella amministrazione straordinaria delle società appartenenti al gruppo, secondo la nozione che così se ne dà, anche se non ricorrono i presupposti soggettivi - entità e qualità della esposizione debitoria - necessari perché si inizi la procedura. Se questi sono i presupposti soggettivi, a quale condizione è sottoposta la procedura di amministrazione straordinaria? Perché essa si apra, è necessaria l'insolvenza del primo dei soggetti coinvolti: e per insolvenza s'intende quella che fa riferimento l'articolo 5 della legge fallimentare. Le Commissioni però hanno apportato una interessante modifica rispetto al testo originario, ponendo una presunzione assoluta di insolvenza, sulla base di una inadempienza particolare: quella relativa a tre mensilità di retribuzione. Questo è avvenuto in considerazione della inerzia storica, dei tribunali nel ritenere lo stato di insolvenza delle grandi imprese, e della

difficoltà oggettiva di questo accertamento, in un sistema nel quale i meccanismi assistenziali finiscono sempre per scattare; è avvenuto, infine, in considerazione della maggiore responsabilità del grande imprenditore, per le conseguenze sociali del suo operato. Quest'ultima considerazione è la ragione di fondo della procedura differenziata cui si sta dando vita. Secondo il testo governativo, approvato dalla maggioranza delle Commissioni, è necessaria anche l'insolvenza delle società da coinvolgere appartenenti al gruppo. La scelta è radicalmente opposta a quella del disegno di legge n. 2380, dell'agosto del 1978, e del decreto-legge presentato ai primi di ottobre del 1978, che riguardano lo stesso tema. Si tratta di scelte sulle quali, a suo tempo, la Commissione affari costituzionali, si è pronunciata positivamente, sollecitando solo un approfondimento, della nozione ,di gruppo, in termini di certezza. Si tratta di scelte che ancora vengono sottoposte alla approvazione del Parlamento, con il disegno di legge n. 2380, anch'esso all'ordine del giorno. Se non si seguisse questa via, resterebbe irrilevante e improduttiva di effetti la sostanziale unità dell'organismo economico articolato in gruppo: debiti e responsabilità non si comunicherebbero all'interno di esso; i diaframmi formali tra i diversi segmenti funzionerebbero da effettiva barriera; il gruppo non verrebbe coinvolto di per sé. La posizione che così si vorrebbe assumere è oggettivamente arretrata rispetto a tutti i precedenti legislativi nazionali dei quali si è dato atto e non tiene conto dell'articolo 239 della proposta per lo statuto delle società per azioni europee, secondo il quale - cito testualmente - " l'impresa dominante del gruppo risponde degli obblighi contratti dalle società dipendenti" . Occorre, quindi, porsi un grosso quesito politico. La scomposizione artificiale (artificiale sul piano economico) tra le diverse parti di un organismo economico che il grande imprenditore gestisce unitariamente consente risultati economici positivi, nuovi, capaci di superare la logica della mera assistenza? O questa logica assistenziale si conferma e si radica addossando alla collettività le iniziative passive e lasciando al grande imprenditore le aziende che fruttano ? Il quesito si rafforza osservando che, in genere, la salute, la solvibilità di talune delle società del gruppo dipende, secondo un preciso rapporto di causa ed effetto, dal malessere, dallo stato di insolvenza di altre società dello stesso gruppo. Da ultimo, un cenno sulle garanzie e sulle modalità dell'accertamento dei presupposti soggettivi e delle condizioni per l'apertura e l'estensione della procedura di amministrazione straordinaria. Si tratta di un accertamento giudiziario, da compiersi, per quanto attiene all'inizio della procedura, ai sensi dell'articolo 195 della legge fallimentare. Sarebbe comunque opportuno che questa norma venisse richiamata anche a proposito dell'estensione della procedura alle società del gruppo. Per concludere, vorrei segnalare il carattere straordinario dell'intervento compiuto con questo atto normativo, che - giova

sottolinearlo - si pone come limite temporale l'entrata in vigore di una legge di riforma del regime delle società. Mi sembra di dover insistere sulla necessità di una sollecita e concludente elaborazione su questo tema, in modo da colmare un ritardo rispetto alle esigenze della realtà e rispetto alla legislazione europea, un ritardo che è cagione delle più gravi difficoltà che ora dobbiamo affrontare: in tema di coinvolgimento dell'intero gruppo, con tutte le società che lo compongono. Ma mentre questo ritardo ancora dura, le scelte che si compiranno per mantenerlo, per difenderne le incongruenze, oppure per colmarlo, nel senso indicato dall'articolo 3 del decreto-legge 30 gennaio 1979, n. 26, oppure nel senso opposto del disegno di legge governativo n. 2380 dell'agosto del 1978, saranno certo pietra di paragone, manifesteranno se si intende veramente avviare con decisione il risanamento delle grandi imprese.

Citaristi

Su un solo articolo del decreto-legge non si è potuto raggiungere l'accordo unanime: l'articolo 3. Tale articolo, per definire il concetto di gruppo - come ha ricordato un momento fa il collega onorevole Mannuzzu -, prevede quattro tipi di rapporti fondati alternativamente sul controllo attivo, sul controllo passivo, sulla sostanziale unicità di direzione e sulla concessione di crediti o garanzie alla società in amministrazione straordinaria o alle altre società collegate per un importo superiore a un terzo del valore complessivo delle proprie attività. Ritengo che questa definizione sia valida per estendere le procedure previste dal decreto a tutte le aziende veramente collegate; sia valida per unificare il complesso produttivo da affidare all'amministrazione commissariale; sia inoltre valida per rendere possibile il trasferimento di impianti e stabilimenti fra loro integrati in modo da poter realizzare un maggiore ricavo. Questa estensione della procedura però presuppone l'insolvenza di tali società, insolvenza che deve essere accertata in sede giudiziaria. Se tali società non sono dichiarate insolventi, non vengono coinvolte nella procedura prevista dal decreto-legge. La maggioranza è favorevole al testo originario dell'articolo 3 e in sede di Commissione ha respinto gli emendamenti presentati che in qualche modo prevedevano una responsabilità solidale delle società collegate, anche se non insolventi, per i debiti della società primaria mente assoggettata alla procedura di amministrazione straordinaria. La maggioranza ritiene che le società collegate lato sensu possano venire coinvolte nel provvedimento iniziato a carico della prima società solo se a loro volta risultino insolventi, restando comunque distinte le masse attive e quelle passive. L'estensione del provvedimento

ha solo lo scopo di raggruppare tutto il complesso aziendale, anche se frazionato fra più società giuridicamente distinte, al fine di gestirle in forma unitaria e di alienarlo a più vantaggiose condizioni. La maggioranza non è insensibile alle motivazioni addotte e contenute negli emendamenti presentati, dalle minoranze e illustrati un momento fa dal collega onorevole Mannuzzu, ma ritiene che tali emendamenti silano in contrasto ,con il nostro ordinamento giuridico e con gli articoli 3, primo comma, e 42, terzo comma della nostra Carta fondamentale. Il relatore ritiene che, fino a quando non sarà superato il principio della responsabilità limitata alle proprie obbligazioni, nel duplice senso che il socio risponde nel limite del proprio conferimento e la società risponde dei debiti propri e non di quelli di altre società in qualche modo ad essa collegate, ogni tentativo di coinvolgere nel procedimento che segue all'insolvenza di un singolo ente anche le altre società considerate facenti parte di un unico gruppo pare destinato all'insuccesso, o almeno a creare problemi e difficoltà giuridicamente insuperabili. E' stato giustamente affermato che ogni società ha diritto a questa limitazione; diritto che sarebbe annullato da una norma che dichiarasse una data società responsabile dei debiti di un'altra, e per di più in base a fatti compiuti, quando una tale responsabilità, per giunta solidale, era non solo non prevista, ma espressamente esclusa.

Macciotta

Oggi prendiamo atto del fatto che ancora una volta le nostre posizioni concordano con quelle del movimento dei lavoratori, e concordano in particolare su una questione che riteniamo centrale in questo decreto-legge, e cioè sull'individuazione del "gruppo" (omissis) . Non ci sfugge la complessità della materia. Esistono delicate questioni giuridiche che già altri colleghi hanno rilevato ed esistono problemi economici posti proprio dall'indeterminatezza ,del concetto di gruppo, dalla complessità delle costruzioni di fatto. E non ci sfugge il fatto che risolvere questi problemi con il decreto- legge non è forse la strada più lineare che si potesse scegliere. Rimarrà, anche dopo la conversione in legge di questo decreto-legge, tutto il tema complesso della riforma, delle società per azioni e della legislazione in questa materia, che è certamente sorpassata e non più adeguata né alla complessità dei problemi né alla crescita della coscienza sociale. (omissis)

La questione centrale - quella che ancora ci vede divisi in quest'aula - è però quella dell'articolo 3. Io credo che il primo comma dell'articolo in questione abbia ben individuato le possibili società componenti il gruppo. Da parte degli esperti del Ministero dell'industria è

stato fatto un lavoro completo che ha meglio individuato la composizione di un gruppo che già in altri provvedimenti era stata formulata. Con il secondo comma questa individuazione è stata - almeno da punto di vista dell'utilizzazione che se ne può fare a norma del decreto-legge estremamente limitata. Quando noi chiediamo che quelle società, individuate come componenti del gruppo, vengano coinvolte nella gestione commissariale, ci muoviamo per una duplice esigenza: di dare un segno di moralizzazione e di poter seriamente procedere sul terreno del risanamento (omissis). Occorre, da una parte, eliminare uno dei polveroni sollevato sulla questione: nessuno ha interesse ad utilizzare società sane per spolparle; si ha interesse, ad assumere le società sane nel complesso del gruppo, per procedere alla moralizzazione ed al risanamento di cui ho detto. Ci si dice che comunque, andando ad un provvedimento per fotografia, la maggior parte delle società che pensiamo debbano essere coinvolte nel gruppo, sarebbe comunque coinvolta: a parte il fatto che ciò è discutibile, in ogni caso ci è stato spesso ricordato che la norma deve essere generale ed astratta, mentre per ogni "Enteco" che è possibile coinvolgere oggi nella eventuale gestione commissariale del gruppo SIR, già è pronta, onorevole rappresentante del Governo, una società parallela alla quale si vanno trasferendo i brevetti e le risorse del gruppo SIR. Molto si è parlato in queste settimane di gruppi potenzialmente coinvolgibili: della SIR, della Liquichimica, della Maraldi. Vorrei parlare, signor Presidente, di un altro di questi gruppi, vorrei parlare della Polisarda, gruppo ignoto ai più. Se esaminiamo lo statuto di questa società, il suo verbale, scopriamo che la Polisarda è proprietaria della Sirfi che è a sua volta proprietà della ViniSarda, a sua volta proprietà della Sardapolimeri, a sua volta proprietà della Siref, a sua volta, proprietà della Sirtene, a sua volta proprietà della Ferlinda. Questa, a sua volta, è proprietaria della Sardoil, della SIR, della Sirben, della Elsir, della Sirom, della Sirm, dell'Antores, dell'Andromeda, dell'Inttermare, dell'Athena; queste società sono a loro volta proprietarie di altre 38 società! Questo, onorevoli colleghi, sino alle ore 14,29 del giorno 27 novembre 1978, perché alle ore 14,30 di quel giorno, davanti al dottor Giovanni Lainatti, si è presentato il signor Nino Rovelli che, in quanto proprietario totalitario del capitale della "SIR - Consorzio finanziario", ha dichiarato di voler conferire a quella società l'intero capitale della società "Ferlinda" di cui era pure titolare dell'intero pacchetto azionario! In quella data, la società Ferlinda è stata incorporata nella SIR - Consorzio finanziario che ha con la occasione cambiato il suo nome ribattezzandosi SIR finanziaria, le 38 società della Ferlinda sono andate insieme alle 55 società della Fisalfa, alle 4 società di Battipaglia, alle 3 società di Sant'Eufemia e via dicendo, per un totale di 128 società: ma in questo elenco non abbiamo trovato la Pausania editore, titolare del giornale L'unione sarda, che è pure del

gruppo Rovelli. Onorevoli colleghi, di quali gruppi stiamo parlando ? E' veramente possibile che si conceda a personaggi come l'ingegner Rovelli o il signor Ursini, o il signor Maraldi, di continuare con questi giochi che sono stati giustamente definiti il processo di rovellizzazione dell'industria italiana?

3.8 Chapter Appendix 2 - Legal texts

TESTO DEL DECRETO- LEGGE 30 GENNAIO 1979, N. 26, ART. 3.	TESTO DEL DISEGNO DI LEGGE APPROVATO DALLA CAMERA DEI DEPUTATI, ART. 3.	TESTO DEL DISEGNO DI LEGGE APPROVATO DAL SENATO DELLA REPUBBLICA, ART. 3.
<p style="text-align: center;">Art. 3.</p> <p>Società o imprese controllate, a direzione unica e garanti</p> <p>Dalla data della pubblicazione nella Gazzetta Ufficiale del decreto con il quale è stata disposta l'amministrazione straordinaria di una società di cui al primo comma dell'art. 1, sono soggette alla medesima procedura a norma del presente decreto-legge, ancorché non si trovino nelle condizioni previste nel detto comma:</p> <p>a) la società che controlla direttamente o indirettamente la società in amministrazione straordinaria;</p> <p>b) le società direttamente o indirettamente controllate dalla società in amministrazione straordinaria o dalla società che la controlla;</p> <p>c) le società che in base alla composizione dei rispettivi organi amministrativi risultano sottoposte alla stessa direzione della società in amministrazione straordinaria;</p> <p>d) le società che hanno concesso crediti o garanzie alla società in amministrazione straordinaria e alle società di cui alle precedenti lettere per un importo superiore, secondo le risultanze dell'ultimo bilancio, ad un terzo del valore complessivo delle proprie attività.</p> <p>L'accertamento giudiziario dello stato di insolvenza delle società suindicate può essere richiesto anche dal commissario o dai commissari nominati con il</p>	<p>identico</p> <p>all'articolo 3, secondo comma, il primo periodo è sostituito dal seguente: L'accertamento giudiziario dello stato di insolvenza delle società su indicate è compiuto dal tribunale ai sensi del secondo comma dell'articolo 1, anche per iniziativa del commissario o dei commissari. E' equiparata allo stato di insolvenza, con conseguente solidarietà passiva, la condizione delle società che hanno partecipato ad atti di trasferimento in pregiudizio della società già assoggettata ad amministrazione straordinaria, o che sono rimaste coinvolte in fatti di sostanziale confusione</p>	<p>identico</p> <p>all'articolo 3, secondo comma, il primo periodo è sostituito dal seguente: L'accertamento giudiziario dello stato di insolvenza delle società su indicate è compiuto dal tribunale ai sensi del secondo comma dell'articolo 1, anche per iniziativa del commissario o dei commissari.</p>

<p>decreto di cui al primo comma e dal pubblico ministero. Alla procedura di amministrazione straordinaria, da disporre con separato decreto per ciascuna società, devono essere preposti gli stessi organi nominati con decreto di cui al primo comma, salvo eventuale integrazione del comitato di sorveglianza anche in eccedenza al numero massimo previsto nell'art. 198 del regio decreto 16 marzo 1942, n. 267.</p> <p>Il Ministero dell'industria, del commercio e dello artigianato e i commissari, allo scopo di accertare la esistenza di società nelle condizioni di cui al primo comma, possono richiedere informazioni alla Commissione nazionale per le società e la borsa e ad ogni altro pubblico ufficio, che sono tenuti a fornirle entro quindici giorni. Al medesimo fine possono richiedere alle società fiduciarie di cui alla legge 23 novembre 1939, n. 1966, le generalità degli effettivi proprietari dei titoli azionari intestati al proprio nome. Tali società sono parimenti tenute a rispondere entro quindici giorni.</p>	<p>patrimoniale con tale società. E al medesimo comma, le parole: del regio decreto 16 marzo 1942, n.267, sono sostituite dalle seguenti: dalla legge fallimentare;</p>	<p>all'articolo 3, dopo il secondo, sono aggiunti i seguenti commi: Nei confronti delle società di cui al primo comma, ancorché non sia stato accertato lo stato di insolvenza, il commissario o i commissari delle società poste in amministrazione straordinaria possono esperire l'azione revocatoria di cui all'articolo 67 della legge fallimentare, relativamente agli atti indicati ai numeri 1), 2) e 3) dello stesso articolo, posti in essere nei cinque anni anteriori alla sentenza dichiarativa dello stato di insolvenza della società in amministrazione straordinaria, e relativamente agli atti indicati al n. 4) e al secondo comma di detto articolo, posti in essere nei tre anni anteriori.</p> <p>Ai fini dell'esperimento dell'azione il commissario o i commissari possono richiedere informazioni alla Commissione nazionale per le società e la borsa, e ad ogni altro pubblico ufficio, che sono tenuti a fornirle entro trenta giorni. Possono altresì chiedere alla CONSOB di effettuare, allo scopo di accertare tutti i rapporti di carattere giuridico e patrimoniale intercorsi tra le società in amministrazione straordinaria e quelle passivamente legittimate rispetto all'azione revocatoria di cui al comma precedente, le indagini consentite dalla legge 7 giugno 1974, n. 216. L'accertamento deve compiersi entro 120 giorni dalla data della richiesta.</p> <p>Il commissario è legittimato a proporre la denuncia prevista dall'articolo 2409 del codice civile contro gli amministratori e i sindaci delle società indicate alle lettere a), b) e c) del primo comma del presente articolo. Ove il tribunale accerti la sussistenza delle più gravi irregolarità di cui al terzo comma del citato articolo</p>
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		<p>2409 il commissario potrà essere nominato amministratore giudiziario della società i cui amministratori hanno compiuto le gravi irregolarità sopra indicate.</p> <p>Le domande giudiziali previste dai commi precedenti e quelle di responsabilità cui il commissario è legittimato a norma dell'articolo 206, primo comma, della legge fallimentare, vanno proposte dinanzi al tribunale che ha accertato il primo stato di insolvenza ai sensi dell'articolo 1, secondo comma, con il rito disciplinato dalla legge 11 agosto 1973, n. 533. Le relative sentenze sono provvisoriamente esecutive.</p> <p>Le norme di cui ai commi precedenti sono applicabili anche agli atti e ai fatti posti in essere anteriormente all'entrata in vigore del presente decreto-legge; all'articolo 3, dopo l'ultimo è aggiunto il seguente comma:</p> <p>Nei casi di società collegate anorma del primo comma del presente articolo, ove si verifichi l'ipotesi di una direzione unitaria, gli amministratori delle società che hanno esercitato tale direzione rispondono in solido con gli amministratori della società in amministrazione straordinaria dei danni da questi cagionati alla società stessa;</p>
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LEGGE 3 aprile 1979, n. 95

Conversione in legge, con modificazioni, del decreto-legge 30 gennaio 1979, n. 26, concernente provvedimenti urgenti per l'amministrazione straordinaria delle grandi imprese in crisi. (GU Serie Generale n.94 del 4-4-1979)

La Camera dei deputati ed il Senato della Repubblica hanno approvato;

IL PRESIDENTE DELLA REPUBBLICA

PROMULGA

la seguente legge:

Articolo unico

È convertito in legge il decreto-legge 30 gennaio 1979, n. 26, concernente provvedimenti urgenti per l'amministrazione straordinaria delle grandi imprese in crisi, con le seguenti modificazioni:

l'articolo 1 è sostituito dal seguente:

Art. 1 - (Imprese soggette all'amministrazione straordinaria e norme applicabili). - Le imprese di cui al primo comma dell'articolo 1 della legge fallimentare, approvata con regio decreto 16 marzo 1942, n. 267, sono soggette a procedura di amministrazione straordinaria, con esclusione del fallimento, qualora abbiano una esposizione debitoria, verso istituti o aziende di credito o istituti di previdenza e di assistenza sociale, superiore a cinque volte il capitale versato ed esistente secondo l'ultimo bilancio approvato nonché a venti miliardi di lire, di cui almeno uno per finanziamenti agevolati.

Quando sia stato accertato giudiziariamente, ai sensi degli articoli 5 e 195 della legge fallimentare, d'ufficio o ad iniziativa dei soggetti indicati dall'articolo 6 della predetta legge, lo stato di insolvenza dell'impresa ovvero l'omesso pagamento di almeno tre mensilità di retribuzione, il Ministro dell'industria, del commercio e dell'artigianato dispone con proprio decreto, di concerto con il Ministro del tesoro, la procedura di amministrazione straordinaria.

La procedura si attua ad opera di uno o tre commissari sotto la vigilanza del Ministro dell'industria, del commercio e dell'artigianato ed è disciplinata, in quanto non diversamente stabilito con il presente decreto-legge, dagli articoli 195 e seguenti e dall'articolo 237 della legge fallimentare. La revoca del commissario è disposta su parere conforme del Comitato dei Ministri per il coordinamento della

politica industriale (CIPI). Del comitato di sorveglianza devono far parte, a seconda che sia composto da tre o da cinque membri, uno o due creditori chirografari, scelti tra persone particolarmente esperte nel ramo di attività esercitato dall'impresa. A tutti gli effetti stabiliti dalla legge fallimentare, il provvedimento di cui al comma precedente è equiparato al decreto che ordina la liquidazione coatta amministrativa; l'articolo 2 è sostituito dal seguente:

Art. 2 - (Poteri e compenso del commissario). - Con il decreto che dispone la procedura di amministrazione straordinaria può essere disposta, tenendo anche conto dell'interesse dei creditori, la continuazione dell'esercizio dell'impresa da parte del commissario per un periodo non superiore a due anni, prorogabile una sola volta per non oltre un anno su conforme parere del CIPI. Con successive decreti, tenendo anche conto di eventuali richieste del comitato di sorveglianza e su conforme parere del CIPI, può essere in tutto o in parte revocata l'autorizzazione a continuare l'esercizio dell'impresa. Il commissario predispone un programma, la cui esecuzione deve essere autorizzata dall'autorità di vigilanza su conforme parere del CIPI. Il programma deve prevedere, in quanto possibile e tenendo conto degli interessi dei creditori, un piano di risanamento, coerente con gli indirizzi della politica industriale, con indicazione specifica degli impianti da riattivare e di quelli da completare, nonché degli impianti o complessi aziendali da trasferire e degli eventuali nuovi assetti imprenditoriali; per quanto possibile deve essere preservata l'unità dei complessi operativi, compresi quelli da trasferire. Sino a quando il programma non è esecutivo, gli atti eccedenti l'ordinaria amministrazione devono essere specificatamente autorizzati dal CIPI a pena di nullità. L'autorizzazione non è necessaria per gli atti previsti nell'articolo 35 della legge fallimentare, se di valore non superiore a lire duecento milioni. Nella distribuzione di acconti ai creditori previsti dal secondo comma dell'articolo 212 della legge fallimentare sono preferiti i lavoratori dipendenti e le imprese artigiane e industriali con non più di cento dipendenti. Il compenso del commissario è liquidato dall'autorità di vigilanza in base agli emolumenti spettanti ai presidenti degli enti pubblici economici e tenendo conto della entità della gestione; dopo l'articolo 2, è inserito il seguente:

Art. 2-bis - (Garanzia dello Stato). - Il Tesoro dello Stato può garantire in tutto o in parte i debiti che le società in amministrazione straordinaria contraggono con istituzioni creditizie per il finanziamento della gestione corrente e per la riattivazione ed il completamento di impianti, immobili ed attrezzature industriali. L'ammontare complessivo delle garanzie prestate ai sensi del precedente comma non può eccedere, per il totale delle imprese garantite, i cinquecento miliardi di lire. Le condizioni e modalità della prestazione delle garanzie saranno disciplinate con decreto del Ministro del tesoro su conforme delibera del CIPI. Gli oneri derivanti dalle garanzie graveranno su apposito capitolo dello stato di previsione del Ministero del tesoro, da classificarsi tra le spese di carattere obbligatorio;

all'articolo 3, secondo comma, il primo periodo è l'accertamento giudiziario dello stato di insolvenza delle società su indicate è compiuto dal tribunale ai sensi del secondo comma dell'articolo 1, anche per iniziativa del commissario o dei commissari; e al medesimo comma le parole: del regio decreto 16 marzo 1942, n.267, sono sostituite dalle seguenti: della legge fallimentare;

all'articolo 3, dopo il secondo, sono aggiunti i seguenti commi:

Nei confronti delle società di cui al primo comma, ancorché non sia stato accertato lo stato di insolvenza, il commissario o i commissari delle società poste in amministrazione straordinaria possono esperire l'azione revocatoria di cui all'articolo 67 della legge fallimentare, relativamente agli atti indicati ai numeri 1), 2) e 3) dello stesso articolo, posti in essere nei cinque anni anteriori alla sentenza dichiarativa dello stato di insolvenza della società in amministrazione straordinaria, e relativamente agli atti indicati al n. 4) e al secondo comma di detto articolo, posti in essere nei tre anni anteriori. Ai fini dell'esperimento dell'azione il commissario o i commissari possono richiedere informazioni alla Commissione nazionale per le società e la borsa, e ad ogni altro pubblico ufficio, che sono tenuti a fornirle entro trenta giorni. Possono altresì chiedere alla CONSOB di effettuare, allo scopo di accertare tutti i rapporti di carattere giuridico e patrimoniale intercorsi tra le società in amministrazione straordinaria e quelle passivamente legittimate rispetto all'azione revocatoria di cui al comma precedente, le indagini consentite dalla legge 7 giugno 1974, n. 216. L'accertamento deve compiersi entro 120 giorni dalla data della richiesta. Il commissario è legittimato a proporre la denuncia prevista dall'articolo 2409 del codice civile contro gli amministratori e i sindaci delle società indicate alle lettere a), b) e c) del primo comma del presente articolo. Ove il tribunale accerti la sussistenza delle più gravi irregolarità di cui al terzo comma del citato articolo 2409 il commissario potrà essere nominato amministratore giudiziario della società i cui amministratori hanno compiuto le gravi irregolarità sopra indicate. Le domande giudiziali previste dai commi precedenti e quelle di responsabilità cui il commissario è legittimato a norma dell'articolo 206, primo comma, della legge fallimentare, vanno proposte dinanzi al tribunale che ha accertato il primo stato di insolvenza ai sensi dell'articolo 1, secondo comma, con il rito disciplinato dalla legge 11 agosto 1973, n. 533. Le relative sentenze sono provvisoriamente esecutive. Le norme di cui ai commi precedenti sono applicabili anche agli atti e ai fatti posti in essere anteriormente all'entrata in vigore del presente decreto-legge;

all'articolo 3, dopo l'ultimo è aggiunto il seguente comma:

Nei casi di società collegate a norma del primo comma del presente articolo, ove si verifichi l'ipotesi di una direzione unitaria, gli amministratori delle società che hanno esercitato tale direzione rispondono in solido con gli amministratori della società in amministrazione straordinaria dei danni da questi cagionati alla società stessa;

all'articolo 4, primo comma, sono soppresse le parole: al momento della dichiarazione o successivamente; al secondo comma, le parole: del regio decreto 16 marzo 1942, n. 267, sono sostituite dalle seguenti: della legge fallimentare;

l'articolo 5 è sostituito dal seguente:

Art. 5 - (Interventi di società consortili). - Ai fini dell'acquisto di aziende, complessi aziendali o impianti appartenenti alle imprese poste in amministrazione straordinaria ai sensi del presente decreto, le società consortili, di cui alla legge 5 dicembre 1978, n. 787, possono costituire nuove società per azioni. Le disposizioni del presente decreto non si applicano, dalla data della costituzione e per la durata della società consortile, alle imprese per il cui risanamento sia stata autorizzata la costituzione di società consortili ai sensi della legge 5 dicembre 1978, n. 787, né alle società che le controllano a norma del secondo comma dell'articolo 2 della legge medesima. Tuttavia la società consortile può in ogni momento domandare la dichiarazione giudiziaria dello stato di insolvenza di tali imprese, ai sensi e per gli effetti del presente decreto;

dopo l'articolo 5, sono inseriti i seguenti:

Art. 5-bis - (Agevolazioni fiscali sui trasferimenti).

I trasferimenti di aziende o di complessi aziendali, anche relative a singoli rami di impresa, appartenenti alle imprese poste in amministrazione straordinaria ai sensi del presente decreto sono soggetti alla imposta di registro nella misura fissa di un milione di lire;

Art. 5-ter - (Modifiche all'articolo 4 della legge 5 dicembre 1978, n. 787). - Dopo l'articolo 4 della legge 5 dicembre 1978, n. 787, è inserito il seguente:

"Art. 4-bis. - Il Ministro del tesoro, sentito il parere del Comitato per il credito e il risparmio, una volta approvati i piani di risanamento ai sensi del precedente articolo 4, può convocare gli istituti di credito a medio e lungo termine che esercitano il credito industriale e le aziende di credito, i quali risultino essere creditori dell'impresa il cui piano di risanamento è stato approvato affinché deliberino sulla costituzione di una società consortile ai sensi e per gli effetti di cui all'articolo 1, destinata al risanamento dell'impresa medesima. La costituzione della società consortile deve essere approvata dalla maggioranza degli, istituti ed aziende votanti la quale rappresenti tre quarti della totalità dei crediti, degli istituti ed aziende convocati per la deliberazione. La partecipazione alla società consortile, la cui costituzione è approvata a norma del comma precedente, è vincolante per tutti gli istituti ed aziende convocati per la deliberazione, i quali sono obbligati a partecipare alla società consortile in misura proporzionale ai rispettivi crediti nei confronti della impresa da risanare, fermi restando i limiti previsti dal quinto e sesto comma dell'articolo 1 della presente legge.

È tuttavia consentito agli istituti od aziende dissenzienti o che non abbiano partecipato alla votazione di rinunciare a partecipare alla società consortile negando la propria adesione con

comunicazione al Ministro del tesoro entro il termine perentorio di 30 giorni dalla comunicazione della deliberazione. In tal caso le quote di partecipazione dei creditori che abbiano negato la propria adesione saranno ripartite fra gli istituti e le aziende partecipanti in misura proporzionale alle rispettive quote, sempre nel rispetto dei limiti previsti dal quinto e sesto comma dell'articolo 1 della presente legge.

Dalla data dell'invio dell'avviso di convocazione di cui al primo comma e per i due anni successivi, gli istituti e le aziende che hanno negato la propria adesione non possono, sotto pena di nullità, iniziare o proseguire azioni esecutive sul patrimonio della impresa per il cui risanamento è stata costituita la società consortile né possono acquistare diritti di prelazione con efficacia rispetto agli istituti ed aziende di credito che hanno partecipato alla società consortile medesima. Le prescrizioni che sarebbero state interrotte dagli atti predetti rimangono sospese e le decadenze non si verificano";

all'articolo 6, il primo e il secondo comma sono sostituiti dai seguenti:

Ai fini di quanto previsto dalla legge fallimentare, relativamente alle imprese per le quali è stata disposta la procedura di amministrazione straordinaria è competente il tribunale che ha accertato lo stato di insolvenza ai sensi del secondo comma dell'articolo 1 del presente decreto, ferma restando la competenza ordinaria per le opposizioni alle sentenze dichiarative dello stato di insolvenza e alle sentenze di cui all'articolo 4 del decreto stesso.

L'opposizione non sospende l'esecuzione della sentenza. La cancellazione di iscrizioni ipotecarie sui beni delle imprese in amministrazione straordinaria venduti dal commissario è ordinata con decreto del Ministro dell'industria, del commercio e dell'artigianato;

dopo l'articolo 6, sono inseriti i seguenti:

Art. 6-bis - (Modalità di trasferimenti di complessi aziendali). -

Nei casi di trasferimenti di aziende, impianti o complessi aziendali o di immobili o mobili in blocco è consentita la vendita senza incanto e la vendita ad offerta privata, previa l'autorizzazione dell'autorità di vigilanza e sentito il parere del comitato di sorveglianza.

Nei casi predetti, il valore dei beni da trasferire è determinate da uno o più esperti nominati dal commissario liquidatore i quali si atterranno ai criteri di valutazione propri a ciascuno dei beni da trasferire e, quando trattasi di aziende o complessi aziendali, ad un criterio di valutazione che tenga conto, tra l'altro, della redditività all'atto della stima e nel biennio successivo.

Art. 6-ter - (Durata di applicazione). - Le disposizioni del presente decreto si applicano sino all'entrata in vigore di una nuova legge di riforma del regime delle società.

La presente legge, munita del sigillo dello Stato, sarà inserita nella Raccolta ufficiale delle leggi e dei decreti della Repubblica italiana. È fatto obbligo a chiunque spetti di osservarla e di farla osservare come legge dello Stato.

Data a Roma, addì 3 aprile 1979

PERTINI

ANDREOTTI - NICOLAZZI -
MORLINO - VISENTINI
- PANDOLFI

Visto, il Guardasigilli: MORLINO

Text of Art. 80 of the legislative decree 270/1999 as issued.

TITOLO IV
GRUPPO DI IMPRESE

CAPO I
ESTENSIONE DELL'AMMINISTRAZIONE STRAORDINARIA ALLE
IMPRESE DEL GRUPPO

Art. 80.
(Definizioni).

1. Ai fini dell'applicazione delle disposizioni del presente capo si intendono:
- a) per "procedura madre", la procedura di amministrazione straordinaria di una impresa che ha i requisiti previsti dagli articoli 2 e 27, facente parte di un gruppo;
 - b) per "imprese del gruppo":
 - 1) le imprese che controllano direttamente o indirettamente la società sottoposta alla procedura madre;
 - 2) le società direttamente o indirettamente controllate dall'impresa sottoposta alla procedura madre o dall'impresa che la controlla;

3) le imprese che, per la composizione degli organi amministrativi o sulla base di altri concordanti elementi, risultano soggette ad una direzione comune a quella dell'impresa sottoposta alla procedura madre.

2. Agli effetti del comma 1, lettera b), numeri 1) e 2), il rapporto di controllo sussiste, anche con riferimento a soggetti diversi dalle società, nei casi previsti dall'articolo 2359, primo e secondo comma, del codice civile.

Text of the first paragraph of art. 3 of Law n. 155/2017 as issued.

Capo II

PRINCÌPI E CRITERI DIRETTIVI PER LA RIFORMA DELLA DISCIPLINA DELLE
PROCEDURE DI CRISI E DELL'INSOLVENZA

Art. 3.

Gruppi di imprese

1. Nell'esercizio della delega di cui all'articolo 1, il Governo si attiene, per la disciplina della crisi e dell'insolvenza dei gruppi di imprese, ai seguenti principi e criteri direttivi:

a) prevedere una definizione di gruppo di imprese modellata sulla nozione di direzione e coordinamento di cui agli articoli 2497 e seguenti nonché di cui all'articolo 2545 -septies del codice civile, corredata della presunzione semplice di assoggettamento a direzione e coordinamento in presenza di un rapporto di controllo ai sensi dell'articolo 2359 del codice civile;

b) prescrivere specifici obblighi dichiarativi nonché il deposito del bilancio consolidato di gruppo, ove redatto, a carico delle imprese appartenenti a un gruppo, a scopo di informazione sui legami di gruppo esistenti, in vista del loro assoggettamento a procedure concorsuali;

c) attribuire all'organo di gestione della procedura il potere di richiedere alla Commissione nazionale per le società e la borsa (CONSOB) o a qualsiasi altra pubblica autorità informazioni utili ad accertare l'esistenza di collegamenti di gruppo, nonché di richiedere alle società fiduciarie le generalità degli effettivi titolari di diritti sulle azioni o sulle quote a esse intestate;

d) prevedere per le imprese, in crisi o insolventi, del gruppo sottoposte alla giurisdizione dello Stato italiano la facoltà di proporre con unico ricorso domanda di omologazione di un accordo unitario di ristrutturazione dei debiti, di ammissione al concordato preventivo o di liquidazione giudiziale,

ferma restando in ogni caso l'autonomia delle rispettive masse attive e passive, con predeterminazione del criterio attributivo della competenza, ai fini della gestione unitaria delle rispettive procedure concorsuali, ove le imprese abbiano la propria sede in circoscrizioni giudiziarie diverse;

e) stabilire obblighi reciproci di informazione e di collaborazione tra gli organi di gestione delle diverse procedure, nel caso in cui le imprese insolventi del gruppo siano soggette a separate procedure concorsuali, in Italia o all'estero;

f) stabilire il principio di postergazione del rimborso dei crediti di società o di imprese appartenenti allo stesso gruppo, in presenza dei presupposti di cui all'articolo 2467 del codice civile, fatte salve deroghe dirette a favorire l'erogazione di finanziamenti in funzione o in esecuzione di una procedura di concordato preventivo e di accordo di ristrutturazione dei debiti.

4. CONTROL AND CONSOLIDATION: ITS EVOLUTION WITHIN THE EUROPEAN LAW AND THE INTERNATIONAL ACCOUNTING STANDARDS VS THE US GAAP DYNAMICS

4.1 Introduction

The objective of the present chapter is to diachronically compare how the notion of control and its use in consolidated financial statements and business combinations accounting evolved in European law (*i*), under international accounting standards as issued by the IASB (*ii*) and in US GAAP (*iii*).

“...εἰδότες καὶ ὑμᾶς ἄνκαὶ ἄλλους ἐν τῇ αὐτῇ δυνάμει ἡμῖν γενομένους δρῶντας ἂν ταῦτό.”

«...all we do is to make use of this law, knowing that you and everybody else, having the same power as we have, would do the same as we do.»

Thucydides, History of the Peloponnesian War. Book 5, 105 from the dialogue of the Athenians to the

4.2 Evolution of the notion of control and consolidation according to the international accounting standard setter

The group is defined in terms of “control” from the first standard on consolidated financial statement IAS 3 issued by the IASC, the precursor of the IASB, in 1976. A group is in fact defined as a parent company and all its subsidiaries which are the companies controlled by the former. This definition will remain unchanged to the latest standard. However, as table 4-1 hereafter shows, the definition of control will be on the contrary subject to many modifications which will ultimately change the identification of the group area required to be traced for consolidation purposes.

The first shift was implicitly already contained in IAS 3. At point 6 of the discussion of the standard the IASC recognized that “In certain rare circumstances companies other than subsidiaries are treated as subsidiaries in the consolidated financial statements of a company that: owns a majority of the equity capital, but less than a majority of the voting power, or *has*

the power to control by statute or contract the financial and operating policies of those companies-italics mine-. These policies are controlled, for example, by the power to nominate a majority of the board of directors, by management contract or by court decree.” In those cases that company may be included in the consolidation area and the relevant reasons should be disclosed. The definition for what is considered an exception becomes the blueprint for the all its subsequent modifications. The characterization of control as “power” recurs in fact in all the definition of control after the one contained in IAS 3.

It is, however, only with the publication of the basis for conclusions on the exposure draft of IFRS 10 in 2008⁵¹ that control rises explicitly to the rank of “accounting model”. The board considered the following three different models as a basis for consolidation⁵²:

- 1) The controlling entity model in which the consolidated financial statements comprise the controlling entity and other entities under its control.
- 2) The common control model in which the combined financial statements⁵³ comprise entities under the control of the same controlling entity or body.
- 3) The risks and rewards model in which two entities are included in the consolidated financial statements when the activities of one entity affect the wealth of the residual shareholders (or residual claimants) of the other entity.

The risk and rewards model is rejected on the basis that it is not conceptually robust see BC33⁵⁴, whereas the common control model is discarded for the purpose of IFRS 10 but not in general. In fact, the Board noted that there are occasions where the combined financial statements derived through the application of the common control model can provide useful information. The Board also observes that even though the controlling entity model should be

⁵¹ The exposure draft of IFRS 10 was not preceded by a discussion paper, which is not necessary according to the IASB’s due process handbook. However, the comply or explain principle applies. I asked the IASB for the motives behind that decision and it turned out that “in April 2008, in response to the global financial crisis and the recommendation of the Financial Stability Forum, the Board decided to accelerate the consolidation project and proceed directly to the publication of an exposure draft”. The Board published the exposure draft in December 2008 (ED10).

⁵² See BC 32.

⁵³ Combined financial statements were already mentioned by ARB 51 issued in August 1959 by one of the precursors of the FASB, the US accounting standard setter body. In their view combined financial statement would be useful where (i) one physical person controls different corporations which are operationally related, (ii) it’s needed to present the financial position of a group of unconsolidated subsidiaries or (iii) to have information on companies under common management. Of course, the three points are not mutually exclusive.

⁵⁴ “The discussion paper sets out the Board’s preliminary view that the controlling entity model should be used as the primary basis for consolidation. It rejects the risks and rewards model as a basis for consolidation on the grounds it is not conceptually robust. However, the Board observed that there are occasions when combined financial statements, and therefore the application of the common control model, would provide useful information to users of financial statements.”

the only basis for consideration it may return to the common control model at the conclusion of “phase D of the conceptual framework project”.⁵⁵

The definition of control in ED IFRS 10 is ambiguous whether the power granting control must be effectively exerted or it may just be potential. However, it is clear from the proposed text of the standard that power needs not be exercised to be qualified as controlling. In paragraph 8 of the exposure draft for example, it is explicitly stated that options or convertible instruments to obtain voting rights can grant their holder the power to direct the activities of the entity. The definition adopted in the standard as issued makes it clear that the interpretation is correct. In fact, according to the standard as issued, “an investor controls an investee when it has the *ability* to affect those returns through its power over the investee”. Being able does not mean that he is effectively using its power. Under this respect the position of the Board appears in line with Parent company theory which is also the approach followed by the Italian jurisprudence years before the introduction of IFRS 10.

Table 4-1 Evolution of the definition of control according to the International Accounting Standard Setter

Ias 3 1976	Ias 27 1989	IFRS 10 ED 2008	IFRS 10 2011
Control is ownership, directly, or indirectly through subsidiaries, of more than one half of the voting power of a company.	Control is the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities.	A reporting entity controls another entity when the reporting entity has the power to direct the activities of that other entity to generate returns for the reporting entity.	An investor ⁵⁶ controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

⁵⁵ In May 2008 the Board published a discussion paper Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Reporting Entity as part of its work on phase D of the conceptual framework project. The project is conducted jointly with the US Financial Accounting Standards Board (FASB). In that discussion paper the Board set out the preliminary view that a group should not be limited to business activities that are structured as legal entities. Rather, a group should be broadly described as being a circumscribed area of business activity.

⁵⁶ The shift from a notion of “reporting entity” to one of “investor” is revealing of a precise position. Paradoxically, institutional investors, the investors *par excellence*, would be granted an exceptional treatment being able in practice to exclude from consolidation companies they control in the sense of this definition.

4.2.1 Minority interests from proprietary to almost entity

Table 4.2 presents the evolution of the presentation of the quota of equity capital of the group not attributable directly or indirectly to the parent company.

The approach followed with the exposure draft of IFRS 10 may point to a convergence towards an entity perspective in line with the intention of the IASB as presented in the exposure draft of a revised conceptual framework written at the same time as the ED of IFRS 10. “The Board decided that an entity’s financial reporting should be prepared from the perspective of the entity (entity perspective)⁵⁷ rather than the perspective of its owners or a particular class of owners (proprietary perspective)”.⁵⁸

Table 4-2 Evolution of the treatment of NCI under the International accounting standards

IAS 3 1976	IAS 27 1989	ED IFRS 10 2008	IFRS 10 2011
9. The minority interest in the equity of consolidated companies should be classified in the consolidated balance sheet as a separate item and should not be shown as part of shareholders' equity. The minority interest in the profits or losses of such companies should be shown separately in the consolidated income statement.	33. Minority interests should be presented in the consolidated balance sheet separately from liabilities and the parent shareholders' equity. Minority interests in the income of the group should also be separately presented.	43A reporting entity presents non-controlling interests in the consolidated statement of financial position within equity, separately from the equity of the owners ⁵⁹ of the parent. 44 Changes in a parent’s ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners).	Idem

⁵⁷ Actually, it’s not a proper entity perspective partly in that IASB and FASB consider the investors in the parent company as the proprietors/owners of the associated group of companies.

⁵⁸ See 25 IASB, May 2008, Exposure Draft: An Improved Conceptual Framework for Financial Reporting; Chapter 1 The Objective of Financial Reporting; Chapter 2 Qualitative Characteristics and Constraints on Decision-Useful Financial Reporting Information, p.5.

⁵⁹ Another hint at the IASB’s true underlying paradigm.

4.2.2 A first scope exception regarding heterogeneous activities later retracted

IAS 3 allowed a scope exception in cases where the activities carried out by the controlled subsidiaries are heterogeneous with respect to those of the parent and other group companies. Also in line with the prevalent jurisprudence following the introduction of the seventh directive, the IASB decided to remove that scope exception with the issue of IAS 27 as Table 4-3 indicates. The following standard doesn't mention explicitly the prohibition to exclude companies from consolidation out of dissimilarity in that the overarching control model as extended in IFRS 10 makes it clear that what counts in deciding whether or not to consolidate an entity is control and not other criteria including the similarities of the activities among group companies.

However, IFRS 10 as amended in 2014 introduced a related important scope exception regarding "investment entities" which will be covered by the next paragraph.

Table 4-3 Evolution of consolidation treatment of heterogeneous companies

IAS 3 1976	IAS 27 1989
In some countries, it is considered appropriate to exclude from consolidation a subsidiary whose business activities are so dissimilar from those of the other companies within the group that the presentation of separate subsidiary financial statements with the consolidated financial statements would provide better information for the parent company shareholders and other users of the statements. An alternative to exclusion in such cases is the grouping, by type of business, of the assets and liabilities within the consolidated balance sheet and the revenue and expenses within the consolidated income statement.	Sometimes a subsidiary is excluded from consolidation when its business activities are dissimilar from those of the other enterprises within the group. Exclusion on these grounds is not justified because better information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries. For example, the disclosures required by International Accounting Standard 14, Reporting Financial Information by Segment, help to explain the significance of different business activities within the group.

4.2.3 A second recently adopted scope exception: Investment entities

The retreatment of the exclusion from consolidation for subsidiaries whose business activities are heterogeneous with respect to those carried out by the parent and other group companies entailed relevant consequences for private equities and institutional investors-investment entities in the IASB jargon-. From that moment on, they were in fact required to consolidate

the controlled companies they invested in. And they didn't come to grips with this requirement in that they did not think it was consistent with the faithful representation principle⁶⁰. That's why the IASB has been under pressure by institutional investors and private equity firms to scope out their participation from the requirement set out in IFRS 10 and instead allow them to measure those investments at fair value. They argued that investment companies should not be required to consolidate the investments they control because they manage those investments on a net basis and, in their view, presenting the underlying assets and liabilities of their investments is misleading and uninformative. They emphasised that US GAAP has a scope exception that exempts an investment company from consolidating its investments.

The IASB managed to contrast these requests invoking the principle of comparability that would be lessened were these requests adopted and pointing to control as the unique criterion for consolidation whose use would admit no exception. In 2008 the IASB confirmed in the basis of conclusion for IFRS 10 its reasoning set out in paragraph BC27 in the Basis for Conclusions on IAS 27:

“The Board concluded that for investments under the control of private equity entities, users’ information needs are best served by financial statements in which those investments are consolidated, thus revealing the extent of the operations of the entities they control. The Board noted that a parent can either present information about the fair value of those investments in the notes to the consolidated financial statements or prepare separate financial statements in addition to its consolidated financial statements, presenting those investments at cost or at fair value. By contrast, the Board decided that information needs of users of financial statements would not be well served if those controlling investments were measured only at fair value. This would leave unreported the assets and liabilities of a controlled entity. It is conceivable that an investment in a large, highly geared subsidiary would have only a small fair value. Reporting that value alone would preclude a user from being able to assess the financial position, results and cash flows of the group.”⁶¹

However, not long after that statement the IASB conceded to the pressures releasing an amendment to IFRS 10 which is now included in the present version of the standard :

⁶⁰ Of course, there is also an underlying special interests story here. The scope exception tailored around investment entities caters to the latter's vested interest to keep asset off their balance sheets (for instance OTC, off-balance sheet, shadow banking) in order to avoid transparency, control and the scrutiny of regulators thereby possibly eluding the application of prudential and fiscal rules. The problem of off-balance sheet (OBS) in financial institutions was a critical point during the last financial crises and was clearly and profusely treated by several analysts and reports. For a general introduction see Biondi, Yuri “Empowering Market-Based Finance: A Note on Bank Bailouts in the Aftermath of the North Atlantic Financial Crisis of 2007: Accounting, Economics and Law - A Convivium.” Accessed October 21, 2017.

<https://www.degruyter.com/view/j/ael.2016.6.issue-1/ael-2016-0004/ael-2016-0004.xml>.

⁶¹ See BC22-BC27 Basis for conclusions on exposure draft, December 2008.

“The IASB was persuaded by the consistent message from investors that, for this narrowly defined type of entity, measuring all of its investments at fair value provided investors with the best information. The IASB ensured that this exception is available only to entities that evaluate the performance of their investments on a fair value basis.”

The approval of the amendment had to face a fierce opposition within the IASB as the section on the alternative views contained in the exposure draft shows. In particular three board members, Sir David Tweedie, Warren J. McGregor and Tatsumi Yamada were in concord in their disagreement with the exception to the principle of consolidation introduced by the exposure draft. They were convinced that the concept of control is the basis of the preparation and presentation of financial statements and “central to determining the boundaries of a reporting entity”. Moreover, in their view investments in controlled entities which may result in significantly different financial positions appear to be the same if they are measured at fair value. In other words, an investment in a controlled entity whose fair value is 1 million euros can correspond both to an controlled entity with assets of 3 million euros and liabilities of 2 million euros and to a controlled entity with assets of 1000 million euros and liabilities of 999 million euros. In their mind financial reporting requirements should also reflect that difference which the proposed amendment would instead obliterate. They also pointed out that the fair value of the investment of the controlled entities may be disclosed in the notes to the consolidated financial statements. It may also be interesting to note that one of the three dissenting board members, Sir David Tweedie, now the Chairman of the Board of Trustees of the International Valuation Standards Council, was the Chairman of the IASB for 2001-2011, which means that he was still in charge of his position while the exposure draft here considered was approved by the Board.

The following numerical example may further illustrate some of the consequences of the consolidation scope exception for investment entities. Let « P » be a parent investment company and « A » and « B » two possible subsidiaries with the stylized balance sheet presented hereafter where all the figures are in million euros.

Parent Investment company		P		
	Assets	400		
	Liabilities	200		
	Equity	200		
Portfolio companies	A		B	
	Assets	3	Assets 1000	
	Liabilities	2	Liabilities 999	
	Equity	1	Equity 1	
i) Assuming no consolidation exception	P"+A		P"+B	
	Assets	402	Assets	1399
	Liabilities	202	Liabilities	1199
	Equity	200	Equity	200
ii) Assuming consolidation exception	P"+A		P"+B	
	Assets	400	Assets	400
	Liabilities	200	Liabilities	200
	Equity	200	Equity	200

Assuming no non-controlling interests, under the consolidation exception ii) the group balance sheet of the case where the parent had only company A as a subsidiary would be indistinguishable from the case where the parent had only B as a subsidiary (the Assets figure include 1 million in both cases corresponding to the fair value of the investment in the subsidiary). However, the group exposure to liabilities which are assumed to consist mainly of debt, would be different in the two cases. And that would correctly be represented in the case i) with no consolidation exception. Allowing for non-controlling interests would not change the main message as illustrated by the following numerical example which employs actual data. The latter are taken from the 2011 annual report of SVG Capital plc, one of UK's largest private equity funds, listed on the London Stock Exchange. Those data coupled with the data disclosed in the comment letter that the fund sent to the IASB in the ambit of the feedback of the exposure draft on investment entities allow for the computation of a pro-forma balance sheet where a consolidation model based on control such as that of IFRS 10 would be in place with no consolidation exception.

	Actual in thousand £ (consolidation exception)		Pro-forma in thousand £ (no exception)
Total assets less current liabilities	1.273.217		2.556.731
Debt	(280.929)		(1.106.282)
Net assets	992.288		1.450.449
Shareholders's funds	992.170		992.170
Non-controlling interests	118		458.279
Total equity	992.288		1.450.449
Debt/Shareholders' funds	28%		112%
Debt/Total equity	28%		76%
Leverage	128%		176%

The impact on group's balance sheet of a consolidation scope exception cannot be overstated. Firstly, as clearly indicated by the example, leverage would be different in the two cases. And that's not just a representational issue. In fact, there might be financial covenants in some debt agreements which are based on the consolidated figures. In that respect, the underestimation of debt under the consolidation exception may lead to overleverage debt risk. On the top of that, many operations can be hidden under the consolidation exception. For example the parent investment company may use its controlling power on subsidiary A or B in the previous example in order to make them raise debt. Then the former might ask the latter to buy its account receivables or risky assets in exchange of cash. Clearly in the consolidation case ii) the group accounts would be as if the parent had raised the debt itself, whereas this would not be clear in the consolidation exception case i). More generally, the elimination of all intra-group transactions and balances between the parent investment companies and its subsidiaries (portfolio companies) would not be carried out in the latter case. By the same token, the parent company may be in favor of an acquisition involving two companies under its control, let's say, a highly leveraged subsidiary acquired by a cash-rich one, if that contributes to the increase in the fair value of its investment which might not

correspond to the best interests of the controlled companies. That operation would appear as an arm's length transaction under i).

4.2.4 From special purpose entities to structured entities

The intended main objective for IFRS 10 was to overcome the dichotomy of the different consolidation basis for the - at the time called- "Special purpose entities" and the rest of entities. In fact, according to SIC-12, SPEs were consolidated following a risk and rewards approach which was different from the control model as presented in IAS 27. Which is to say the decision about control could depend on whether a reporting entity concludes that an entity is within the scope of IAS 27 or SIC-12. As made explicit in the Basis for conclusion to the exposure draft of IFRS 10 -see BC98-BC121-the IASB believed that structured entities should not be treated differently from other entities when applying the definition of control of an entity, and that a quantitative analysis would inevitably create structuring opportunities and problems in terms of calculating returns.

The IASB noted that it was against the publication of a rule-based document such as the FASB's FIN 46(R), which requires that a reporting entity must consolidate another entity when it receives a particular level of the expected returns of that entity, regardless of whether it has power to direct the activities of the entity. According to the IASB, FIN 46(R) created structuring opportunities which led to the amendments to FIN 46(R) in September 2008.

The amended US-GAAP standard met the favor of the IASB. "The Board came to conclusions similar to those of the FASB regarding the assessment of control of a structured entity. The Board noted that how a structured entity is controlled will reflect the particular facts and circumstances of that entity, such as how the returns of the entity are shared and how decisions, if any, are made about the activities that affect those returns. Unlike entities that are controlled through a governing body, there is no single, simple test that the Board could identify for assessing control of a structured entity. Rather, it is necessary for a reporting entity to assess those specific facts and circumstances."

4.2.5 IAS 22 and its *epigoni*

The first standard on business combinations accounting (IAS 22) was approved by the board of the international accounting standard setter, at the time called International Accounting Standards Committee IASC, in June 1983 precisely 10 years after the foundation of the latter

in June 1983 and 7 years after the first international standard on consolidated financial statements (IAS 3). It adopted an approach which was closer to the entity concept of group of companies than its revised versions or the standards that took its place as I suggest in what follows. A first indication that this is the case comes from the treatment of the recognition of minority interests, now more correctly designated as non-controlling interests. In fact the original IAS 22 states at its 45th paragraph that

“A minority interest that arises on a business combination should preferably be stated at the appropriate proportion of the post-acquisition fair values of the net identifiable assets of the subsidiary. *Alternatively* [italics mine] it may be stated at the appropriate proportion of the pre-acquisition carrying amounts of the net assets of the subsidiary” (IAS 22 § 45).

On the contrary, the version of the same standard revised ten years later prescribes the following benchmark treatment on the measurement of the net assets at acquisition date.

Benchmark Treatment Allocation of Cost of Acquisition

“The assets and liabilities recognised in accordance with paragraph 27 should be measured at the aggregate of:

- the fair value of the identifiable assets and liabilities acquired as at the date of the exchange transaction to the extent of the acquirer's interest obtained in the exchange transaction; and
- the minority's proportion of the pre-acquisition carrying amounts of the assets and liabilities of the subsidiary.

Any goodwill or negative goodwill should be accounted for in accordance with this Standard and the following permitted alternative.” (IAS 22, 1993 § 31)

Allowed Alternative Treatment

“The assets and liabilities recognised in accordance with paragraph 27 should be measured at their fair values as at the date of acquisition. Any goodwill or negative goodwill should be accounted for in accordance with this Standard. Any minority interest should be stated at the minority's proportion of the fair values of the assets and liabilities recognised in accordance with paragraph 27”. (IAS 22, 1993 §33)

From the excerpts reported above it appears that the preference between entity theory and parent company theory changed in the revised standard which favoured the latter. One of the reasons for a preference for parent company theory can be gleaned from the revised standard itself. Almost as a justification it specifies that the minority interests have not participated in the acquisition, which is correct from a parent's owners perspective. Another reason might be the influence by the US standards and practices. As indicated by Table 4.4, hereafter, in its original version IAS 22 allowed the possibility to adjust a positive consolidation difference against shareholders' equity. This is not the case for the revised standard, which prescribes instead the recognition of the consolidation difference as an asset no matter what in line with the US practices.

Table 4-4 Evolution of the treatment of the consolidation difference under IFRS

IAS 22 (1983)	IAS 22 (revised 1993)	IFRS 3
<p>40. An enterprise should adopt one of the following policies for dealing with any difference (whether positive or negative) between the cost of acquisitions and the fair values of the net identifiable assets acquired: (a) recognition in income in accordance with the procedures in paragraphs 41-42, or (b) immediate adjustment against shareholders' interests.</p> <p>41. Where the policy in paragraph 40 (a) –i.e. purchase accounting-is adopted, any excess of the cost of acquisition over the fair values of the net identifiable assets acquired should be recognised as an asset in the consolidated financial statements as goodwill arising on acquisition, and amortised to income on a systematic basis over its useful life. If it is found at any time that goodwill arising on acquisition is not supported by future income, it should, to the extent necessary, be charged</p>	<p>44. Any excess of the cost of the acquisition over the fair values of the identifiable assets and liabilities acquired as at the date of the exchange transaction should be described as goodwill and recognised as an asset.</p> <p>50. The unamortised balance of goodwill should be reviewed at each balance sheet date and, to the extent that it is not supported by future economic benefits, it should be recognised immediately as an expense. Any write-down of goodwill should not be reversed in a subsequent period.</p>	<p>32.The acquirer shall recognise goodwill as of the acquisition date measured as the excess of (a) over (b) below:</p> <p>(a) the aggregate of:</p> <p>(i) the consideration transferred measured in accordance with this IFRS, which generally requires acquisition-date fair value (see paragraph 37);</p> <p>(ii) the amount of any non-controlling interest in the acquiree measured in accordance with this IFRS; and</p> <p>(iii) in a business combination achieved in stages (see paragraphs 41 and 42), the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.</p> <p>(b) the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this IFRS.</p>

immediately to income.		
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Also the evolution of the treatment of a negative consolidation difference points towards the US counterpart. In the first version of the standard there exists the possibility of avoiding the recognition in income of the negative consolidation difference. In the following version the cases of a lucky buy or a “lemon” are more explicitly taken into consideration. Concerning the lucky buy case, deferred income should be recognized as income in the income statement «when the future economic benefits embodied in the identifiable depreciable/ amortisable assets acquired are consumed ». Concerning the lemon case, negative goodwill is generally recognised as income when the future losses materialise. In contrast, in the most recent standard the excess is recognized by the acquirer in the income statement on the acquisition date in its entirety, irrespectively of the origin of the negative consolidation difference.

Table 4-5 Evolution of the treatment of a negative consolidation difference under IFRS

IAS 22 (1983)	IAS 22 (revised 1993)	IAS 22 (revised 1998)	IFRS 3
<p>40. An enterprise should adopt one of the following policies for dealing with any difference (whether positive or negative) between the cost of acquisitions and the fair values of the net identifiable assets acquired: (a) recognition in income in accordance with the procedures in paragraphs 41-42, or (b) immediate adjustment against shareholders' interests. In either case, paragraphs 43-45 apply.</p> <p>42. If the cost of acquisition is lower</p>	<p>49. When the cost of the acquisition is less than the acquirer's interest in the fair values of the identifiable assets and liabilities acquired as at the date of the exchange transaction, the fair values of the non-monetary assets acquired should be reduced proportionately until the excess is eliminated. When it is not possible to eliminate completely the excess by reducing the fair values of non-monetary assets acquired, the excess which remains should</p>	<p>61. To the extent that negative goodwill relates to expectations of future losses and expenses that are identified in the acquirer's plan for the acquisition and can be measured reliably, but which do not represent identifiable liabilities at the date of acquisition (see paragraph 26), that portion of negative goodwill should be recognised as income in the income statement when the future losses and expenses are recognised. If these identifiable future losses and expenses are not recognised in the expected period, negative goodwill should be</p>	<p>34. Occasionally, an acquirer will make a bargain purchase, which is a business combination in which the amount in paragraph 32(b) exceeds the aggregate of the amounts specified in paragraph 32(a). If that excess remains after applying the requirements in paragraph 36, the acquirer shall recognise the resulting gain in profit or loss on the acquisition date.</p>

<p>than the aggregate fair value of net identifiable assets acquired, it should either be treated as deferred income and recognised in income on a systematic basis, or allocated over individual depreciable non-monetary assets acquired in proportion to their fair values.</p>	<p>be described as negative goodwill⁶² and treated as deferred income. It should be recognised as income on a systematic basis over a period not exceeding five years unless a longer period, not exceeding twenty years from the date of acquisition, can be justified.</p> <p>Allowed Alternative Treatment</p> <p>51. Any excess, as at the date of the exchange transaction, of the acquirer's interest in the fair values of the identifiable assets and liabilities acquired over the cost of the acquisition, should be described as negative goodwill and treated as deferred income. It should be recognised as income on a systematic basis over a period not exceeding five years unless a longer period, not exceeding twenty years from the date of acquisition, can be justified.</p>	<p>treated under paragraph 62 (a) and (b).</p> <p>62. To the extent that negative goodwill does not relate to identifiable expected future losses and expenses that can be measured reliably at the date of acquisition, negative goodwill should be recognised as income in the income statement as follows: (a) the amount of negative goodwill not exceeding the fair values of acquired identifiable nonmonetary assets should be recognised as income on a systematic basis over the remaining weighted average useful life of the identifiable acquired depreciable/ amortisable assets; and (b) the amount of negative goodwill in excess of the fair values of acquired identifiable nonmonetary assets should be recognised as income immediately.</p> <p>63. To the extent that negative goodwill does not relate to expectations of future losses and expenses that have been identified in the acquirer's plan for the acquisition and can be measured reliably, negative goodwill is a gain which is recognised as income when the future economic benefits embodied in the identifiable depreciable/</p>	<p>The gain shall be attributed to the acquirer.</p>
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⁶² "Negative goodwill" is not the most adequate expression. See also Onida (1951).

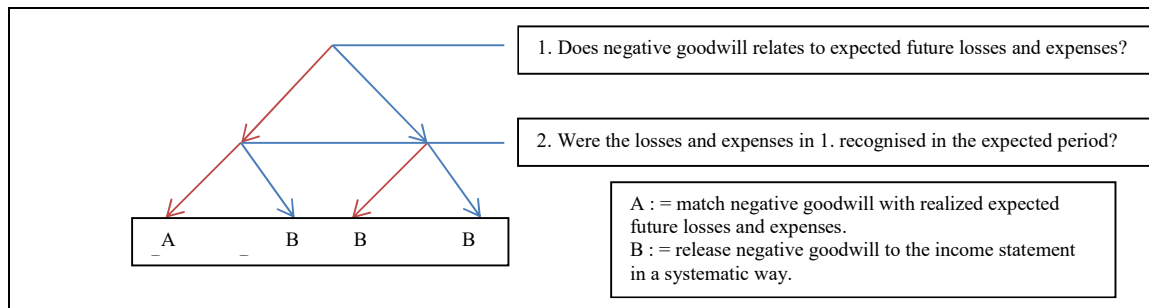
		amortisable assets acquired are consumed. In the case of monetary assets, the gain is recognised as income immediately.	
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As indicated by Table 4-5 the treatment of “negative goodwill” went through a major overhaul in the second revision of IAS 22 issued in 1998. Both the recognition upon and after acquisition were brought more in line with the treatment of goodwill. In fact, as to the former point the standard prescribes that negative goodwill should be presented as a deduction from the assets of the reporting enterprise i.e. a “negative asset” also called contra-asset, in the same balance sheet classification as goodwill. As to the latter point negative goodwill should be treated according to the entity’s estimates of the events and reasons which gave birth to it. In other words, if for instance the company deems that negative goodwill is the result of expected future losses and expenses, then⁶³ the former is required to release negative goodwill in the income statement on the basis of the realization of the expected future losses and expenses. In particular, the release of negative goodwill in the income statement according to IAS 22 (revised 1998) must be carried out according to two methods. The preferred solution is to match the former with realized expected future losses and expenses (A). If that is not possible the standard prescribes to release negative goodwill to the income statement in a systematic way on the basis of the weighted average useful life of depreciable/amortizable assets (B). The diagram contained in Box 4.1 hereafter illustrates the process⁶⁴. The red lines indicate that the answer to question 1. or 2. is “Yes” and the blue lines “No”. Only in the exceptional cases where negative goodwill is higher than the fair values of non-monetary assets at acquisition and it cannot be matched with the expected losses in that either they cannot be measured reliably or are not realized, it can be released in income immediately. In that case, the standard setter might have considered with a sufficient margin of prudence that the acquiring firm is in the presence of a realized gain. The latter exceptional treatment was the basis for the unique solution in IFRS 3 the standard which superseded IAS 22 in 2004.

⁶³ Clearly after having verified that identifiable assets have not been overstated and identifiable liabilities have been omitted or understated.

⁶⁴ Compare also the diagram contained in Box 1 with the solution proposed by Saraceno more than 35 years earlier expounded in chapter 2.

Box 4.1 Negative goodwill recognition according to IAS 22 (revised 1998)



This is a clear evidence of an evolving standard, certainly driven by vested interests⁶⁵. Finally, it is interesting to note that while both versions of IAS 22 make reference to the purchase method and the pooling of interests method, only the former specifies that the object of the former method is to “account for the acquired enterprise by applying the same principles as are applied in the normal purchase of assets”⁶⁶. In particular, the pooling of interest method *may* be applied to mergers according to IAS 22 and *should* be applied to mergers according to the revised versions of the standard.

“When a business combination is deemed to be a uniting of interests the pooling of interests method detailed in paragraphs 46-47 may be used”. IAS 22.

“A uniting of interests should⁶⁷ be accounted for by use of the pooling of interests method as set out in paragraphs 62, 63 and 66”. IAS 22 revised, 1993.

⁶⁵ See Ramanna’ studies on accounting for business combinations and goodwill quoted in the references.

⁶⁶ In E45, the exposure draft to IAS 22 revised and in the final standard itself the message is similar “The use of the purchase method results in an acquisition of an enterprise being accounted for similarly to the purchase of other assets”. (E45 paragraph 18)

⁶⁷ However, in the French translation of IAS 22 as revised in 1998 published in the Official journal of the European union (L 261/194 paragraph 77) in 2003 a uniting of interest *must* be accounted for by use of the pooling of interest method: “*Une mise en commun d’intérêts doit être comptabilisée selon la méthode de la mise en commun d’intérêts, telle qu’elle est décrite aux paragraphes 78, 79 et 82*”

The revised version in 1998 maintains the same wording. Instead, the conditions to qualify for a pooling are mentioned only in the revised version of the standard at paragraph 15.⁶⁸ The pooling of interest method is then prohibited by IFRS 3 and its successive amendments⁶⁹.

4.3 The European perspective

At the time before 2005 when international accounting standards as endorsed by the European Union were not compulsory for consolidated statements of companies listed on Regulated Exchanges the main reference for the set-up of consolidated accounts beside national GAAP was European law. Consequently, it was possible to apply the international proposed treatment if it did not violate the European law. However, art. 16 Paragraph 3 of the directive usually smoothed the contrasts arising in practice between the international standards and European law in that invoking the true and fair view principle⁷⁰ might have made the use of the international standards possible when they were not fully in line with some points of the Seventh directive. Also the nature of the directive as a compromise subsuming different views but unable to provide a consistent synthesis might have favoured the diffusion in practice of the international standard.

4.3.1 Consolidation scope and definition of subsidiary

One important issue where the compromise nature of the directive is apparent is the definition of the consolidation scope and the implicit definition of subsidiary. In fact, the latter is the result of a “non-choice” between a consolidation model based on economic control and a model based on legal ownership. Such a compromise solution is presented in the two paragraphs with several subparagraphs Article 1⁷¹ consists of. The first condition points to ownership:

⁶⁸ The substantial majority of the voting common shares is exchanged 1), the fair value of the combining enterprises are similar 2) and the shareholders of the combining companies keep the same voting rights in the combined entity with respect to each other after the combination as before.

⁶⁹ See Biondi et al. studies on pooling vs purchase methods of accounting for business combinations quoted in the references in particular Baker et al. (2009).

⁷⁰ On the “true and fair view” see Arnaldo Canziani, *Critica della « true and fair view » quale pseudo-concetto empirico*, in AA.VV., *Studi in onore di Ubaldo De Dominicis*, Trieste, 1991 and also the same author’s contribution in Gray, S. J., Adolf Coenenberg, and Paul Gordon. *International Group Accounting (RLE Accounting): Issues in European Harmonization*. Routledge, 2013 and in Bensadon, Didier, and Nicolas Praquin. *IFRS in a Global World: International and Critical Perspectives on Accounting*. Springer, 2016.

⁷¹ Article 1 is part of Section 1 on the “conditions for the preparation of consolidated accounts”.

“A Member State shall require any undertaking governed by its national law to draw up consolidated accounts and a consolidated annual report if that undertaking (a parent undertaking):

(a) has a majority of the shareholders’ or members’ voting rights in another undertaking (a subsidiary undertaking);”

(Seventh directive art.1)

However, it is possible to consider as a subsidiary within the consolidation scope an undertaking which is either “managed on a unified basis by the parent undertaking (art.1 par. 2 (b)) or controlled by parent undertaking⁷² through a shareholder agreement (art 1 (d) (bb)) or through the exercise of a dominant influence (art.1 par. 2 (a)).⁷³

4.3.2 Positive consolidation difference

European law as stated in the Seventh Directive required full consolidation i.e. 100% of the net assets of the controlled company shall be recognized in the consolidated balance sheet, even if the percentage of the net assets owned by the parent company is lower than 100%⁷⁴. However, when it comes to the computation of the consolidation difference⁷⁵, two are the methods accepted by the EU law as indicated by the first paragraph of article 19 reported hereafter:

Book value method 19 1-a, revaluation method 19 1-b

“The book values of shares in the capital of undertakings included in a consolidation shall be set off against the proportion which they represent of the capital and reserves of those undertakings:

- a) That set-off shall be effected on the basis of book values as at the date as at which such undertakings are included in the consolidations for the first time. Differences arising from such set-offs shall as far as possible be entered directly against those

⁷² i.e. a shareholder of that undertaking which satisfies the conditions contained in art. 1

⁷³For an overview on the regulation on the scope of consolidation including Europe see Christopher Nobes. “The Development of National and Transnational Regulation on the Scope of Consolidation.” *Accounting, Auditing & Accountability Journal* 27, no. 6 (July 31, 2014): 995–1025. doi:10.1108/AAAJ-03-2013-1287.

⁷⁴ The assets and liabilities of undertakings included in a consolidation shall be incorporated in full in the consolidated balance sheet (Seventh Directive art. 18)

⁷⁵ The consolidation difference assumes a different definition and value according to the model of reference:

- Under an historical cost approach (book values), the difference is about the book value of shares and the book value of the relative share of equity. (see point a). This excludes the inclusion of goodwill derived from the difference between values of assets and liabilities.
- Under the fair value approach, the difference points to goodwill (see point b).

items in the consolidated balance sheet which have values above or below their book values.

- b) A Member State may require or permit set-offs on the basis of the values of identifiable assets and liabilities as at the date of acquisition of the shares or, in the event of acquisition in two or more stages, as at the date on which the undertaking became a subsidiary.”

(Seventh directive Art 19. Paragraph 1)

These two methods may also be the starting point for the computation of non-controlling interests. In fact, the latter are never explicitly mentioned by the directive. However, the first method may indicate that the book value of the net asset of the controlled company at first consolidation date is the measurement basis also for non-controlling interests. By the same token, the second method may indicate that the [fair]⁷⁶ value of the net asset of the controlled company at first consolidation date may also be used as a measurement basis for non-controlling interests. Also the fact that the directive is not explicit with respect to the treatment of non-controlling interests point at the compromise nature of the former, the result of the confluence of different traditions. In any case, under the second method

“Any difference arising under paragraph 1 above shall be added to or deducted from consolidated reserves as appropriate”.

(Seventh directive Art. 20 Paragraph 2)

In particular, art. 30 indicates that a positive consolidation difference may also written off against reserves

“A Member State may permit a positive consolidation difference to be immediately and clearly deducted from reserves”.⁷⁷

(Seventh directive Art. 20 Paragraph 2)

4.3.3 Negative consolidation difference

The treatment of negative goodwill⁷⁸ the IASC arrived at in more than 15 years in 1998 is strikingly similar to the treatment proposed by the European commission years earlier and

⁷⁶ The directive never mentions “fair value”.

⁷⁷ This means that positive goodwill is considered to be a loss.

contained in the seventh directive issued in 1983. In point of fact, according to the latter a negative consolidation difference shall be shown as a separate item in the consolidated balance sheet with an appropriate heading. In cases where the offsetting of positive and negative differences is authorized by a Member State, a breakdown of such differences must also be given in the notes on the accounts. In particular, European law allowed the possibility to transfer a negative consolidation difference⁷⁹ to the consolidated income statement only in cases

“where that difference corresponds to the expectation at the date of acquisition of unfavourable future results in that undertaking, or to the expectation of costs which that undertaking would incur, in so far as such an expectation materializes; or in so far as such a difference corresponds to a realized gain”.

(Seventh directive Art.31)

Clearly, the true and fair view requirement as stated in Seventh directive Art. 16 may be invoked to exclude the inclusion of the negative consolidation difference in the consolidated income statement.

4.3.4 Accounting for mergers according to EU law

Article 20 of the seventh directive reported hereafter may be considered as informing the application of the pooling of interest method for mergers.

1. “A Member State may require or permit the book values of shares held in the capital of an undertaking included in the consolidation to be set off against the corresponding percentage of capital only, provided that:
 - a) the shares held represent at least 90 % of the nominal value or, in the absence of a nominal value, of the accounting par value of the shares of that undertaking other than shares of the kind described in Article 29 (2) (a) of Directive 77/91/EEC ;
 - b) the proportion referred to in (a) above has been attained pursuant to an arrangement providing for the issue of shares by an undertaking included in the consolidation; and
 - c) the arrangement referred to in (b) above did not include a cash payment exceeding 10 % of the nominal value or, in the absence of a nominal value, of the accounting par value of the shares issued”.

⁷⁸ Most correctly consolidation difference and goodwill are not synonymous even if some articles use the words interchangeably as synonyms (for example Ding et al. 2008). Moreover the directive never mentions goodwill and the IASB and IFRS never mention the consolidation difference.

⁷⁹ Negative goodwill implies an immediate profit on the transaction (under IFRS 3). As to a negative consolidation difference, the directive is prudent in recognizing that difference as a profit.

2. “Any difference arising under paragraph 1 above shall be added to or deducted from consolidated reserves as appropriate”.

(Seventh directive Art.31)

It seems that the directive worries about intragroup transactions, since the cash threshold is introduced to scope-out transactions with consolidated undertaking. Moreover, the purchase method (also called acquisition accounting) may be allowed for accounting for mergers in that the law of each member state “may require or permit” the use of the pooling method if the conditions set out in points a, b and c are met.

4.4 The US GAAP perspective

The US had already a relevant experience of merger and acquisition including two merger waves when the first national regulation on consolidation was issued in 1934 as a part of US regulators’ overarching response to the financial crisis started in 1929. Article 4 of the regulation S-X of the securities act of 1934 of the SEC (Securities and Exchange Commission) introduced the first consolidation requirements at the national level which were based on ownership to determine the companies to be consolidated. In fact, the very first rule is that “the registrant shall not consolidate any subsidiary which is not a majority-owned subsidiary” thereby excluding from consolidation the entities which are not a majority-owned subsidiary of the parent (see article 4 of regulation S-X of 1934, Rule 4-02- “Consolidated statements of the registrants and its subsidiaries”). The regulation also covered the consolidation difference simply requiring to disclose the amount of the difference and its treatment in a note: see rule 4-05 “As to the consolidated subsidiaries, there must be set forth in a note to each consolidated balance sheet filed a statement of any difference between the investment in subsidiaries consolidated, as shown by the parent’s books, and the parent’s equity in the net assets of such subsidiaries as shown by the books of the latter. If any such difference exists, there must be set forth the amount of the difference, and the disposition made thereof in preparing the consolidated statements, naming the balance sheet captions and stating the amount included in each”. The regulation also prescribed to recognize separately minority interests in the consolidated balance sheet “with separation being made between the minority interest in the capital and in the surplus”. The former also introduced special requirements for insurance companies, banks, and public utility holding companies. Overall, the tone set by SEC regulation S-X of 1934 turned out to be followed by the norms which

came after. In fact, both ARB 51 issued in 1959 and FAS 94 1987 which included in the consolidation perimeters also subsidiaries with heterogeneous activities, were phrased in terms of majority-owned subsidiaries.

The watershed in US GAAP took place in 1995 with the at-that-time innovative solutions proposed by the FASB Policy and procedures draft on consolidation “*FASB (Financial Accounting Standards Board) (1995, October). Consolidated Financial statements: policy and procedures. Exposure draft E133*”⁸⁰. Among the latter the most important is a non-temporary “ability to control” as the criterion used to define the consolidation perimeter in lieu of the criterion valid up to that moment based on the ownership of a majority voting interest. The proposed definition of control is the following:

“Control of an entity is power over its assets-power to use or direct the use of its individual assets of another entity in essentially the same ways as the controlling entity can use its own assets” (FASB, Policy and procedures paragraph 10). This is a corporate investor perspective. In particular, the use or ability to direct the use of the assets of a subsidiary made possible by control enables the parent to “establish the subsidiary’s policies including its capital and operating budgets and select, determine the compensation of and dismiss personnel responsible for implementing its policies”. (ibidem) The same document also makes it clear that “control of an entity is an exclusionary power”. In order to make the concept of control more crystalline from an operational point of view, paragraph 14 lists a series of examples and cases where it is likely that an entity is controlled by another entity. The notion of control adopted by the FASB reduces the gap with an entity view even if effective control is not required. The proprietary view is still presented in the dissenting view section of the document whereby control without ownership of a majority voting interest is not sufficient to trigger the requirement to consolidate. The treatment of goodwill is more in line with the latter view in that, following the so-called purchased-goodwill approach, it must be recognized only with respect to the part effectively acquired by the parent, therefore the part ideally attributable to minorities has not to be identified (paragraph 27). The exposure draft also prescribed the inclusion of non-controlling interests⁸¹ in consolidated equity (paragraph 22), the reporting entity of the consolidated financial statements as the group as a whole (par 7), the full fair value revaluation of the assets and liabilities of the subsidiary and the elimination of the values linked to intra-group transactions also in the presence of noncontrolling interests (par 111). Concerning the gains and losses realized as a result of the

⁸⁰ See also Zambon (1996) p.376 and Zambon and Zan (2000).

⁸¹ Before this document they were referred to as “minority interests”.

modification of the participating interest in the controlled company, they are treated as impacting exclusively consolidated equity. Overall, the solutions proposed by that document mark a drastic change compared with what was required by the relevant standards up to that moment. Given the importance of the changes, the FASB itself identified the underlying reasons in the same document. Firstly, the board mentioned reasons related to achieving consistency with the Conceptual Framework prevailing at the time. In particular, defining the group in terms of control by the parent company appears more in line on the one hand with the definition of “asset” contained in SFAC No. 3 (statement of financial accounting concepts) i.e. assets are defined as “probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events” (paragraph 19), on the other hand with the inclusion of minorities in equity suggested in SFAC 6 and with the qualitative characteristic of completeness of information. Secondly, in the board’s view, relevance, reliability, neutrality and comparability were enhanced as a result of the proposed solutions, which pointed to an improvement in the qualitative characteristics of accounting information. Thirdly, reasons of international convergence also played a role from the point of view of the FASB board. In fact, the latter observed that both Australian accounting standards and British accounting standards had in 1992 adopted a definition of control relevant for consolidation which was based on the ability of the parent to extract the most benefits from the controlled company. On the top of that, both the mentioned standards and IAS 22 in its revised form chose to adopt full fair value revaluation of assets and liabilities of the controlled company also in the presence of minorities. Finally, also the rise of hedge funds, investment funds and pension funds, which took place in that period probably had a bearing on the shift of the FASB about consolidation policy and procedures. In fact, as Figure 4-1 from Gillan and Starks shows, 1995 was a sort of tipping point, in that in that year the ownership share of institutional investors in US listed companies surpassed 50%.

Figure 4-1 Percentage Ownership of Institutional Investors in U.S. Stock Markets



Source: Gillan and Starks 2007. Institutional investors: Asset managers (for example mutual funds, hedge funds), financial intermediaries (for example banks, insurance companies).

Given the increased importance of those entities in the potential determination of the participated companies' strategic direction, it probably appeared no more possible to treat the former entities as minorities outside consolidated equity as the proprietary approach prevailing at the time would have required.

The significance of the FASB's 1995 exposure draft on consolidation⁸² may be better appreciated when read against the responses it raised. With the benefit of hindsight, a comment letter a researcher would be most interested in related to this context would be the one of Enron. The latter was prospering at that time also thanks to the montages that later led to its demise and it would therefore have an incentive to make its voice heard also through a comment letter. On the other hand there would also have existed other more subtle ways of lobbying against the FASB's proposal more incline to secrecy considering the public nature of comment letters. However, Enron had a good reputation at the time and nothing may have

⁸² The exposure draft was not approved by the board also for the total rejections of many constituents imbued in a purely proprietary view. It took a financial scandal such as that of Enron and the demise of Arthur Andersen eventually for the issuance in 2007 of SFAS 160 (Appendix B) which defined a subsidiary in terms of "a controlling financial interest". However, it suffices to read the aim of consolidated financial statements according to SFAS 160 to see that it was a sort of gattopardo revolution. In ARB 51: "The purpose of consolidated statements is to present, primarily for the benefit of the shareholders and creditors of the parent company, the results of operations and the financial position of a parent company and its subsidiaries essentially as if the group were a single company with one or more branches or divisions" (ARB 51). After FAS 160 the text was modified as follows: "The purpose of consolidated financial statements is to present, primarily for the benefit of the owners and creditors of the parent, the results of operations and the financial position of a parent and all its subsidiaries as if the consolidated group were a single economic entity".

hinted at its later demise which may also be one motive that made secrecy reasons not prevail. In fact, it turns out that on the 12 of January 1996 the FASB received a 5-page letter from Enron Corporation categorized as “Letter of Comment No. 53” whose content relevant for my ends is illustrated hereafter.

4.4.1 Enron’s view on the FASB’s 1995 proposal on consolidation

It may be unsurprising that Enron found the requirements prevailing at that time adequate and saw no need for a revision or a change on consolidation policy. In Enron’s view consolidated financial statements for a business enterprise should accommodate exclusively shareholders of the parent undertaking and the procedures for their preparation should “continue to follow the parent company approach”. Consistently with that view, legal control, be it actual or potential, is the basis for determining the entities to be included in the consolidation perimeter. Moreover, in line with the preferred treatment of non-controlling interests which are considered as outsiders, Enron was against the proposed recognition in consolidated equity of the gains or losses deriving from the modification of the equity interest of the parent in the subsidiaries without loss of control. Finally, as to special purpose entities, Enron proposed to treat them outside the ambit of control and with different rules from those employed to decide whether a subsidiary had to be consolidated⁸³.

Another way to better assess the importance of the FASB’s 1995 proposal may also be to read it against the practices preferred about 20 years earlier by the Enron’s auditing firm, Arthur Andersen Co⁸⁴ and the latter’s reaction to the proposal.

4.4.2 A fourth perspective: Arthur Andersen 1974

It would be interesting to add to the historical reconstruction of the evolution of the intertwined standards on consolidated financial statements and accounting for business combinations a fourth perspective beside the three expounded above: the one of accounting firms. The latter are in fact in the front line of the “accounting supply chain” which gives them the experiential knowledge of the accounting practices while being at the same time the true enactors of the standards issued by the different standard setting bodies. Unfortunately, this information on accounting firms’ perspective is normally either not codified in an outlet or available just in response to exposure draft of possible standards such as in the case of

⁸³ According to Enron’s comment letter the main issue with special purpose entities is “the extent to which other owners are at risk”.

⁸⁴ Arthur Andersen was in charge of Enron’s auditing and that involvement subsequently led to its demise.

comment letters. However, in some cases accounting firms prepared internal documents to inform their practice for multinational companies and in exceptional cases also clearly presented their views on how a given operation should be accounted for. The volume⁸⁵ edited by Arthur Andersen in 1974 is such an exception. In fact, not only did the latter present the company's reconstruction of the practices prevailing at that time, but it also included a set of proposed standards on different accounting topics, including accounting for business combinations and the preparation of consolidated financial statements. As to the former, Arthur Andersen and Co. had clear views rooted in firm ground which were in part against the practice of the time and are summed-up by the following points:

- The consolidation difference⁸⁶ had to be reflected, in their view, as an addition or deduction from shareholders' equity⁸⁷ with disclosure of the total market value of any equity issued as consideration⁸⁸.
- The acquirer should record the economic resources of the acquired company at their fair value at the date of the combination.
- The acquirer should record the liabilities of the acquired company at their current values⁸⁹ at the date of the combination.
- If an acquirer cannot be identified, the business combination should be accounted for at fair values as a new entity.

In particular, their approach would in their mind lead to the "elimination of the goodwill problem". They explicitly recognize that accounting should inform the market and instead the capitalization of goodwill brought about a loop (a circularity in their own words) between the

⁸⁵ I would like to thank a former partner of the firm for letting me refer to that volume.

⁸⁶ Defined as the difference between (i) the excess of the fair value of the acquired company's economic resources over the current value of those of its liabilities that are assumed by the acquiring entity and (ii) any cash disbursed and the current value of debt issued in the business combination.

⁸⁷ At the time when firms were free to choose their preferred policy different methods for accounting for business combinations coexisted. In any case, immediate write-off was very common and largely accepted. See the encompassing study of Fabricant, Solomon. *Revaluations of Fixed Assets, 1925-1934*. National Bureau of Economic Research, 1936. The practice of writing-off goodwill immediately was also largely diffused in the UK. For the 300 cases reviewed by Nobes (1992) in the fiscal year 1988-1989, 285 had their goodwill immediately written off against reserves or no goodwill at all.

"No one can accurately measure the value of goodwill, patents or trademarks; consequently, all valuations are suspect and subject to correction, and as we shall see later, influenced by the prevailing state of business hopes. It is for this reason that intangibles are so often written down, or written off, or never allowed to appear in the balance sheet." (ibidem)

⁸⁸ That implies that positive goodwill is reported as an immediate loss and then written-off of equity. They also think that the form of the consideration is not relevant in that the latter does not affect the basis on which the acquired asset is stated by the acquirer.

⁸⁹ It is not clear what would be the difference in practice between current values and fair values according to Arthur Andersen firm.

market and accounting. Given the clearness and specificity of their opinion I report the latter hereafter in full

“A result of applying the procedures set forth above⁹⁰ is that the value attributed to the exchange and not identified with acquired economic resources (goodwill) is not put on the balance sheet and amortized to future earnings. Goodwill is not an economic resource since it lacks the basic characteristic of exchangeability. Furthermore, its continuing value is essentially unmeasurable since it relates solely to future expectations of earnings. The cost of goodwill is a product of stock market speculation and thus is subject to the myriad factors affecting stock market prices—prices that change every day. A cost that is such a product has no permanence as an indication of value because it is volatile as the moods that determine stock market prices. Therefore, the cost of goodwill is not a value relevant to the present or future determinations of a company’s economic resources or the interests of creditors and equity owners in those resources. Moreover, the future earnings anticipated by the goodwill should not be destroyed by amortizing against those earnings the collective guess of investors, at the time of a business combination, of what those earnings might be. Such a process introduces circularity into accounting by allowing evaluations of the users of financial statements to affect those statements, and thus breaks down the segregation of the accounting function from the investor function.” (see p. 92 in Arthur Andersen and Co. (1974). *Accounting Standards for Business Enterprises Throughout the World*. St. Charles, IL: Arthur Andersen).

It must be noted that at the time the accounting for business combination varied from country to country giving rise to a situation best described by the firm in question as “being chaotic”. In particular, the purchase method and the pooling-of-interests method were recognized in the US and the criteria set forth by the US Accounting Principles Board to select the suitable method were considered “arbitrary” and with “no grounding in economic facts or logic”. The Canadian Institute of Chartered Accountants had issued a recommendation on the subject in December 1973 and the ICAEW, Institute of chartered accountants of England and Wales had issued an “exposure draft” entitled “Accounting for acquisitions and mergers” in 1971.⁹¹ Overall, Arthur Andersen and Co. found that the variations among the method used to determine the cost of an acquisition and among the method used to account for the net identifiable assets acquired caused “extreme differences” in the amounts recorded as goodwill especially across different countries.

⁹⁰ i.e. in particular the first point out of the four mentioned above.

⁹¹ Arthur Andersen mentions five different practices on accounting for goodwill including the practice considered acceptable by the accounting profession in the United States prior to 1970 which was followed by other countries consisting in recording goodwill as an asset without amortising it unless a reduction in “value” becomes evident. The following impairment procedure contributing to the *financialisation* approach of IAS/IFRS was thus superimposed on a practice which was common in a previous period.

When it comes to consolidation policy, the position of Arthur Andersen and Co. was still anchored in a proprietary approach but tried to go beyond the practice prevailing at the time. In fact, the firm didn't get to a fully-fledged control model and that it is not surprising given the difficulties that the shift to the latter model would have presented for the auditing practice which was one of the main business of the company. In particular, they defined a subsidiary of the reporting company as a company in which "the reporting company and its other subsidiaries own a majority of the company's voting securities". However, they concede that in some cases it may be appropriate for a reporting company to treat as a subsidiary for consolidation purposes a company in which it holds a 50% or a significant minority interest provided it also has an option to acquire a majority interest and a contract granting it management control over the operations of the other company. In any case, their proposed consolidation concept were in line with those prevailing at that time which were informed by a proprietary approach. Actually, in their view consolidated financial statements should be "responsive to the point of view of the primary users of such statements-shareholders, potential shareholders and creditors *of the parent company*" (italics mine). In other words, their proposal maintained that consolidated financial statements are an extension of the parent-company statements. Consistently with that view, minority interests are shown outside consolidated equity. However, differently from coeval practices, they are in favour of a full consolidation approach whereby a subsidiary's assets and liabilities "should not be reflected in reduced amounts proportionate to the parent company's ownership" and they are implicitly against exclusion from consolidation for companies whose activities are heterogeneous with respect to those of the parent. In fact, they propose to limit exclusion to those rare cases where "control⁹² over the subsidiary is likely to be temporary or does not rest with the majority owners⁹³".

4.4.3 Arthur Andersen's response to the FASB's 1995 exposure draft on consolidation

There are some received ideas and concepts which, although their validity is far from proven, persist over time. "The parent company approach" may be counted among the former and the response of Arthur Andersen to the FASB's 1995 exposure draft on consolidation is no exception. In fact, that approach which was their preferred one in 1974 continued to retain their total favour more than 20 years later. And that is the main reason for Arthur Andersen's complete rejection for the different control-based approach proposed in the FASB's exposure

⁹² In this context control means the ownership of the majority of the voting equity.

⁹³ Most likely for example as where the subsidiary is in legal reorganization or bankruptcy.

draft as indicated in the former 12-page letter of comment. In that document Arthur Andersen recognized that the FASB's proposal was based on the economic entity approach which Arthur Andersen intends as an approach whose main consequence is to inform the preparation of financial statement from the perspective of all shareholders, be they controlling or non-controlling (clearly in their own limited interpretation of those terms). Not only was Arthur Andersen against such approach but it also encounters difficulties in coming to grips to the reasons for the proposed change and it tried to suggest some solutions which would get cosmetically the same result of the entity approach without relinquishing their preferred approach. For example, they assumed that the FASB's changes were due to their desire to conform with the conceptual framework. In order to be consistent with the latter and maintain the parent company approach they suggested to report minority interest as a separate part of equity instead as of liabilities. However, they also made clear that minority shareholders must exclusively be concerned with information presented in the separate financial statement of the relevant subsidiary.

Overall, the reaction of Enron and its auditor, Arthur Andersen to the FASB's proposal on consolidation pointed to, on one side, the limits to opacity-generating structuring opportunities that such a control-based standard would have imposed, and, on the other side, to the prospected difficulties and adaptation costs that auditing companies would have incurred into coupled with an increased risk of litigation. However, their lobbying in conjunction with the mainstream constituents contributed to preventing the adoption of the FASB's proposal. Allegedly, it took a financial scandal resulting in the demise of Enron, the auditee, and Arthur Andersen, the auditor, to make the wind in part change direction.

4.4.4 Consolidated Financial Statements: Policy and Procedures (ED, October, 1995)

Like Arthur Andersen also the other audit major companies are strongly against the 1995 proposal of the FASB on consolidation. However, they are unanimous in recognizing the importance of the proposed new consolidation policy. In fact, the latter is described as a "drastic change in practice", a "dramatic change in consolidation accounting" (PriceWaterhouse), a "radical change in the consolidation concept" (Coopers & Lybrand) and "resulting in major changes to financial reporting (KPMG).

There are two major classes of reasons which explain the open opposition of audit companies to the FASB's exposure draft.

Firstly, they are hostile to the proposed change from a consolidation model based on a parent company view to a model *purportedly* based on an entity view. The comment letters are explicit on this point “We support the parent company concept” (Ernst & Young),

“the parent company concept is the most appropriate model to follow for consolidation procedures” (PriceWaterhouse),

“we do not support consolidation procedures that strictly follow the economic unit focus that is proposed by the Board. We believe that current practice, which follows principally a parent company focus is appropriate” (KPMG)

“we do not support the proposed change from the parent company concept to the economic entity concept. The parent company concept has worked well and is widely understood by users of financial statements. Further, we are concerned that application of the economic entity concept can produce accounting results that are inconsistent with the underlying economics of transactions involving subsidiaries, and can in fact be misleading to investors.” (Coopers & Lybrand).

Moreover, the proposed change appears unwarranted from the perspective of the major audit companies in that they claim to be not aware of any dissatisfaction with the parent company concept by preparers, users, auditors and others. That absence of a need for an overhaul of consolidation policies by the audit companies’ clients contribute to making the proposal even more unjustified to audit companies’ eyes.

Besides the latter’s aversion to an entity approach to consolidation, the second class of reasons for the strong opposition to the FASB’s proposal is associated to operationality and auditability issues of the proposed new approach. In particular, a consolidation policy based on effective control instead of legal control would require a proper assessment by the auditors which cannot rely on bright-line rules. That is perceived by the audit companies as highly subjective. For example Ernst & Young note that

“in situations where there is not a majority ownership, decisions about consolidation would have to be extremely subjective and therefore difficult to audit” and PriceWaterhouse adopts similar terms when they refer to applying the proposed definition of control as a “very important and extremely subjective area”.

In keeping with their strong preference for a parent company view, audit companies are convinced that consolidated shareholders’ equity should portray the overall interests of shareholders of the parent company. Therefore, auditors are against the inclusion of noncontrolling interests in consolidated shareholders’ equity. By the same token, consistently with the preferred treatment of noncontrolling interests, acquisitions or disposal of equity of a

subsidiary while maintaining control is not viewed as a treasury stock transaction as in the FASB's exposure draft. Instead, changes in a parent's participation in a subsidiary are seen as arms' length transactions with third parties which, consequently, should give rise to a gain or a loss.

Finally, also the reaction of the big six auditors on the proposed treatment for investment entities is quite telling. When the FASB's 1995 exposure draft was still a preliminary view document, the proposed consolidation policy would apply to « business enterprises and not-for-profit organizations that control other entities regardless of their legal form » which implied that entities like venture capital companies, LBO funds, pension plans, mutual funds and investment companies were not singled out for a special treatment. However, some audit companies raised the point, in their comments on the preliminary view⁹⁴, whether the proposal would meaningfully apply also to investment entities or more generally « entities that currently follow a fair value accounting model for their investments in accordance with accepted industry practice ». The FASB accommodated that view and exempted from the proposal all entities which « in accordance with generally accepted accounting principles carry substantially all of their assets, including investments in controlled entities, and liabilities at fair value with changes in value reported in a statement of net income or financial performance ». The exemption was judged as too strict by the audit companies which mentioned the issue in their comment letters i.e. Coopers&Lybandagree, Price Waterhouse, KPMG and Ernst&Young. In fact, all those four companies observed that the requirement that entities would carry substantially all assets *and liabilities* at fair value would have to be modified requiring that in order to be exempted from the scope of the proposal on consolidation it suffices to record substantially all assets at fair value.

⁹⁴See in particular the response of PwC to the preliminary view on consolidation policy in 1995: "We believe that the Board should specifically address the applicability of the PV document to those entities following a fair value accounting model for investments and recommend that they be excluded from the scope of the consolidations project. Investment companies, business development companies, venture capital firms and certain similar entities have a long history of reporting their investments at fair value, regardless of their ability to control or exercise significant influence over the investee. We believe this practice should continue because it provides the most relevant and useful information to current and prospective investors. Requiring consolidation in those circumstances where the ability to control exists would likely be counterproductive, because the primary interest of the investor is in the value of the investment portfolio. We see no compelling reason to force consolidated financial statements on users who do not find them helpful". In April 1995 the FASB met with AICPA's investment companies committee, the SEC and investment companies in order to inform the Board's views about a possible exception of investment entities from the scope of the exposure draft.

Table 4-6 Audit companies and « Consolidated Financial Statements: Policy and Procedures (ED, October, 1995) »

	Arthur Andersen	Coopers&Lybrand	Deloitte&Touche	Ernst&Young	KPMG	Price Waterhouse
Stance on the proposal	We are strongly opposed to the changes in consolidation procedures proposed in the ED.	Favorable to an effort that would provide a uniform and comprehensive standard addressing consolidation policy and procedures that would apply to substantially all entities regardless of their form.	Support the FASB's efforts to develop a consolidation policy applicable to all business enterprises and not-for-profit organization. Support the issuance of a final Statement.	Do not support the proposal and its issuance.	Do not support the issuance of the ED as a final standard.	Do not support the proposed consolidation policy.
Consolidation policy	Unilateral non-temporary control should be coupled with a residual interest in the other entity.	In addition to control, an entity also should have a more than de minimis economic interest in the controlled entity in order to consolidate that entity. That is, an economic interest in the risks and rewards of ownership is necessary.	Consolidation policy should be based on effective control and significant beneficial interest. The former should be based on indicators.	Based on verifiable ownership test that generally requires more than a 50 percent voting interest.	Control and significant ownership are necessary conditions for consolidation.	Unilateral control and a significant economic interest are necessary conditions for consolidation. The former is defined as "the unilateral ability to direct or cause the direction of the management and operating and financing policies of another entity."
View on noncontrolling interests	Not reported in equity.	Not reported in equity.	n.a.	Not reported in equity.	Minority interests are not a component of equity.	They are not equity. Classified between liabilities and owner's equity.
Changes in a parent's ownership interest in a subsidiary while maintaining control	Reported as acquisitions of additional ownership in the subsidiary.	Should be accounted for as transactions with outsiders i.e. not as if they were treasury stock transactions .	n.a.	Not accounted for as transactions in the equity of the consolidated entity.	Should not be recorded as treasury stock transactions.	Should be reflected in the income statement.

4.4.5 Follow-up on audit companies' positions on the Consolidated Financial Statements: Purpose and Policy ED issued in February 1999

Facing the harsh criticism of major audit companies and other preparers, the FASB issued a revised exposure draft on consolidated financial statements in 1999. It was a version less encompassing than the previous one in that some critical aspects of the latter were expunged from the text. In fact, the focus of the revised version was on the purpose and policy concerning consolidated financial statements instead of the policy and procedures the previous version focused on. Dropping the consolidation procedures⁹⁵ was an understandable move of the FASB given the related controversial reaction of audit companies and respondents in general. Other changes were made in order to meet the favor of some constituents. One of such changes concerns the definition of control which in the revised version was defined as “The ability of an entity to direct the policies and management that guide the ongoing activities of another entity so as to increase its benefits and limit its losses from that other entity's activities”. Interestingly, the revised definition with its focus on the ability to direct the policies and management of another entity was more in line with the original definition proposed in 1991 than the definitions proposed in 1994 and 1995 which focused on directing the individual assets of another entity (see table 4-7 hereafter). The 1991 definition, in its turn, appears to be based on the definition of “control” issued by the SEC in Rule 10A-3(e)(4) of the Exchange Act of 1934. In fact, according to that law, “control” (including, with its correlative meanings, “controlled by” and “under common control with”) is defined in as “the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.” Therefore, the FASB’s definition of control as revised in 1999 ultimately was based on the original definition introduced in the US legal corpus. Compared to that definition, “power” was substituted by the more neutral and aseptic

⁹⁵ According to the FASB the decision to focus on the definition of control of an entity and the implementation guidance instead on the consolidation procedures was taken in August 1997. The Board intended to get the information derived through its business combinations project and the information of other standard setting bodies before addressing again consolidation procedures (Consolidated Financial Statements: Purpose and Policy, February 1999, §173). And yet, dropping the consolidation procedures from the exposure draft allowed the FASB to avoid the controversial proposals on reporting noncontrolling interest in subsidiaries and changes in a parent’s ownership interest in a subsidiary among others.

“ability” and benefits resulting from the use of the ability are explicitly included⁹⁶. The revised definition met the favor of audit companies. In particular, Arthur Andersen notes that

“We are pleased to see that the revised definition of control focuses on the ability to direct policies and to hold management accountable to those policies, instead of focusing on directing assets, as did the prior definition. Focusing on directing policies and management is the approach we supported in our previous comment letters”.

Concerning the second point the same auditor continues:

“We are pleased to see that the revised definition of control has added the notion that an entity is not a parent unless it derives benefits from the activities of its investee. This notion is critical so that via consolidation a parent is only recording the individual assets and liabilities from which it incurs risks and derives rewards.”

Table 4-7 Comparative evolution of the notion of control according to the FASB 1991-1999

Discussion Memorandum (1991)	Preliminary Views (1994)	Initial Exposure Draft (1995)	Revised Exposure Draft (1999)
The power of one entity to direct or cause the direction of the management and operating and financing policies of another entity.	The power to use or direct the use of the individual assets of an entity to achieve the objectives of the controlling entity.	The power to use or direct the use of the individual assets of another entity in essentially the same ways as the controlling entity can use its own assets.	The ability of an entity to direct the policies and management that guide the ongoing activities of another entity so as to increase its benefits and limit its losses from that other entity's activities.

However, neither the exclusion of the controversial “consolidation procedures”, nor a revised definition of control among other things managed to make the audit companies change their stance on the exposure draft. The latter ranged from the « extreme disappointment » of Ernst&Young about the Board’s willingness to pursue the project on consolidated financial statements to the serious reservations of PwC about the ED.

The reasons for the audit company rejection of the FASB’s revised exposure draft on consolidated financial statement are substantially the same for their hostility toward the initial exposure draft. Firstly, the revised exposure draft is not in line with the parent company

⁹⁶ The FASB itself notes that the condition concerning the increased benefits or limited losses resulting from the decision-making ability inherent in the controlling power is similar to what prescribed in the United Kingdom and by the International Accounting Standard Committee (IASC).

approach which meets the preference of audit companies, and although the former doesn't explicitly refer to the entity view, that is still a source of concern as mentioned by PwC. In fact, according to the latter

“[the revised ED] excludes the concept that consolidated financial statements are primarily for the benefit of the shareholders and creditors of the parent company. By excluding this basic tenet, the Board appears to be moving away from the parent-company approach. Although the ED does not explicitly address the economic-unit concept, we wish to stress that we do not support it. In our view, applying the economic-unit concept would substantially change the concept of consolidation that has worked well for many years and which, we believe, is understood by the user community”.

Secondly, the notion of “effective control” is still vehemently opposed by audit companies. Concerning this point KPMG writes

“In our view, there should be no room in the definition of control for a notion of "effective control" that depends upon the assumed continuing forbearance or apathy of a party or parties holding the majority voting interests in an entity. one party has the unilateral legal right or the currently exercisable unilateral ability to obtain the legal right to impose its will on the management and/or governing board of the entity with respect to its future financing and operating policies.”

Similarly, Arthur Andersen explains that

“our confusion over the ED occurs because different parts of the ED embody different bases for evaluating control. Specifically, the "majority voting interest" and "right to obtain a majority voting interest" presumptions embody a unilateral control approach, whereas the "large minority voting interest" presumption takes a bilateral-apathy control approach”.

By the same token Ernst&Young

“oppose the direction of the FASB's consolidation project- believe that control should be objectively determinable and should be presumed when a company owns a majority of the voting interest of an entity (sometimes referred to as "legal control")”,

and Deloitte

“we believe that control should not be presumed unless legal control exists. Effective control should be determined based on an evaluation of the relevant facts and circumstances”.

However, the position of PwC, for its part, slightly departs from the chorus, in that it would support “effective control” if it were associated with a significant economic interest of the investing company in the investee:

“We support the conceptual underpinnings of the requirement that consolidation take place when effective control exists. The concept of effective control focuses on the substance, not the form, of the parent-subsidiary relationship. The Board's proposal would require that consolidation take place when one entity has "effective control" over another entity - without regard to the investors level of economic interest. In our opinion, a consolidation policy standard that is premised solely on control could result in the users receiving information that is not particularly relevant. We believe that there should be an additional criterion for consolidation - namely that the parent-subsidiary relationship must carry economic consequences for the controlling entity (parent) that are significant relative to the controlled entity (subsidiary).”

Moreover, the hostility of audit companies toward the revised exposure draft continues to be associated to the perceived reduction in auditability and operability that “effective control” would have brought about, see for example KPMG “Under these circumstances, we believe that the Board's efforts to replace so-called bright-line tests with judgment-based fuzzy-line tests will fail to produce the intended result”.

Concerning investment entities, the FASB extended the scope exception in accordance with respondents’ observations excluding from the scope of the revised ED entities that report substantially all their assets at fair value. Audit companies support this exception and ask the FASB to confirm that the specialized investment entity accounting would roll up to a non-investment parent (see Arthur Andersen’s comment letter).

4.4.6 Investment Entities FASB vs IASB

In the U.S. the concept of “investment entities” has existed for a long time, at least from the definition crystalized in the Investment Company Act of 1940⁹⁷. Consequently, U.S. GAAP has a well-established set of complete accounting and reporting guidance for investment

⁹⁷ The analysis of that law is beyond the scope of the present chapter. Suffice it to mention that according to the Investment Company Act of 1940 an affiliated person of another person means -according to that law person might be either physical or legal person – is “any person directly or indirectly controlling, controlled by, or under common control with, such other person”. Moreover the same law also declares that “the national public interest and the interest of investors are adversely affected when the control of investment companies is unduly concentrated through pyramiding or inequitable methods of control, or is inequitably distributed, or when investment companies are managed by irresponsible persons.”

companies that in general requires measurement of investments at fair value. In contrast, the concept of “investment entities” appears to be either totally alien to certain other jurisdictions or to vary greatly across others. Therefore, when the IASB, under the pressure of investment funds and other investment entities decided to prepare the exposure draft on the consolidation exception for investment entities presented above had to propose their own definition which should be valid in all the jurisdictions where IFRS are adopted. At first, the FASB, considering that the IASB had invoked convergence reasons as being of primary importance for the proposed changes, decided to find a common definition for “investment entities” not anchored to the one in the Investment Company Act of 1940⁹⁸. However, the FASB finally decided that investment company under the Investment Company Act of 1940 is also an investment company for accounting purposes and the IASB had to come up with its own definition which is different from the one adopted by its U.S. counterpart. Beside this major difference coupled with the fact that for the IASB accounting for investment entities is developed as an exception to consolidation while the U.S. principles have a comprehensive set of accounting requirements for those entities, there are other two points of difference worth mentioning here. Firstly, under IFRS, a noninvestment entity parent is required to consolidate controlled investees held by an investment company subsidiary in its consolidated financial statements. In contrast, the FASB continued to maintain that the ad-hoc accounting has to be retained also in that case. Secondly, IFRS requires investment entities to have an exit strategy for investments without stated maturity dates such as equity securities and nonfinancial assets. Also U.S. GAAP have an exit strategy requirement but only for investments whose objective consists in realizing capital appreciation⁹⁹.

4.5 Chapter conclusions

European law is greatly weakened from its being the result of a compromise –simplifying-of the entity approach generally followed in continental Europe (in particular Germany and Italy) and the UK legal approach more akin to a proprietary view. Moreover, as indicated by the EU definition of subsidiary, elements of both legal ownership and economic control

⁹⁸ According to that law ““control” means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company”.

⁹⁹ There are other differences but are mainly consequences of the points presented above, for example as a result of the different definition of investment entity, IFRS requires an entity to measure and not to manage the performance of substantially all of its investments on a fair value basis to qualify as an investment entity whereas management on a fair value basis is a normal characteristic for investment entities in the USA.

coexist. The FASB, for its part made an apparent shift toward a control approach with the publication of the exposure draft in 1995. In 2008 the exposure draft of IFRS 10 also proposed control as the main criterion for consolidation, later confirmed by the final standard. However, it was in following developments, like the treatment of investment entities that that the IASB original view proved to be still vital. In particular, the IASB's proprietary view disguised as entity revealed its true nature in the investment-entity-consolidation exception.

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5. LOBBYING ON ACCOUNTING STANDARDS ON CONSOLIDATION: A REVIEW OF THE COMMENT LETTERS SUBMITTED TO THE IASB IN THE AMBIT OF THE EXPOSURE DRAFTS OF IFRS 10 AND THE AMENDMENT ON INVESTMENT ENTITIES.

5.1 Introduction

Lobbying activities may significantly influence the decisions of regulators about a wide spectrum of areas. Accounting regulators, in particular, might be prone to be influenced by different lobbying constituents. In fact, accounting research has provided evidence about the effects of “political” lobbying on accounting standards, Zeff (2002) and about the consequences of lobbying by audit companies, Puro (1984) and by other categories of constituents. The latter may have different methods to make their voice heard and ultimately influence the outcome of the accounting standards setting process. Constituents can in fact express their views on proposed accounting regulation during preparatory work/standard-making process either directly with the standard setter or indirectly contacting accounting bodies such as the European Financial Reporting Accounting Group (EFRAG). Another way of expressing their voice is through a comment letter in response to the request of information on a given proposed standard as prescribed by the due process of the international standard setter. These letters are publicly available and have been variably used in accounting research in order to retrieve data about respondents’ lobbying on accounting standard such as their position on a given proposed standard and the type of arguments raised in order to support the latter. In the present chapter I review the comment letters on the Exposure draft of IFRS 10 on consolidated financial statements and the related

' There are only a few fundamental issues in financial accounting. The FASB ducked them all.'

Robert Anthony, Harvard Business Review (Jan.-Feb. 1987).

amendment on the scope¹⁰⁰ exception of investment entities in order to assess to what extent the accounting regulation on consolidation was shaped by respondents' comments. To that end the 304 unique comment letters received by the IASB in response to the request for information for IFRS 10 and its amendment on investment entities are collected and reviewed. Research suggested that comment letters submitted in response of a proposed standard are a means for lobbyists of exerting persuasion and influence upon the standard setter (Sutton, 1984; Booth and Cocks, 1990; MacDonald and Richardson, 2004). The rich content of comment letters has been exploited by researchers through review and analyses of them (e.g. Hope and Gray, 1982; Nobes, 1992; Tutticci et al., 1994; Weetman et al., 1996; Jupe, 2000; Weetman, 2001). The present chapter contributes to the latter stream of literature exploiting two virgin sets of comment letters, the one of letters sent in response of the exposure draft of IFRS 10 and the other one of letters responding to the exposure draft of the amendments to the latter standard concerning investment entities. It's also the first study which includes a set of comment letters relative to an amendment of the standard which attracted the other set of comment letters.

The review of the two sets of comment letters taken together provides evidence on the nature of the lobbying activity which might have contributed to the introduction of the investment entity consolidation exemption. The descriptive statistics are presented in the next paragraph.

5.2 Descriptive statistics

Table 5-1 provides the geographic repartition of the two sets of comment letters. Curiously, the amendments attracted more comments than the exposure draft of the standard itself. Letters from Canada, UK and US are predominant in both sets and account for 40% of the total number of letters in the amendment set. In terms of users' type, non-corporate respondents are the most prevalent in both sets accounting for almost 70% of the total in the first set and 65% in the second. Financial institutions and associations are 35% and 49% of the respective totals. The letters sent by the Chinese Ministry of Finance (the Chinese accounting standard setter), Morgan Stanley and Norwegian Accounting Standards Board are missing.

¹⁰⁰ Here and after scope refers to the accounting scope of consolidation. The latter might differ from the scope of regulatory consolidation as indicated by the Basel framework.

Table 5-1 Geographic repartition of respondents to ED IFRS 10 and ED on investment entities

Respondents' Country	Count of Country
Australia	11
Austria	1
Belgium	1
Canada	11
China	1
Europe	9
Finland	1
France	7
Germany	10
Hong Kong	1
India	1
International	12
Ireland	4
Italy	1
Japan	2
Korea	1
Malaysia	1
Mexico	1
Netherlands	3
New Zealand	4
Norway	1
Pakistan	1
Poland	1
Romania	1
Russia	2
Singapore	1
South Africa	3
Spain	1
Sweden	3
Switzerland	7
Taiwan	1
UK	25
US	17
Zambia	1
Grand Total	148

Respondents' Country	Count of Country
Argentina	1
Asia-Oceania	1
Australia	8
Belgium	1
Brazil	1
Canada	27
Europe	9
France	7
Germany	5
Guersney	1
Hong Kong	2
India	4
International	15
Ireland	1
Israel	1
Italy	1
Japan	8
Korea	1
Latin America	1
Luxembourg	2
Malaysia	2
Mexico	1
Netherlands	2
New Zealand	3
Norway	1
Pakistan	1
Poland	1
Qatar	1
Rwanda	1
Singapore	2
South Africa	6
Spain	2
Sweden	4
Switzerland	3
UK	26
US	12
Zambia	1
Grand Total	166

Tables 5-2 and 5-3 present the repartition by type of respondents to ED IFRS 10 and ED on investment entities, respectively. The EFRAG, the European Commission adviser whose opinion is important for the endorsement process of IFRS in Europe is kept distinct from the other types in that it does not correctly belong to any of those, whereas the IOSCO, International Organisation of Securities Commissions, is classified as a standard setter. The tables reveal that financial institutions are the most prevalent type in both exposure drafts accounting for about 22% and 32% of each respective total number of respondents. Their importance is even greater than what that number may suggest in that they can make their voice heard also through associations. In fact, the latter account for about 22% of each total in both exposure drafts' set of respondents. The number of comment letters sent by financial institutions, directly or through an association, stands out also when compared to what has been documented for other exposure drafts issued by the international standard setter. In this regard, Jorissen et al. (2012) find that for all comment letters sent directly to the IASB over the period 2002–2006, financial preparers and association of financial preparers account for 11,7% and 11,8% of the total behind associations of accountants and auditors (17,8%) corporate preparers (14,3%) and national standard setters (14,1%).

Table 5-2 Repartition by type of respondents to ED IFRS 10

Respondents' type	Count of type
Academic	3
Accounting firms and accountancy bodies	26
Association of financial institutions	32
Association of preparers	7
Audit firm	6
Corporate preparer	13
EFRAG	1
Financial institution	32
Government	6
Non-academic individual	3
Standard-setter	19
Grand Total	148

Table 5-3 Repartition by type of respondents to ED on investment entities

Respondents' type	Count of type
Academic	2
Accounting firms and accountancy bodies	28
Association of financial institutions	37
Association of preparers	2
Audit firm	6
Corporate preparer	5
EFRAG	1
Financial institution	52
Government	5
Non-academic individual	4
Regulator	2
Standard-setter	21
Stock exchange	1
Grand Total	166

5.3 Lobbying for an investment-entities scope exception in ED IFRS 10

IFRS 10 Consolidated financial statement was issued in order to overcome the shortcomings of the previous accounting regulation on consolidation covered by IAS 27 and the interpretation SIC-12. The two latter regulations created inconsistencies across different entities in the application of the definition of control based on the power to govern financial and operating policies in IAS 27 and on risks and rewards in SIC-12. Instead, IFRS 10 introduced a single consolidation model based on control as the basis for consolidation for all types of entities. Moreover, the new consolidation standard provided guidance on the so-called “agency relationships”. The latter would have potentially provided an escape hatch for entities like investment funds or institutional investors which may have found a justification for avoiding consolidation of the companies they control. In fact, some respondents from the investment fund industry in particular, approve of the introduction of agency relationships accounting in that they see themselves as belonging to that case. This is the case of Blackrock and Invesco for example

“We believe that if an asset manager were required to consolidate the asset it manages, the users of its financial statement would find them both uninformative and

potentially misleading. We therefore strongly support the approach to agency relationships adopted by the Exposure Draft.” (Blackrock, CL56)

“Additionally, the considerations outlined in paragraphs BC88 through BC95 are key for investment managers, as investment managers often act in a fiduciary capacity and have a direct investment in the funds they are managing (as acknowledged in paragraph BC91). This is very common in the industry, as investors often like to see the “skin in the game” in the form of a co-investment of the investment manager before investing in the fund. We encourage the Board to retain the agency consideration when finalizing.” (Invesco, CL102)

However, that possibility is reduced in that the agents who directly hold voting rights in the controlled entity besides acting on behalf of a principal, i.e. the so called “dual agents” may not be recognized as such for accounting purposes. In fact, some respondents, in particular from the insurance industry, have concerns that they would not fall under the scope of the proposed agency relationship accounting. For example, the American Council of Life Insurers notes that

“If paragraph B11 does not apply to investment funds, this may lead to an increase in the consolidation of mutual funds for those entities that have dual roles as principal and agent. Having an asset manager consolidate a fund where he has none, or a minimal amount, of the underlying risk of the consolidated assets and liabilities seems to be counterintuitive of a consolidation model. An example would be a 15% owner/manager of a mutual fund, who receives both a fixed and performance fee. The manager has a fiduciary responsibility to its investors and must follow established investment guidelines. Under the proposed guidance, the manager would be required to consolidate the investment vehicle because he would be deemed to have the power to direct as an agent and, through its fee arrangement, receives benefits that could potentially be significant to the fund”. (ACLI, CL78)

Similar concerns are shared by Partners Group, a global alternative asset management firm headquartered in Switzerland.

“Especially the comments in B11 will lead to continuous discussions in our industry between preparers of financial statements and auditors”. (Partners Group, CL61)

On the contrary, other respondents warn that the introduction of a regulation tailored around agency relationship may lend itself to abuses in the investment fund industry. In other words they point out that a loose interpretation of agency relationship may result in inappropriately scope out entities that should be most correctly consolidated. The Institute of chartered

accountants of England and Wales (ICAEW) and the Committee of European Banking Supervisors (CEBS), are among the former.

« In the context of managed funds where the fund manager has dual capacity, as both a principal with ‘some skin in the game’ and as an agent, it would be too easy to assert that the manager is acting in a fiduciary capacity. As they stand, the proposals are likely to lead to structuring opportunities to avoid consolidation. A reporting entity might be exposed to the returns of an investment vehicle and have significant power to direct its activities, but because it has a contractual duty to act in the best interest of the principals it might be able to claim that it is acting as an agent. We therefore fear that the proposals may result in entities being excluded from consolidation where this is not appropriate ». (ICAEW, CL70)

« Whilst the ED does acknowledge the dual agency / principal role in the context of managed funds where the fund manager is both a principal with ‘some skin in the game’ and an agent, it would be too easy to assert that they are acting in a fiduciary capacity i.e. solely as an agent hence the decision is made to not consolidate. We feel that the proposals may lead to entities coming off balance sheet where this is not appropriate ». (CEBS, CL73)

In sum, some respondents may intend agency relationships regulation as lending itself to encompass the case of investments funds and investment companies in general while others are against such an extensive interpretation. On the top of that, other respondents may have felt that the single control principle introduced by IFRS 10 would have made investment entities change their accounting practices and start to consolidate entities which were previously not considered as part of the group they control in that they would not have qualified as “agents”. In order to prevent that outcome, they explicitly mentioned in their comment letter that they are favourable to a single control principle accompanied by a scope exception for investments entities. In the second column of table 5-7 I put a « Yes » if the respondent called for such exemption. Those calls are unprompted remarks in that nowhere in the request of information constituents are asked whether a scope exception for a particular industry would be appropriate. As table 5-7 shows respondents calling for such exemption are mainly based in Canada and that it is not surprising since the GAAP of that country allow investment entities not to consolidate their controlled investees. Instead, the classification of constituents by type provides an interesting observation. I build a matrix which counts the number of respondents for each of the four cases asked generated by the following two

dimensions whether they asked for a scope exception of investment entities or not and whether they are a financial institution or an association of financial institutions or not.¹⁰¹

The implications of agent/principal relationships for investment entities were also discussed by the EFRAG in its endorsement advice of IFRS 10 addressed to the European commission. In this regard, the EFRAG acknowledged the opinions received from some constituents (banks and insurers involved with investment funds) that applying the control principle in IFRS 10 to investment funds is not appropriate (see paragraph 41, pp. 65-66 of the endorsement document). However, the “EFRAG believes that it is conceptually the correct principle to apply the control principle to all investees that an investor controls and will therefore lead to appropriate financial reporting” and that would reduce the lack of transparency and omission of relevant information. The importance of the question in the endorsement of IFRS 10 is also emphasized by the two dissenting opinions i.e. two EFRAG members arguing against the endorsement of IFRS 10 in the European Union. In fact, the first dissenting member points to the inadequacy of agency relationships as defined in the standard which can result in the “consolidation of holdings in traditional mutual funds and similar transactions in which there exist neither economic or legal rights nor market risk” (paragraph 7, p. 74). Similar convictions are shared by the other dissenting member who thinks that the agency relationships as defined in the standard is not appropriate in that it would require the consolidation of mutual or investment funds also in cases in which the controlling entity has a small stake in the former.

However, some months after the endorsement, the EFRAG will de facto embrace the dissenting views expressed in the endorsement document of IFRS 10. That will happen through the endorsement of the amendment of IFRS 10 on investment entities.

¹⁰¹ The test statistic for the 2-tailed Fisher exact test is 0.0524 which is statistically not significant for any level lower than 5%, which suggests that other institutions beside those related to the financial sector lobbied in favour of a scope exception of investment entities. For example the Corporate Reporting Users' Forum sees “little reason for the consolidation of investment funds”. Probably their preference for a parent company view may have contributed to their preference for a scope exemption for investment entities. For their view on parent/entity concept see the following excerpt from their comment letter in response to the exposure draft on amendments in IFRS 3 business combinations in 2005. “The entity concept (*sic*) whereby financial information is presented with the shareholders of the parent company as the primary focus is one that users accept and are comfortable with. Whilst there are undoubted merits in the alternative ‘economic entity’ approach (and many of us look at companies from an ‘enterprise’ perspective on occasions) they are not overwhelming, and we cannot see sufficient flaws or problems with the current parent company approach to warrant this change or if these flaws do exist they have not been sufficiently explained or demonstrated in the draft standard.”

5.3.1 Classification of the answers by respondents' type

Table 5-4 presents for each respondent's type the number of those who argued that the consolidation model proposed by IFRS 10 should, if adopted, be accompanied by a scope exception for a particular class of entities such as "investment entities". Table 5-4 together with table 5-2 reveal that about one third of associations of financial institutions who gave their feedback on IFRS 10 made such objection.

Table 5-4 Repartition by type of the answers to ED IFRS 10 regarding investment entities

Respondents' type	Count of answers in favour of a scope exception for investment entities
Academic	0
Accounting firms and accountancy bodies	3
Association of financial institutions	10
Association of preparers	0
Audit firm	1
Corporate preparer	1
EFRAG	0
Financial institution	5
Government	1
Individual	0
Standard-setter	2
Grand Total	23

5.4 Constituents' response to ED on investment entities: an amendment to IFRS 10

Shortly after the issue of IFRS 10, the IASB issued the exposure draft proposing an exception to the control principle for investment entities whereby the latter have no choice but measuring their investments in controlled investees at fair value, i.e. consolidation is not permitted. A comparison of the Exposure draft with the final standard as amended shows that the six criteria for qualifying as an investment entity in the former are reduced to 3 in the final standard and are not binding i.e. it is not necessary to meet all the three criteria to qualify as an investment entity. In particular, the criterion that "substantially all of the investments of the entity are *managed*, and their performance is evaluated, on a fair value

basis” (see also paragraph B17 on fair value management) becomes “*measures* and evaluates the performance of substantially all of its investments on a fair value basis (italics mine)”. Moreover, also the statement that “in most cases, investment entities would have investment entity parents” is dropped from the final amended standard. That decision might have been influenced by the observation made by several respondents (for example Blackstone, the Japan institute of certified public accountants, the Canadian securities administration, the Korean Accounting Standards Board (KASB), the South African Institute of Chartered Accountants (SAICA), Allianz) that in many instances the party with the controlling financial interest in a consolidated fund is not an investment entity.

The exposure draft attracted 166 unique comment letters. In table 5-8 in column 2 is indicated for each respondent whether he was favourable to the proposal, i.e. « No » if the respondent was against¹⁰². Instead, column 4 reports whether for each respondent he was favourable to the fair value accounting roll up to a non-investment parent company¹⁰³.

Out of 166 respondents 22 were against the approval of the exposure draft¹⁰⁴. Long-term investors Investor AB, Eurazeo, Wendel, Alliance Trust PLC and Remgro Limited appear recalcitrant to the latter. In particular, Investor AB whose business model is to generate long-term returns for their shareholders and who is not like short-term investors who create value by buying, developing and selling their controlling participations, believe that entities under control should be consolidated in order to provide relevant information to their investors. They also lament that the exposure draft is rule based and inconsistent with the Conceptual framework. Eurazeo for his part, is one of the leading listed holding companies in Europe, with more than 4 billion euros in assets. The former is a long-term shareholder whose goal is to transform the companies in which it holds a stake through an active involvement. In their view the consolidation exception would deteriorate the quality of the information provided by long term investors as they are. The above views are shared by Wendel, one of Europe’s leading investment companies in size with the characteristic to be a long-term investor with permanent capital and access to capital markets. Besides being a long-term oriented investor,

¹⁰² The precise question 1 was “Do you agree that there is a class of entities, commonly thought of as an investment entity in nature, that should not consolidate controlled entities and instead measure them at fair value through profit or loss? Why or why not?”

¹⁰³ Question 6 in the ED which reads as follows:” Do you agree that the parent of an investment entity that is not itself an investment entity should be required to consolidate all of its controlled entities including those it holds through subsidiaries that are investment entities? If not, why not and how would you propose to address the Board’s concerns?”

¹⁰⁴ In tables 5-7 and 5-8 in the chapter appendix I report the list of the names of respondents to the exposure draft on investment entities and the list of the names of respondents to the exposure draft of IFRS 10. Those who responded to both exposure drafts are shaded in blue.

Wendel is the fund controlled by the homonymous family, a trait it has in common with Investor AB (controlled by the Wallenberg family) and Eurazeo (Richardson family). Their business model is not driven by a pre-defined exit strategy. Reporting at fair value through profit and loss would not reflect the way performance is managed in that company. Instead, consolidation would be more meaningful. Finally, Alliance Trust PLC, an investment trust listed on the London Stock Exchange denounced a lack of conceptual basis which makes the proposal contrary to the conceptual framework.

Also The School of Accountancy of the University of the Witwatersrand, South Africa and two individuals were against the proposed modification to IFRS 10. The first noted that “with regard to the practical application of the term ‘investment entity’, theoretically, any investor (barring short term speculators) would have the primary objective of enjoying future dividends or long term capital appreciation, making the defined term and accounting exception prone to being applied by analogy when convenient to do so”. Subjectivity inherent to the determination of an investment entity creates in their view a “consolidation escape hatch”. Moreover, they argue that

“simply accounting for a controlling interest at fair value fails to differentiate between a business relationship characterized by a fiduciary duty (or, at very least, an ability) to direct the underlying assets and operations of the respective entity from a passive interest accounted for under IFRS 9: Financial Instruments (IFRS 9)”. (CL10)

Among the individuals, P. van Wijck, an academic from the Netherlands, reasoned that the exposure draft links the exception to consolidation requirement to characteristics of the parent entity instead of general reporting principles and that would influence economic decision making instead of portraying the effects of economic decisions. For his part, Steve Todd, an academic from New Zealand, denounces the lack of conceptual basis of the proposed modification on investment entities and the risk of proposing entity-type tailor made standards.

A few institutions were also opposing the exposure draft on investment entities. The department of treasury and finance of Australia was against the industry-specific departure from consolidation principle proposed by the amendment. They argued that the IASB had only recently released IFRS 10 and IFRS 12 and related standards, yet ED 2011 on investment entities was substantiated by comments received in response to ED 10 on Consolidated financial statement.

“Amending these new standards, before their effective mandatory date, appears to be contrary to the notion that standards are best practice at the time of publication”.
(CL11)

Furthermore, they made it clear that the IASB stated that the concept of control is central to concept of reporting entity in the conceptual framework project, and the implementation of the exposure draft would undermine the validity of that project. Also The Stock Exchange of Hong Kong Ltd. pointed out that the exposure draft would be a departure from the principle of control, that it is unduly complex, rule based and will result in a decrease of comparability with respect to other groups of companies. They also note that the elimination of all intra-group transactions and balances would not be carried out under what is proposed by the Exposure Draft. The OIC, the Italian standard setter mentioned the danger of the scope exclusion in that

“financial crisis has clearly demonstrated that many entities sought (and seek) to avoid to consolidate losses or liabilities of certain subsidiaries/SPEs”. (CL160)

Only one institutional member of the OICV-IOSCO (Organisation Internationale des commissions de valeurs-International Organization of Securities Commissions) Standing Committee No. 1 (his identity is not disclosed) was against the approval of the exposure draft which in his view would allow abuse by investment entities. The Consejo Mexicano de Normas de Información Financiera (CINIF), the accounting standard setting body in Mexico, affirms that the amendment violates the basic consolidation principle of the Conceptual Framework, and they firmly believed that individual standards (the accounting laws) should never violate the Framework.

One respondent, the French accounting standard setter (Anc-Autorité normes comptables) agreed that a consolidation exception is relevant for some investment entities but in their opinion the exception must be strictly limited to “entities that primarily manage their investments on a fair value basis and with pre-defined exit strategies”. In other words the consolidation exception must be consistent with the business model of the investment entity which on its turn must be strictly defined¹⁰⁵ and that this is true at each level of reporting (the investment entity itself and its parent). That is why they disagree with “the IASB proposal to

¹⁰⁵ On the contrary according to the Joint Accounting Bodies Australia superannuation entities (also known as pension plans) should also be scoped within the exemption as they operate under the same rationale as ‘investment entities’. By the same token Lloyd banking group deems that the definition of investment entities must be widened, Barclays denounces rule based approach whereby particular characteristics and only those characteristics are valid to qualify for an investment entity and the Macquarie group suggests that the definition of investment entities should include life insurance companies.

forbid the consolidation exception at a non investment parent company level, unless the business model of the investment entity is no longer relevant at the group level”.

That opinion is shared by the European Financial Reporting Advisory Group (EFRAG) which is probably one of the respondents that receive the greatest attention by the IASB in that the adoption of the international standards by the European Union depends on the former’s advice. Contrary to its previous position EFRAG supported the scope exception from consolidation for investment entities.

The EFRAG was also in favour of the non-investment parent fair value roll-up. On the contrary, the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) are among the 22 respondents (out of 166) who support the IASB’s position that a parent of an investment entity, in its consolidated financial statements, should not retain the fair value accounting that is applied by its investment entity subsidiary to controlled entities, unless the parent qualifies as an investment entity itself. Column 6 in table 5-8 reports the respondents who share the same view which include the Spanish minister of finance and economy, ministerio de economia y hacienda and Onex, a Canadian based corporation listed on the Toronto stock exchange that invests directly and together with a number of private equity funds.

Concerning exit strategies, column 5 of table 5-8 reports the view on the matter for each respondent. Besides the French standard setter (ANC), other respondents called for putting more emphasis on the exit strategy including a requirement of having a pre-defined exit strategy into the criteria to qualify as an investment entity. Long-term investment funds Eurazeo, Wendel and Remgro Limited are among the former. Also the ICAEW, EFRAG, European Securities and Markets Authority (ESMA), Federation of European Accountants (FEE), European Banking Federation (EBF) and the Accounting Standards Board of Japan (ASBJ) share the same view. However, the IASB decided not to follow those recommendations.

5.4.1 Classification of the answers by respondents’ type

Tables 5-5 and 5-6 present the partition by respondents’ type of the answers to question 1 on the consolidation scope exception for investment entities and question 6 on the prohibition of the roll-up to a non-investment parent. In particular, for each respondent type the first column indicates the number of those who answered affirmatively to question 1, whereas the second provides the number of those who gave a negative answer and the third counts the answers

which are either not available or not univocal. Both tables 5-5 and 5-6 reveal that standard-setters are the most divided respondents' type. Moreover four standard-setters are divided also within themselves in that they do not express a unanimously agreed answer such as the case of the IOSCO. On the contrary, audit firms share the same opinion both regarding question 1 and question 6. More specifically, they all agree with the investment entity scope exception and they are all against the prohibition of the non-investment parent roll-up. Interestingly, audit firms maintained the same opinion on the matter that they had at least since 1995 when they raised the issue in the ambit of the comments to the preliminary views on the FASB's exposure draft on Consolidated Financial Statements: Policy and Procedures (ED, October, 1995) which proposed a consolidation model substantially based on de facto control. In fact, in that context some audit firms raised the point whether the proposal would meaningfully apply also to investment entities or more generally « entities that currently follow a fair value accounting model for their investments in accordance with accepted industry practice».

Table 5-5 Repartition by type of answers to question 1 in the ED on Investment Entities

Respondents' type	Count of "Yes"	Count of "No"	N.A.
Academic	0	2	0
Accounting firms and accountancy bodies	24	2	2
Association of financial institutions	34	0	3
Association of preparers	2	0	0
Audit firm	6	0	0
Corporate preparer	5	0	0
EFRAG	1	0	0
Financial institution	40	9	3
Government	3	2	0
Individual	4	0	0
Regulator	2	0	0
Standard-setter	11	6	4
Stock exchange	0	1	0
Grand Total	132	22	12

Table 5-6 Repartition by type of answers to question 6 in the ED on Investment Entities

Row Labels	Count of "Yes"	Count of "No"	N.A.
Academic	0	0	2
Accounting firms and accountancy bodies	5	23	0
Association of financial institutions	3	30	4
Association of preparers	0	2	0
Audit firm	0	6	0
Corporate preparer	1	3	1
EFRAG	0	1	0
Financial institution	2	37	13
Government	1	4	0
Individual	4	0	0
Regulator	0	2	0
Standard-setter	6	13	2
Stock exchange	0	0	1
Grand Total	22	121	23

5.5 Conclusions

The review of the comment letters sent in response to the exposure draft of IFRS 10 and its amendment on investment entities suggests that other constituents besides financial institutions and their associations contributed to lobbying in favour of the scope exception of investment entity. In particular, the review of the second set of comments indicates that investment funds whose nature is characterised by long-term responsible investments or are controlled by a family are opposed to the prohibition of reporting consolidated financial statement for groups controlled by investment entities and instead being required to measure those participations at fair value.

Moreover, the analysis of the answers by respondents' type indicates that associations of financial companies were the most active in raising the issue about the scope exception for investment companies in the ambit of the feedback to IFRS 10. Consistently with their view, the former continued to be in agreement with the scope exception in the exposure draft about the modification to IFRS 10 related to investment entities. On the contrary, standard setters do not share a unique view on the matter and instead they prove to be the most divided respondents' type. Instead, audit firms appear to agree regarding the consolidation treatment of investment companies. More specifically, they all support the investment entity scope exception and they are all against the prohibition of the non-investment parent roll-up. That is

in line with the opinion on the matter that they had at least since 1995 when they raised the issue in the ambit of the comments to the preliminary views on the FASB's exposure draft on Consolidated Financial Statements: Policy and Procedures (ED, October, 1995).

5.6 Chapter References

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5.7 Chapter Appendix

Notes to tables 5-7, 5-8

In table 5-7 second column respondents who mention that their view on investment entities and are favorable for a scope exception for investment entities are associated to a «Yes », «No» otherwise. Their view on control is mainly taken from question 2 hereafter.

In table 5-8 second column respondents affirmatively answering to question 1 hereafter are associated to « Yes », « No » otherwise.

In table 5-8 fourth column respondents affirmatively answering to question 6 hereafter are associated to « Yes », « No » otherwise.

From the exposure draft ED 10 Consolidated Financial Statements issued in 2008

Question 2

« Is the control principle as articulated in the draft IFRS an appropriate basis for consolidation ? »

From the exposure draft on investment entities exception issued in 2011

Question 1

« Do you agree that there is a class of entities, commonly thought of as an investment entity in nature, that should not consolidate controlled entities and instead measure them at fair value through profit or loss? »

Question 6

« Do you agree that the parent of an investment entity that is not itself an investment entity should be required to consolidate all of its controlled entities including those it holds through subsidiaries that are investment entities? »

Names of submitters of a comment letter to the IASB in response to the exposure draft IFRS 10 and the exposure draft on investment entities. Shaded in blue are the commenters who responded to both exposure drafts' invitation to comment. The view on control is indicated when available.

Table 5-7 Respondents to ED IFRS 10

Submitter to ED IFRS 10	Scope exception for investment entities	View on investment entities	View on control	Other issues
Edward W. Trott	No			
Ruslan Batdalov	No			
Hannu Juhani	No			
Pieterse van Wijck	No			
Accounting Research and Development Foundation	No			
Accounting Standards Board	No			
Accounting Standards Board of Japan	No		The proposed definition of control will be an appropriate basis for consolidation to all entities. However it could lead to application difficulties.	recommend defining the structured entity as an entity whose activities could not be directed through the voting rights
Accounting Standards Council of Singapore	No		Control principle is an appropriate basis for consolidation. However, it is unclear if there is an established link between power and returns.	IFRS should include a risks and rewards fall back test.
ACTEO, AFEP, MEDEF	No		Support a single control principle. However, the proposals suggest application difficulties.	Disclosure requirements should converge with the FASB's ones.
AFRAC-Austrian financial reporting and auditing committee	No		Support the use of a control principle that incorporates some elements of risks and rewards.	
Allianz	No	Consolidation might be required even though there is no control of the funds or the funds'assets, since an investor can always redeem his investment at any time. Consolidation of non-controlled funds would not represent the economic reality	The introduction of structured entities and the linkage of power with the variability of returns would cause a bifurcation of the intended single control model	strongly support the retention of the equity method for investments with significant influence-dominant shareholder concept-no need for a fall-back test
Allied Irish Bank Plc	No			
American Council of Life Insurers	Yes	Investment companies should be excluded from the scope.		
Association of British Insurers	No			
Association of Certified Chartered Accountants	No			

Submitter to ED IFRS 10	Scope exception for investment entities	View on investment entities	View on control	Other issues
Association of investment companies	Yes	Recommend that the Board investigate the possibility of an exemption of investment companies.		
Association of Mutual Insurers and Insurance Cooperatives in Europe (AMICE)	No		welcomes a single definition of control for all entities	
Audit Commission	No			
Australia and New Zealand Banking Group (ANZ)	No	In the answer to question 7 investment entities are implicitly mentioned		
Australian Accounting Standards Board	No		Supports the control principle as a single basis for consolidation but does not believe the proposed definition of control can be applied to all entities. .	
Australian Bankers' Association	No		Generally, the control principle is an appropriate basis for consolidation. However the practical link between power to direct and returns causes concerns which may result in significant implementation difficulties.	Concerned about the disconnection with the FASB's pronouncements
Bank of Scotland Treasury	No			
Barclays PLC	No	In the answer to question 5 investment entities are implicitly mentioned		
Basel Committee on Banking Supervision	No		Control is an appropriate basis for consolidation but it does not incorporate the concept of risks and rewards sufficiently and the link between power and returns.	
BDO	No	There should be a risk and rewards test capable of overriding the "power to direct" test. That would allow fund managers with the power to direct the activities of the fund to generate returns for itself and failing the risk and rewards test to exclude those fund from consolidation.	The definition of control might result in certain entities-structured entities incorrectly being excluded from consolidation.	A risk and rewards test is essential.
Belgian Accounting Standards Board (BASB) (CBN-CNC)	No			

Submitter to ED IFRS 10	Scope exception for investment entities	View on investment entities	View on control	Other issues
BlackRock Investment Management	No	IE not explicitly mentioned -asset manager is mentioned should be excluded.		Their letter deals exclusively with their support for the approach to agency relationship in the ED. They make the agency relationship include the case of asset managers.
BNP Paribas	No		Control is an appropriate basis for consolidation. However, ED 10 actually proposes two ways of assessing control depending on the nature of the entity under consideration.	
British Bankers' Association (BBA)	No		The proposed control definition cannot be applied appropriately to all structured entities, in particular those where for decision making it is irrelevant who nominally controls them.	Believe risk and rewards fall back test should be included.
British Columbia Investment Management Corporation	No			
BT Group plc	No		Risks and rewards approach is a component of control and should be incorporated in the definition of the latter.	
Bundesverband Oeffentlicher Banken Deutschlands	No		the proposed definition of control is not suitable for all entities.	
Bundesverband Deutscher Banken	No			
BUSINESSEUROPE	No			
BVCA-British Private Equity and Venture Capital Association	Yes	Do not agree with the Board's decision not to restrict the entities that are required to prepare consolidated statements. Exemption for investment companies and investment funds		
Caisse Nationale des Caisses d'Epargne	Yes	Power should not be taken into consideration when assessing control of a entity managing mutual funds which should not be consolidated.	It is not possible to apply a single consolidation principle to both structured entities and to other entities.	joint project with the FASB
Canadian Accounting Standards Board - Staff	Yes	IFRS should require investment companies to report controlling interests in investees at fair value		
Canadian Bankers Association	Yes	Concerned that fund managers who have a small ownership in the mutual fund would be required to consolidate the mutual fund.	Control is an appropriate basis for consolidation. However, when the control principle cannot be clearly applied-certain structured entities-a qualitative fall back test may be necessary.	
Capital One	No			

Submitter to ED IFRS 10	Scope exception for investment entities	View on investment entities	View on control	Other issues
CEBS-committee of european banking supervisors	No		concerned that the ambiguity of the proposed control model would lead to fewer structured entities being consolidated even though there is exposure to the role of risk and rewards	recommend incorporating notions of risk and rewards -residual risk as in SIC 12-into the control principle
Central Bank of Russia	No			
CFA Institute Center for financial market integrity	No		agree with definition of control enhanced by including a discussion of the key indicators	there should be a risks and rewards "fall back" test, which is similar to the view we expressed in our response to the proposed amendments to FASB Statement No. 140 and FIN 46R.5 This test would be designed to cover situations in which it is not possible to determine which party has the power to direct activities
CFA Society of the UK	No			
Chartered Institute of Management Accountants	No			
CINIF Consejo Mexicano para la Investigacion y Desarrollo de Normas de Informacion Financiera	No		believes the proposed definition of control is applicable to all entities	
Citigroup Inc.	No	The guidance on agency relationships should be clarified to avoid confusion in practice on, for example, whether a general partner (investment manager) should consolidate a partnership (fund or similar entity).		
Commonwealth Bank of Australia	No		Control principle is an appropriate basis for consolidation. However, power to direct might relate to a participation in or exposure to returns.	Concerned about the disconnection with the FASB's pronouncements
Confederation of British Industry	No			
Confederation of Swedish Enterprise (Svenskt Näringsliv)	No		It would be an improvement to have one definition that governs consolidation	Major parts of the ED are tailored for banks, investment funds etc.
Conseil National de la Comptabilité (CNC)	No		the CNC considers that the preliminary debate is not conclusive enough to replace the notion of control as defined by IAS 27 and the control indicators in SIC 12 with respect to "Special Purpose Entities" with a single definition of control that would be sufficiently robust to be applied consistently to all entities	
Credit Suisse	No			

Submitter to ED IFRS 10	Scope exception for investment entities	View on investment entities	View on control	Other issues
DASB-Dutch accounting standards board	No		The proposed consolidation principle will increase the potential to structure entities and probably decrease the number of entities to be consolidated.	
Deloitte Touche Tohmatsu	No		The proposed control definition cannot be applied to all entities as its two main elements- power to direct activities and generation of returns are not clearly explained in the ED	Concerned that the ED is not a joint work with the FASB
Deutsche Bank	No	The agency relationship should not be compromised if the agent's involvement with the entity is insignificant.	Support one principle of control for all entities. However, there will be application difficulties for SPEs.	Encourage collaboration with the FASB. Risk and rewards should not be a factor to determine control.
Deutsche Beteiligungs AG	Yes	We therefore propose to introduce a scope exemption for investment entities in the new standard on consolidation		
EFAMA - The European Fund and Asset Management Association	Yes	Strongly believe that mutual funds should account for all their investments at FVTPL rather than having regard to ED IFRS 10		The absence of voting rights does not indicate that the entity is a structured entity
EFRAG	No	implicitly mentioned-entities with dual roles	in our view what is needed is the incorporation explicitly of risks and rewards into the consolidation principle. We consider that power cannot always be verified and that where power cannot be verified then it is necessary to consider risks and rewards.	
Ernst & Young	No			
European Association of Public Banks (EAPB)	No			control and structured entities need to be defined more precisely
European Insurance CFO Forum	No			
European Securitisation Forum	No			
F.Hoffmann-La Roche Ltd	No			
FAR SRS	Yes	an industry scope exemption is to be considered		
FEE-Federation of european accountants	No	implicitly mentioned-entities with dual roles		
FEI Canada	No			
Florida Institute of CPAs	No		Appropriate basis for consolidation. It can be applied to all entities within the scope of IAS 27 and SIC-12	
Francis Richard Pereira	No			

Submitter to ED IFRS 10	Scope exception for investment entities	View on investment entities	View on control	Other issues
French Banking Federation	No			
GDF SUEZ, Paris	No	the definition of control is defective for joint ventures and structured entities		it should be helpful to perform a risk and rewards fall back test. However the board does not explain what a risk and rewards fall back test should be.
German Accounting Standards Committee (DRSC)	No		The proposed definition of control cannot be applied to structured entities. A risk and rewards notion/indicator should be included.	
Goldman Sachs	No		The ED maintains a two model approach where the nature of the entity may affect the consolidation decision	
Grant Thornton International	No			
Group of 100	No			
Holcim Group Support	No			
Hong Kong Institute of Certified Public Accountant	No		The same definition of control should be applied to all entities-structured or not-overcome the dichotomy in the ED between	
HSBC Holdings	No	Agency relationship guidance is ambiguous in cases where the fund manager has a direct interest in the fund.	The control definition is hard to apply to structured entities. A risk and rewards indicator should be included.	Convergence with the FASB's US GAAP is particularly important for consolidation.
HSBC Infrastructure Company Limited	No			
Hydro-Québec	No		Control principle as proposed in ED 10 is an appropriate basis for consolidation.	
ICAEW	No	implicitly mentioned	don't believe that the proposed definition of control alone as articulated can be applied to all entities	
ICAI-institute chartered accountants ireland	No			
Institut der Wirtschaftsprüfer (IDW)	No		The control principle is an appropriate basis for consolidation for all entities. However, the structure of the ED might still imply that different consolidation models have to be applied.	
Institute of Chartered Accountants of Pakistan (ICAP)	No		The control principle is an appropriate basis for consolidation but hard to apply for entities within the scope of SIC-12.	
Institute of International Finance	No			
Institute of Management Accountants	No			

Submitter to ED IFRS 10	Scope exception for investment entities	View on investment entities	View on control	Other issues
Instituto de Contabilidad y Auditoria de Cuentas (ICAC)	No			
International Association of Insurance Supervisors (IAIS)	No			
International Private Equity and Venture Capital Valuation Board (IPEV Board)	Yes	Experience has shown that consolidated financial accounts produced according to the requirements of IAS 27 are of little use for investors in private equity, venture capital funds and venture capital management companies.		
Invesco Ltd	Yes	Reporting the interest of the investment manager in the investment products is more appropriate and helpful to the users than consolidation.		Concerned that the ED 10 is issued in advance and not in convergence with the FASB's amendments to interpretation No. 46 (R)
Investment Company Institute	Yes	We recommend that the Board provide a scope exception for investment companies that account for their investments at fair value with the change in value reflected in earnings		
Investment Management Association	No	concerned that consolidation can be triggered where, in addition to managing collective investment schemes, a manager invests in a scheme.	agrees that the proposed control definition can be applied to all entities within the scope of IAS 27 and SIC-12	
Investment Management Project Group (IMPG) of The South African Institute of	No			
IOSCO	No		The core principle of consolidation should be based on current control and not on having the ability to control at some point in the future.	
Irish Funds Industry Association	Yes	Investments funds should be exempted from the scope of the ED and addressed in a separate project.	The proposed definition of control cannot be applied to all entities most notably investment funds.	Concerned that the FASB is not involved.
J.P. Morgan Chase & Co.	No			
Japanese Institute of Certified Public Accountants	No			
Joint Accounting Bodies in Australia (CPA Australia, The Institute of Chartered Accountants and the National Institute of Accountants)	No			

Submitter to ED IFRS 10	Scope exception for investment entities	View on investment entities	View on control	Other issues
Kingston Smith LLP	No			
Korean Accounting Standards Board	No			the fall back test could be a supplement but not an exception to the principle that consolidation is the basis of control.
KPMG	Yes	Encourages the Board to explore further whether it would be appropriate to introduce a scope exemption for investment companies (i.e. an entity that <i>manages</i> all investments on a fair value basis)	support the single control model but don't think the proposed definition of control can be applied to all entities.	
Larsen & Tubro Limited	No			
Lend Lease Corporation Limited	No			Consolidation would not be appropriate in agency arrangements where all arrangements are at arm's length and the agent acts in a fiduciary capacity.
London Investment Banking Association	No			the current right to direct is the key
Macquarie Bank	No		agree with a single model of consolidation for all entities but does not believe the ED achieves the objective.	due process concerns
Malaysian Accounting Standards Board	No			
Man Group Plc	No	implicitly referred to in agency relationship		no scope exclusion is mentioned
Manulife Financial	Yes	A scope exemption is needed for investment entities		
Mazars	No			
MBIA Inc.	No		favorable to one single model based on power	
Ministry of Finance	n.a.			
Morgan Stanley	n.a.			
Mortgage Bankers Association	No			
National Australia Bank	No			
Nestlé	No			
New South Wales Treasury	No		control as "capacity to dominate decision making, directly or indirectly"	due process concerns
New Zealand Treasury	No			
Norsk RegnskapsStiftelse - Norwegian Accounting Standards Board	n.a.			

Submitter to ED IFRS 10	Scope exception for investment entities	View on investment entities	View on control	Other issues
Office of the Comptroller General of Canada	Yes	we would advance that for investment companies, it is not the intention of management that would drive the need to record their investments at fair value, but the nature of the business they conduct and the provision of information required by the users of their financial statements.		
Organismo Italiano di Contabilita	No			
Partners Group Holding AG	No			
Petro-Canada	No			
Polish Accounting Standards Committee	No			
PricewaterhouseCoopers	No			
Property Council of Australia	No			
Royal Bank of Canada	No			
Royal Dutch Shell	No		favourable to one single model based on power	
Securities Commission	No		favourable to one single model based on power	
South African Institute of Chartered Accountants (Investment management project group)	Yes	Investments funds should be scoped out from the definition of control	Cannot be applied to all entities within the scope of IAS 27 and SIC-12-in particular, investment funds should be excluded	definition of structured entity
Southern African Venture Capital and Private Equity Association (SAVCA)	Yes	would favour a dispensation of private equity industry from the ED		
Swedish Financial Reporting Board	Yes	we have doubts that consolidating investment funds and mutual entities, based on returns that comes from synergies would create consolidated financial reports that faithfully represent a group		
SwissHoldings	No			
Syngenta Ltd	No			
Tax Research LLP	No			
Telstra Corporation Ltd	No			
The Body of Experts and Licensed Accountants from Romania (CECCAR)	No			

Submitter to ED IFRS 10	Scope exception for investment entities	View on investment entities	View on control	Other issues
The Center for Accounting & Controlling of the Zurich University of Applied Sciences	No			
The Charity Commission for England and Wales	No			
The Corporate Users' Forum (CRUF)	Yes	Investment funds are a separate case where we believe that there is sufficient regulation to safeguard clients such that the risks associated with all economic returns are passed from the investment manager to the client. We see little reason for such funds to be consolidated.		due process concerns
The Financial Reporting Standards Board of the New Zealand Institute of Chartered Accountants (NZICA)	No		favourable to one single model based on power	due process concerns
The Hundred Group of Finance Directors	No			
The Institute of Chartered Accountants of Scotland	No			think that the ED in fact proposes two models-one for structured entities and one for unstructured entities
The Investment Funds Institute of Canada	No	think consolidation is not appropriate for investment entities		
TransCanada Corporation	Yes			
UBS AG	Yes	The Board should address the unique nature of investment funds.	controlling entity model is an appropriate basis for consolidation for all entities	IFRS should not include a risks and fall back test.
User Advisory Council of AcSB - Canada	Yes	strongly supports the basis for the exemption of investment companies as in AcG 18	structures that hold controlling interests in other entities for investment purposes should not be required to apply the control definition	
VMEBF e.V.	No		favourable to one single model based on power	
Volkswagen AG	No			
Wellington Management Company LLP	No		favourable to one single model based on power	

Table 5-8 Respondents to ED on investment entities

Submitter to ED investment entities	Q1-scope exception	Caveats on the scope exception	Q6-Fair value roll-up to non-investment parent	View on exit strategy criterion
3i Group plc	Yes		No	
ACCA	Yes		No	
Accounting Standards Board	Yes		No	
Accounting Standards Council	Yes		No	Existence of an exit strategy should be included in paragraph 2
ACTEO/AFEP/MEDEF	Yes		No	
AIMA Canada	Yes		No	
ALFI-association of the luxembourg fund industry	Yes		n.a.	
Alliance Trust	No	The proposals lack any conceptual basis and are indeed contrary to the IASB Conceptual Framework.		
Allianz	No		No	Exit strategy is a necessary condition for being eligible for the exemption.
American Council of Life Insurers	Yes		No	
AMP Limited	Yes	The inclusion of investment-linked funds would result in more relevant information.	No	
Accounting Standards Board of Japan	Yes	The IASB should clearly define fundamental concept or principle underlying the proposal and establish specific criteria based on that concept or principle.	No	The existence of an exit strategy should be more emphasised in the standard as essential criteria.
Asian Oceanian Standard Setters Group	Yes		No	
Association for Financial Markets in Europe	Yes		No	
Association of British Insurers	Yes	The criteria need to cover the retail investment funds held on balance sheet by UK insurance companies.	No	
Association of investment companies	Yes	AIC recommends a mixed model allowing an investment company to fair value controlled entities which represent its investing activities and consolidate controlled entities representing other business activities.	No	

Submitter to ED investment entities	Q1-scope exception	Caveats on the scope exception	Q6-Fair value roll-up to non-investment parent	View on exit strategy criterion
Association of Real Estate Funds	Yes	real estate funds should be included in the exemption.	n.a.	
Augentius Fund Administration LLP	Yes		No	
Australian Accounting Standards Board	No	permitting alternative methods for the same economic phenomenon diminishes comparability.	Yes	
Australian Foundation Investment Company Ltd	No	A separate accounting requirement for investment entities would reduce comparability.	n.a.	
Autorite des normes comptables (ANC)-(ex cnc)	Yes	The investor holding horizon must be taken into account coupled with fair value management of investments and the exit strategy.	No	The notion of exit strategy must be explicitly added to the criteria in paragraph 2
Barclays PLC	Yes	The exception should be principled-based and aligned within which the investment is held rather than the characteristic of the entity.	No	
Belgian Accounting Standards Board (BASB) (CBN-CNC)	No	The concept of control should be maintained. Investment entities should be encouraged to disclose the fair value of their subsidiaries.	n.a.	
BBVA Group	Yes		No	
BDO	Yes		No	
BlackRock Investment Management	Yes	Don't agree that all six criteria in paragraph 2 must be met in order to qualify as an investment entity. This requirement is inconsistent with a principle-based view.	No	
BP	Yes	Concerned that the criteria can be interpreted to include holding companies such as BP plc	n.a.	The existence of an exit strategy should be one of the criteria to differentiate an investment entity from a holding company.
Brazilian Accounting Pronouncements Committee (CPC)	Yes		No	
British Bankers Association	Yes		No	

Submitter to ED investment entities	Q1-scope exception	Caveats on the scope exception	Q6-Fair value roll-up to non-investment parent	View on exit strategy criterion
British Columbia Investment Management Corporation	Yes	Too restrictive criteria. An entity should not be disqualified from the exception simply because it is engaged in developing property held by the investee.	n.a.	
BVCA-British private equity and venture capital association	Yes		No	
BVI	Yes		No	
Caisse de depot et placement du Quebec	Yes		No	
Canada Pension Plan Investment Board	Yes	CPP is concerned that the criteria would preclude CPP which is a pension fund to continue to measure all its investment at fair value.	n.a.	
Canadian Accounting Standards Board - Staff	Yes		No	
Canadian Bankers Association	Yes		No	
Canadian Life and Health Insurance Association Inc.	Yes		No	
CapMan Plc	Yes	Defining all the factors as criteria that must be met in order to qualify as investment entity is too restrictive.	No	
CDC Group	Yes		No	
CFA Institute	Yes		No	
CGA-Canada	Yes	exception should be applied at the individual investment level and not at the entity level.	No	
Challenger Ltd	Neutral	exemption at odds with the principles-based approach		
Chartered Accountants Ireland	Yes		No	
Chris Barnard	Yes		Yes	
CINIF-accounting standard setter Mexico	No		Yes	
Citigroup Inc.	Yes		No	the business should not be required to have an exit strategy
Clairvest Group Inc.	Yes		n.a.	
Commission des normes comptables	Yes	Consolidation should remain an option	No	Exit strategy is less relevant for investment entities that have a primary focus on investment income. It should not become a criterion within paragraph 2.

Submitter to ED investment entities	Q1-scope exception	Caveats on the scope exception	Q6-Fair value roll-up to non-investment parent	View on exit strategy criterion
Contrôleur des finances du Québec-missing				
Corporate Reporting Users' Forum (CRUF)	Yes		No	
CRUF (Canada)Corporate Reporting Users' Forum	Yes		Yes	
CSA (Canadian Securities Administrators)	Yes		No	
Daiwa Securities Group Inc.	Yes		No	
Deloitte KassimChan	Mixed views.	The Board's preference for decision usefulness over accounting principle is not appropriately justified.	No	
Deloitte Touche Tohmatsu	Yes		No	
Deutsche Bank	Yes		No	
DRSC-Accounting Standard Committee of Germany	Yes	Not only investment entities should benefit from being excluded from consolidating their controlled investments.	No	
Duff & Phelps LLC	Yes	We believe that an investment entity is recognizable when you see it, but is not easily defined using check the box criteria.	No	
DASB	Yes		No	
EBF-European Banking Federation	Yes		No	Exit strategy should be placed as part of the criteria for identifying an investment entity rather than in the application guidance.
EFAMA - The European Fund and Asset Management Association	Yes		No	
EFRAG	Yes		No	The exit strategy criterion should be included in the body of the standard and not in the application guidance.
European Public Real Estate Association on behalf of various real estate federations	n.a	Too vague criteria may let scope in some property corporate groups.	n.a	
Ernst & Young	Yes		No	

Submitter to ED investment entities	Q1-scope exception	Caveats on the scope exception	Q6-Fair value roll-up to non-investment parent	View on exit strategy criterion
Eurazeo	No		n.a.	The existence of a predefined exit-strategy should be added in the criteria in paragraph 2
European Banking Authority (EBA)	Yes		Yes	
European Insurance CFO Forum/CEA	Yes		No	
European Private Equity & Venture Capital Assoc	Yes	The criteria required to qualify an investment entity are too restrictive.	No	
European Securities and Markets Authority (ESMA)	Yes		Yes	Exit strategy as a separate criterion
FACPCE (Federacion Argentina de Consejos Profesionales de Ciencias Economicas)	Mixed views.	Some of the respondents agree others are opposed to the proposal in that they consider it a violation of the Conceptual Framework.		
Far - The Institute for the Accountancy Profession	Yes	Far is however not convinced that industry-specific requirements and exceptions should be used in IFRS.	No	
Farm Credit Canada	Yes			0
FBF-Federation Bancaire Francaise	Yes		No	
FEE-Federation of European Accountants.	Yes		No	It should be in the criteria not just in the application guidance. The exit strategy enabling to realise capital appreciation or investment strategies that generate long-term investment income cfr Luxembourg.
Florida Institute of CPAs	Yes		Yes	
Fonds de solidarite, Found Acton & Desjardins	Yes		n.a.	
Friends Life	Yes		No	
Glass-Group of Latin American Accounting Standard	Yes except Argentina and Mexico		Yes	
Grant Thornton International	Yes		No	
Hong Kong Institute of Certified Public Accountants	Yes		No	
HoTARAC (Heads of Treasuries Accounting & Reporting Advisory Committee)	No	there is no sound conceptual basis for a industry-specific departure from consolidation.	Yes	
HSBC Holdings				
Hydro-Québec	Yes		No	

Submitter to ED investment entities	Q1-scope exception	Caveats on the scope exception	Q6-Fair value roll-up to non-investment parent	View on exit strategy criterion
IAASB-auditing standards	n.a.		n.a.	
IACVA-International Association of consultants, valuers and analysts	Yes	There should be an irrevocable choice-irrevocable election to take advantage of the proposed exemption. The difference between investment entity and holding company is mainly one of intent.	No	
IAIS-international association of insurance supervisors	Yes		n.a.	
ICAEW	Yes	The definition of investment entities should be reconsidered making the exception available to venture capital firms, unit trusts, mutual funds, investment-linked insurance funds.	No	More emphasis should be given to the exit strategy and should be included in the body of the final standard not just the application guidance.
ICAS-Institute of chartered accountants of Scotland	Yes		No	
ICPAR (Institute of Certified Public Accountants of Rwanda)	Yes		Yes	
ICPAS (Institute of Certified Public Accountants of Singapore)	Yes		Yes	
IFIC (The Investment Funds Institute of Canada)	Yes		No	
ILAG-Investment and Life Assurance group	Yes		No	
Ferreira Juvenal	Yes		Yes	
Scott Strachan	Yes		Yes	
Individual Raimondo Eggink	Yes	exemption limited to private equity collecting funds from multiple investors	Yes	
Institute of Certified Public Accountants of Israel	Yes		No	
Institut der Wirtschaftspruefer in Deutschland e.V.	No	An exception could be provided to all entities in respect of their investment that are held for capital appreciation, investment income or both.	No	
Institute of Chartered Accountants of India ICAI	Yes		Yes	

Submitter to ED investment entities	Q1-scope exception	Caveats on the scope exception	Q6-Fair value roll-up to non-investment parent	View on exit strategy criterion
Institute of Chartered Accountants of Pakistan	Yes		No	
Institute of Management Accountants	n.a.	They point to the need of convergence with the FASB on the matter.		
Instituto de Contabilidad y Auditoria de Cuentas	Yes	The definition of investment entities should be precised and closed to those entities that do not fulfill all the requirements	Yes	
International Private Equity and Venture Capital Valuation Board (IPEV Board)	Yes		No	
Investment Management Association	Yes		No	
Investor AB	No		n.a.	
Investors Group	Yes		n.a.	
IOSCO	Yes except one member		No except a minority of members	
Japan Foreign Trade Council, Inc.	Yes		No	
Japan Securities Dealers Association	Yes		No	
Japan Venture Capital Association	Yes		No	
Japanese Bankers Association	Yes		No	
John Laing plc	Yes	Criteria are too narrow	n.a.	
Joint Accounting Bodies in Australia (CPA Australia, The Institute of Chartered Accountants and the National Institute of Accountants)	Yes	Pension plans should be scoped in the focus should be on the investment activity of the entity rather the investment entity itself.	No	
Korean Accounting Standards Board	Yes		Yes	
KPMG	Yes		No	
Larsen & Tubro Limited	Yes		Yes	
Lloyds Banking Group plc	Yes	investment-linked insurance funds should be included in the exception.	No	
LPEQ Listed Private Equity	Yes		No	
Mackenzie Financial Corporation	Yes		n.a.	
Macquarie Bank	Yes	There should be an irrevocable choice of measuring investments at fair value instead of a mandatory requirement. Life insurance companies should be included.	No	

Submitter to ED investment entities	Q1-scope exception	Caveats on the scope exception	Q6-Fair value roll-up to non-investment parent	View on exit strategy criterion
Malaysian Accounting Standards Board	Mixed views.	The IASB should work on a rebuttable presumption approach, if control is actually rebutted consolidation can be avoided.	No	
Man Group plc		Only Q9 was answered		
Mazars	Yes	Identification criteria can be improved. In certain limited circumstances measuring controlled entities at fair value provides a more useful information than consolidation.	No	There should be more emphasis on the exit strategy.
Morgan Stanley	Yes		No	
National Australia Bank	n.a.	Only Q9 was answered		
Nedbank Group Ltd	Yes		No	
New Zealand Superannuation Fund	Yes		No	
Norsk RegnskapsStiftelse - Norwegian Accounting Standards Board	No		Yes	
NSL Group	Yes		No	
NZ Accounting Standards Board	No	The lack of a overarching principle opens the way to manipulation.	Yes	
Office of the Comptroller General of Canada	Yes		No	
Organismo Italiano di Contabilita	No		Yes	
Onex Corporation	Yes	Onex's investors continue to find financial information where controlled investments are consolidated as the most useful for their investment decisions.	Yes	
Paris Orléans SA-holding Rothschild banking group	Yes		No	
Pieter van Wijk-academic	No		n.a.	
PricewaterhouseCoopers	Yes		No	
Prudential	n.a.	Discussion limited to retail investment funds which should not be consolidated by insurance companies.	n.a.	
PSP investments	Yes		No	
Real Estate Information Standards (REIS)	Yes		No	
Remgro Limited	No		No	More emphasis should be put on exit strategies
RSM International	Yes		No	

Submitter to ED investment entities	Q1-scope exception	Caveats on the scope exception	Q6-Fair value roll-up to non-investment parent	View on exit strategy criterion
SA Venture Capital and Private Equity Ass.	Yes	Criteria are too narrow	n.a.	
SAICA-South African institute of chartered accountants	Yes		No	
SAICA Long-Term Insurance Project Group (LTIPG)	Yes		No	
SEBI-Securities and Exchange board of India	Yes		Yes if significant investment	
SIFMA	Yes		No	
SNC-Lavalin	Yes		No	
Standard Chartered	Yes	It would be more appropriate to have principles based on management's intent for each individual investment in determining the consolidation exemption	No	
Steve Todd-academic	No		n.a.	
SVG Capital	Yes		n.a.	
Swedish Bankers' Association	n.a.		n.a.	
Swedish Financial Reporting Board	Yes		No	
Swiss Insurance Association	Yes		No	
Swiss Life	Yes		No	
TD Asset Management	Yes		n.a.	
The Bank of New York Mellon Corporation	Yes		No	
The Blackstone Group	Yes	Fair value attributes should be applied to all investments held by an investment entity and not just controlled investments.	No	
The Guernsey Society of Chartered and Certified Accountants	Yes		No	
The Japanese Institute of Certified Public Account	Yes	Agree to set strict criteria in order to qualify as an investment entity	No	
The Life Insurance Association of Japan	Yes		No	
The Stock Exchange of Hong Kong Ltd.	No		n.a.	
Treasury Board Secretariat	Yes			
UBS AG	Yes		No	
Uranium Participation Corporation	Yes		Yes	
User Advisory Council of AcSB - Canada				
verificateur general du Quebec, Canada	Yes		No	

Submitter to ED investment entities	Q1-scope exception	Caveats on the scope exception	Q6-Fair value roll-up to non-investment parent	View on exit strategy criterion
Wendel	No	Investment entities involved in the strategic and operational development of its investments and whose strategy is not driven by pre-defined exit strategies should not be prevented from consolidating their investments.	No	The concept of a planned exit strategy at inception must be explicitly added to the other criteria in paragraph 2.
Wits-School of accountancy	No		n.a.	
Zambia Institute of Chartered Accountants (ZICA)	Yes		No	

6. AN ANALYSIS OF THE COMMENTS RECEIVED BY THE IASB IN THE POST IMPLEMENTATION REVIEW OF IFRS 3 *BUSINESS COMBINATIONS*

6.1 Introduction

The objective of the present chapter is to provide a critical assessment of the comment letters received by the IASB in response to the request of information related to IFRS 3 *Business Combinations* and the feedback statement which ensued. IFRS 3 is a long and complex standard which spans more than 650 paragraphs and goes with different levels of guidance. In order to assess its conformity with the relevance and faithful representation principles, like every standard issued by the IASB, also IFRS 3 went through a post-implementation review. Given the importance of the covered matter the latter was the result of a process

“È Debitori de raxon de miser Francesco Balbi e de mi Jachomo Badoer diè aver a dì 15 hotobre per Joxef Salia zudio suo debitor, el qual me asignò ser Felipo Chontarini a zorni 15 da poi el retorno de la prexente galie de Mar Mazor, quando serano scorsi. c. 23 perp. 306 car. o. Badoer, Giacomo. Il Libro Dei Conti Di Giacomo Badoer (Costantinopoli 1436-1440): Testo a Cura Di Umberto Dorini et Tommaso Bertelè. [A Cura Dell’ Istituto Italiano per Il Medio Ed Estremo Oriente. Il Nuovo Ramusio, Vol. 3. Roma: Istituto poligrafico dello stato, 1956]

carefully articulated into several steps. In the first the IASB had to identify the scope of the PIR and the areas which the request for information had to be focused upon -November 2013-. The chosen areas made then the basis for the questionnaire that was published in January 2014 in the ambit of the request for information. Within the deadline set in May 2014, the IASB received 92 unique comment letters which, coupled with the feedback received in the 30 outreach events, were then the subject of a summary issued in September 2014. On the same date a review of the relevant academic research was presented to the IASB board. The evidence gathered at that point was deemed sufficient for the preparation of the report and feedback statement which was finally issued in June 2015. That document together with the review of academic research, the summary of the comments received from the outreach activities and from the 92 comment letters and the letters itself are publicly available on the IASB website. The rest of the present chapter is organized as follows. In

section 6.2 I briefly review the accounting literature using comment letters sent to the accounting standard setters as an empirical basis and in section 6.3 I present a description of the comment letters. Sections 6.4 and 6.5 are the core of the chapter. The former presents the results of a statistical analysis following the methods employed by the related literature whereas the latter presents a qualitative review of the comment letters in which I organize along four axis the most representative comments. Finally, in section 6.6 the feedback given by the international standard setter is analysed against the points resulting from the preceding section and section 6.9 concludes after a brief illustration on further developments on the definition of business and common control issues according to the EFRAG discussion paper in sections 6.7 and 6.8, respectively.

6.2 Review of the accounting literature using comment letters

6.2.1 Closely related research

Accounting research employing the method of comment letters focuses on the forces which shape the standards and their modifications from the exposure draft to the final version. Therefore, differently from the present paper, the primary subject of study concerns the comment letters addressed to the standard setter in response to the exposure draft of the standard. In a closely related article, Anantharaman (2015) studies the evolution of SFAS 141 and 142 using the 213 responses to ED 201 and the 209 responses to the revised exposure draft ED 201R. She categorizes the entities participating in the comment letters process on the basis of the FASB's classification of responses. The latter are then classified by type of respondent into those which agree with the FASB's position, those that do not and those with no comment. Three issues are chosen for ED 201, namely are all business combinations acquisitions? How should goodwill be treated once recognized? Is there any reliable way to review goodwill for impairment so that an impairment-only approach can be adopted? With respect to the former question, arguments supporting the "no answers" are classified by type of respondent into those which rest upon an "economic consequences" justification and those which make reference to conceptual arguments whereby the elimination of pooling, for example, would affect any of the qualitative characteristics of accounting information mentioned in the Conceptual Framework. The relative majority of respondents 49% is against the abolition of the pooling of interests (they answer no to the question whether all business combinations are acquisitions) and yet the revised exposure draft doesn't conform to their

opinion. Therefore the author concludes that other forces should have shaped the evolution of that standard. A clear interpretation of the evolution of SFAS 141 and 142 was provided in a previous paper by Ramanna (2008) who tracks the political contribution of the respondents who were in favor of pooling in their answers to the ED 201 and shows that the pro-poolers proved to be those in favor of the impairment-only approach proposed in ED 201R which, offering more discretion in impairment, can be interpreted as a compromise for the abolition of pooling dictated in part by the SEC.

6.2.2 Other papers using comment letters for accounting research

Yen, Alex C., D. Eric Hirst, and Patrick E. Hopkins (2007) analyze the comment letters submitted in response to the FASB's Comprehensive Income Reporting Exposure Draft. They organize the arguments employed by the respondents into a taxonomy and investigate whether there is an association between the industry of respondents and the nature of the argument advanced in their letters. Larson (2008) presents a classification by country of the most common arguments employed by respondents to the IASC exposure draft on special purpose entities (SPEs) and he finds that opposition came mostly from respondents based in countries where the rules on SPEs are more flexible than those proposed by the IASC.

Comment letter analysis has also been employed to analyse the direction of lobbying behavior with respect to a wide array of standards, from the one defining the concept of control used to determine the consolidation scope in the UK (Stenka, Renata, and Peter Taylor, 2011) to the standard which regulates share-based payments (Giner Begoña, and Miguel Arce, 2012). Finally Allen, Ramanna, Roychowdhury (2013) examine the entire set of comment letters addressed by big N auditors to 126 exposure drafts of the FASB issued between 1973 and 2006 in order to investigate whether the increased concentration in the auditing industry resulted in more concerns over the auditors' perception of decreased reliability.

6.3 General description of the received comment letters

The comment letters were prompted by a fairly detailed and encompassing questionnaire articulated into ten points: 1-background and experience of the respondent in business combinations 2-the definition of a business, 3-fair value measurement in a business combination, 4-the separate recognition of intangible assets from goodwill and the

recognition of negative goodwill, 5-impairment of goodwill and indefinite-life intangible assets, 6-accounting for non-controlling interests, 7-accounting for step acquisitions and loss of control, 8-disclosures, 9-other matters, 10-effects. The points 2-8 are generally structured around two inquiries, one which asks whether that given treatment as specified by IFRS 3 is useful and what are the implementation, auditing, enforcement challenges the other. An emphasis on the usefulness of information resulting from the requirements as per IFRS 3 points to investors as the primary addressees of the standard setter. As the latter recognizes in the feedback statement the questionnaire is mainly geared towards investors. However, given that investors didn't prove to be very responsive, as expected, the outreach activities were focused on the latter¹⁰⁶.

As it can be seen from Table 6-1 the answers from preparers and industry organisations are predominant whereas investors are underrepresented.

Table 6-1 Classification of respondents

Type of respondents	Number of respondents	Percentage
Preparers and industry organization	31	34%
Accounting firms and accountancy bodies	20	22%
Standard-setters	16	17%
Regulators	9	10%
Professional associations	3	3%
Investors	1	1%
Individual	5	5%
Other	7	8%
<i>Total</i>	<i>92</i>	<i>100%</i>

Also counting the investors' views subsumed into the responses by standard-setters, that number wouldn't change much. Among the most responsive group, those of preparers and industry organization, financial institutions are represented just by one insurer and asset management company, Allianz AG and two banks, Banco Bilbao Vizcaya Argentaria S.A. and Standard Chartered PLC.

Table 6-2 shows instead the geographical repartition of the received comments. All the main European countries are represented with the exclusion of Italy, from that country the only response comes from the Italian Standard setter.

¹⁰⁶ See PIR p. 15: "We focused our outreach activities on investors' and investors' representative bodies, because *we expected few comment letters from investors and many questions included in the RFI aimed to get investors' views on such questions*" italics added.

Table 6-2 Geographical repartition of respondents

Geographical Area	Number of respondents
USA	3
Oceania	7
Africa	3
America excluding USA	10
Asia	14
Europe	45
International	7
Not determinable	3
<i>Total</i>	<i>92</i>

6.4 Statistical analysis following the methods developed by the literature

Building upon Tutticci et al. (1994) and Giner and Arce (2012), I identify the key issue in the respondents' comment letters and I classify the position of each respondent on that issue (agree, disagree or no opinion). Then, I analyse their position along three dimensions: the type of arguments they employ in favor or against that key issue (*i*), the interest group they belong to (*ii*) and the geographic origin of each respondent (*iii*). In my case the key issue is the position of respondents regarding the impairment-only model for subsequent goodwill accounting.

Firstly, I dissect the arguments employed by respondents in favour or against the impairment-only model. Research has classified arguments as conceptually based arguments Jupe (2000), Giner and Arce (2012) and self-referential Jupe (2000) or economic arguments (Stenka and Taylor (2003), Giner and Arce (2012)). In their footsteps I build a typology of arguments as follows. At first, I go through each comment letter selecting the arguments used by respondents in favour or against the impairment-only solution. I start with the first comment letter advancing some arguments on that point and I note those arguments. Then I take a second comment letter and if it does provide some arguments on the usefulness of the impairment-only approach relatively to amortization I select those arguments and check whether they are substantially the same as those presented by the previous comment letter or not. If it is the case i.e. some arguments are substantially the same as those presented by the previous letter I put a 1 next to that argument. Instead, if the argument was not mentioned by the previous letter I add that argument to the list. I repeat this process for each unique comment letter. Tables 6-3 and 6-4 present the result of the latter. I organize the arguments

along six dimensions listed in the first column: faithful representation, relevance, accountability, discretion, cost reasons, disclosure. The second column presents the full spectrum of the arguments adopted by respondents whereas the third column reports -for each argument belonging to the full spectrum- the number of respondents whose letter includes that argument i.e. the count of “1”.

Table 6-3 indicates that the respondents’ main concerns are associated with the subjectivity inherent to the inputs and methods for impairment testing. In particular, respondents lament the high degree of judgment and discretion in hypothesis behind impairment testing. Moreover, sometimes making such hypothesis entails a relevant cost be it in terms of the time management has to devote to the issue or due to the need to ask the services of an external valuation specialist. In fact, cost reasons associated with impairment testing are the second most mentioned arguments by respondents. Instead, the third most mentioned arguments is linked to the fact that ultimately impairment testing offers leeway to recognizing internally generated goodwill.

Concerning the arguments supporting the non-amortization of goodwill in table 6-4, arguments based on the “arbitrariness” of amortization are the most prevalent. In other words, those respondents point out that in their view amortizing goodwill doesn’t reflect the use it’s made of it and would instead lead to the recognition of expenses which do not match the benefits generated by the synergies represented by goodwill. Implicitly, that may suggest that according to those respondents impairment testing might faithfully portray the value of goodwill, instead. And that outcome may be achieved in part thanks to the flexibility in the recognition of goodwill write-downs made possible by the judgmental and discretionary nature of impairment testing.

Table 6-3 Arguments against the impairment-only approach

Argument class	Argument	Count
Faithful representation	Goodwill has a limited useful life	21
	Amortization presents a view of goodwill which is more in line with faithful representation than impairment testing	26
	Impairment ultimately lowers comparability between acquisitive companies and organically developed companies	7
Relevance	Users don't use information provided by impairment testing	14
	Impairment testing leads to recognizing internally generated goodwill	40
	Impairment testing on large CGU may reduce the impairment recognized	12
	impairment testing recognizes untimely losses	24
	Impairment testing information has no use for management	15
	CGU may be subject to redefinition and that breaks the purported link between goodwill allocated to a given CGU and the outcome of impairment testing	9
Accountability	Amortization enhances accountability	8
Discretion	Management has discretion in goodwill allocation to CGU	35
	The complexity of impairment testing fosters discretion	32
	Non-controlling interests make impairment more difficult	9
	Value-in-use is a valuation tool full of limitations	22
	Fair value less cost to sell has many limitations	8
	Estimates and hypothesis employed in impairment testing entail a lot of judgement and managerial discretion	54
Cost reasons	Impairment testing costs outweigh benefits	49
Disclosure	Disclosures are unsuitable or not-necessary	5
	Disclosures are not complied with	6

Table 6-4 Arguments in favour of the impairment-only approach

Argument class	Argument	Count
faithful representation	Amortization results in subjective, arbitrary and mainly unjustified goodwill expensing	19
Relevance	The information provided by impairment testing is more useful than that provided by amortization	12
	Impairment testing provides relevant information which has confirmatory value	14
	Impairment testing provides information which can inform prediction making	3
Accountability	Impairment testing keeps the management accountable	14
	Impairment testing allows for a view into management projections of the business	15
Disclosure	Disclosures on impairment testing provides useful information	8
	Disclosures on impairment testing makes it reliable	10

Therefore, the most prevalent argument in favour of the impairment-only model may be seen as the counterpart to the most prevalent argument against the latter model. The former would put the discretion and judgment required by carrying out an impairment test in a positive light, whereas the latter would put those two characteristics in a negative light.

However, the true reasons for the general respondents' aversion to the impairment-only approach may be others perhaps more prosaic. In fact, the arguments used especially against the current standard solution appear to employ the categories and concept adopted by the IASB and defined also in its conceptual framework. Actually, the very fact that I can organize the great majority of the comments along those lines¹⁰⁷ may be consistent with the latter observation. Furthermore, it is surprising to me that 40 respondents employed a technical argument such as that impairment testing would ultimately lead to the recognition of internally generated goodwill which has for long been forbidden under IFRS. That may suggest that respondents tend to adopt arguments aimed at pointing out the inconsistencies of the impairment-only approach in the ambit of the IASB's framework rather than arguments perhaps more akin to their true reason for preferring an alternative approach.

¹⁰⁷ The third arguments classified under the "faithful representation" label and the fourth under the "relevance" label may most correctly be classified under comparability and timeliness which in any case are enhancing qualities of financial reporting according to the IASB framework.

In sum tables 6-3 and 6-4 suggest a profound discontent of respondents with the impairment-only model to the point that they might have made an instrumental use of contrarian arguments to influence the possible future IASB's actions and decisions in the matter.

In order to investigate the origin of that discontent, I now turn to the interest group each respondent belongs to. I partition the set of comment letters into three groups on the basis of their position on the usefulness of impairment-only approach relatively to amortization¹⁰⁸. For some letters it is not possible to retrieve that information, either because they don't have a precise opinion or they don't provide an answer. Therefore, I group these letters in a third group. Then, I partition each of the three groups into eight subgroups on the basis of the respondent's type. Table 6-5 is the result of this process. I do the same for the question¹⁰⁹ regarding the operationality of the impairment-only model and I present the results in table 6-6. Both tables are reported hereafter.

Table 6-5 Usefulness of the impairment-only model useful by respondents' type

	Yes	No	n.a./no opinion
Accounting firms and accountancy bodies	5	4	11
Professional association	1	1	1
Industry organisation	2	2	4
Company preparer	5	10	8
Individual		1	4
Regulator	2	1	6
Standard setter	7	4	5
Investor	1		
Other	2	1	4
<i>Total</i>	25	24	43

Finally, following Giner and Arce (2012) who in their turn built upon Jupe (2000) and Tutticci et al. (1994), I perform a Fisher exact test¹¹⁰ and a Pearson χ^2 test. The latter are tests for association of the respondents' type and their position about the impairment-only model. The test statistic is not significant, which provides no evidence of association between the respondents' type and their position on the key issue¹¹¹. Adopting an analogous process I construct table 6-6 related to the operationality of the impairment test question and again I

¹⁰⁸ In substance the question answered by the respondents is: "do you find the impairment-only model useful?"

¹⁰⁹ i.e. "do you find the impairment-only model operational?"

¹¹⁰ See Weisstein, Eric W. "Fisher's Exact Test." From MathWorld--A Wolfram Web Resource <http://mathworld.wolfram.com/FishersExactTest.html>

¹¹¹ I also disambiguate the preparer type into financial preparers and non-financial preparers with similar results.

obtain not statistically significant results for both Fisher exact test¹¹² and a Pearson χ^2 test.

Table 6-6 Operationality of the impairment-only model by respondents' type

	Yes	No	n.a./no opinion
Accounting firms and accountancy bodies	2	8	10
Professional association	1	1	1
Industry organization	2	3	3
Company preparer	6	10	7
Individual		2	3
Regulator	1	3	5
Standard setter	3	8	5
Investor	1		
Other		4	3
<i>Total</i>	16	39	37

However, results are different when I analyse the relationship between the geographical origin of each respondent and the position on the key issue. In particular I group respondents in two groups: those belonging to the Continental model i.e. Austria, France, Germany, Italy, Spain, Sweden and Norway, and those belonging to the Anglo-Saxon model i.e. Australia, Canada, India, Kenya, Malaysia, New Zealand, Singapore, South Africa, United Kingdom and United States. Tables 6-6 and 6-7 present the results for the questions on usefulness and operationality of the impairment-only model vis-à-vis amortization, respectively. In the former case the Fisher exact test is significant at the 0.01% level (p-value 0.000). Also the Pearson χ^2 test and the likelihood-ratio test are significant at the 0.01% level (Pearson χ^2 statistic= 24.6690, p-value = 0.000, likelihood-ratio χ^2 statistic = 27.2886, p-value = 0.000). In particular, the average values expected to be observed assuming no association between the geographical origin of each respondent partitioned in Anglo-Saxon model and Continental model on the one hand and their position on the key issue on the other hand are 12.3 in the case of respondents who do not find the impairment-only model useful and belonging to the Anglo-Saxon model instead of the realized 3 and 10.7 instead of 19 for those belonging to the Continental-model and considering the impairment-only model not useful. Concerning the question on operationality of the impairment tests, the results are significant, too. More specifically, the Fisher exact test is significant at the 0.01% level (p-value 0.000), the Pearson χ^2 test and the likelihood-ratio test are also significant at the 0.01% level

¹¹² See Weisstein, Eric W. "Fisher's Exact Test." From MathWorld--A Wolfram Web Resource <http://mathworld.wolfram.com/FishersExactTest.html>

(Pearson χ^2 statistic= 16.3029, p-value = 0.000, likelihood-ratio χ^2 statistic = 17.1877, p-value = 0.000). Moreover, the expected number of respondents who don't find the impairment test operational and belong to the Continental model is 9.8 instead of the observed 20. In sum, each of the three non-parametric tests employed suggests that there is a relationship between the geographic origin of respondents grouped in either the Anglo-Saxon model or the Continental model and their position on both the usefulness and operationality of the impairment-only model for goodwill vis à vis amortization. More specifically, the three tests detect the presence of an association¹¹³ of the respondents geographical origin with their position on the key issue.

Table 6-7 Usefulness of the impairment-only model useful by geographic origin

	Yes	No	n.a./no opinion	Total
Continental European model	6	19	6	31
Anglo-Saxon model	12	3	22	37
<i>Total</i>	18	22	28	68

Table 6-8 Operationality of the impairment-only model geographic origin

	Yes	No	n.a./no opinion	Total
Continental European model	6	20	5	31
Anglo-Saxon model	9	7	21	37
<i>Total</i>	15	27	26	68

Overall, tables 6-7 and 6-8 provide evidence consistent with respondents' geographical origin being a relevant explicative variable for their position on the key issue, which may also lie behind the true motives against the impairment-only model in lieu of the arguments identified as being instrumentally-used.

Some caveats are in order concerning the previous results and more generally in my view the research using comment letters to the accounting standard setter as an empirical basis and which employs statistical tests to draw conclusions. Firstly, some respondents will necessarily receive special attention by the accounting standard setter not granted to others. In other words, not all respondents can be treated equally, investors, accounting firms, other standard setters, some international organizations (IOSCO for instance), the European financial reporting advisory group (EFRAG) or the Institute of chartered accountants of

¹¹³ which may not be a causality relationship.

England and Wales (ICAEW) are likely to be considered differently compared to other perhaps more peripheral institutions. On the top of that, the FASB, which is one of the main influencer of the IASB's policies¹¹⁴ never sends comment letters to the latter, differently from other standard setters or accounting rule-making bodies (such as the Ministry of Finance in China for instance). Secondly, comment letters are not written by organizations but by physical persons. Which means that it is not always immediate to do as if the content expounded in a comment letter portrays the view of the institution. In fact, comment letter writers can belong to different levels of the institutions' hierarchy and they may prepare a collective answer to the questions proposed by the standard setter. Finally, even assuming that the view of the comment letter writer perfectly represents the view of the institution he refers to, it may be possible that the arguments advanced do not truthfully correspond to the actual view of the institution¹¹⁵. Moreover, the writers know when submitting the letter that the latter will be published. Therefore, the arguments advanced may more correctly represent a means to achieve an intended outcome regarding the approval or modification of a given accounting policy or to rationalize the shortcomings of a standard adopting the language shared with the standard setters as my analysis of the arguments employed against the impairment-only model suggests.

6.5 Qualitative analysis

In terms of content and style of response, the comments are quite varied. At one extreme there is the respondent who chooses to deal exclusively with a subject connected to Business combinations accounting- see for example the letter from IBM which deals exclusively with business combinations common control, at the opposite extreme there are the respondents who answer diligently to every single question in the questionnaire. Between these two extremes some respondents just formulate their answer in such a way as to give the gist of the critical points-see PwC-, others provide a throughout, almost didascallic treatment especially for some questions-just compare the 6 pages for the answer related to the definition of a business by Sanofi versus the two 8 line paragraphs by PwC. The letters from national standard setters tend to fall under the latter extreme and in most case they include their own surveys, see also the survey by the European Securities and Market Authority (ESMA).

¹¹⁴ See Büthe, Tim, and Walter Mattli. *The New Global Rulers: The Privatization of Regulation in the World Economy*. Princeton ; Oxford: Princeton University Press, 2011.

¹¹⁵ Not to mention the reticence of certain Asian Standard setters.

Finally, some respondents choose to present in the core of the letter the topics of particular concern to the industry which they belong to and then answer the questionnaire, others content themselves to skip that point.

The letters compiled by preparers are generally signed by the group chief accountant or group controller who presumably reports directly to the CFO. In some companies the letter is signed by the chief accounting officer and the head of accounting principles and policies Bayer AG. Two signatures also for Linde AG, head of group accounting and reporting and head of IFRS competence and external reporting. In the following section I will describe how respondents view the difference between the acquisition of an asset or group of assets and the acquisition of a business.

6.5.1 Asset acquisitions versus business combinations

Acquiring an asset is generally completely different from acquiring a business. In natural languages we can use the same verb-to acquire-with two different objects-business and assets-. That could generate the misconception that the action is the same, what changes is the object. And yet the difference between a business and an asset or group of asset is so relevant that acquiring*a business is a completely different action from acquiring an asset.

Moreover, in some cases what is formally, from the legal point of view, a sale of the asset can be in fact, from the economic point of view a merger or an acquisition. Let's suppose that the directors of A sell all the assets of A to B. Then, they use the cash receipts deriving from the sale to buy shares of B. Finally A is dissolved after paying its creditors and resolving any pending issues and the shares of B owned by A are distributed among its shareholders. In this example I argue that the economic result of the sale of asset coupled with the dissolution of A is economically equivalent to an acquisition of A by B financed by shares. In other words, B has de facto acquired A. Clearly a sale of assets is quite different from an acquisition of a business in particular in terms of the prerogatives to the target shareholders granted by the law. That's why in some cases some stakeholders of the target may be induced to reveal a merger masked as an asset acquisition and particularly in the US jurisprudence on this topic has flourished.¹¹⁶

Given the different nature of an asset acquisition versus the acquisition of a business it can be useful to ask if from the accounting point of view it is justified to have two different

¹¹⁶ For examples of lawsuit related to the de facto merger theory and the associated rulings see Ventoruzzo, Marco. *Comparative Corporate Law*. 1 edition. West Academic Publishing, 2015, pp. 482-490.

treatments for the two cases as it is currently under IFRS. Table 6.9 reports the main differences between the two cases.

Table 6-9 Business combination vs asset acquisition

Item	Business combination	Asset acquisition
Goodwill/gain on bargain purchase	Recognised	Nor recognised. Any excess consideration over the fair value of the net assets acquired has to be reallocated to the latter
Contingent consideration	Recorded at acquisition date FV as per IFRS 3. For liability classified contingent consideration changes in FV must be recorded in P&L at each reporting date till expiration of the related earnout agreement.	No clear guidance. Normally is capitalised.
Deferred taxes	Recognised as per IAS 12-see IAS 12 §19 and §66. Temporary differences are recognised with goodwill as the counterpart entry	Not recognised as per IAS 12 §15 b)
Transaction costs	Expensed	Capitalised
Equity consideration	IFRS 2 -Share-based payment-does not apply	IFRS 2 applies
Step acquisitions	IFRS 3 applies	No guidance

The second question in the request for information questionnaire prepared by the international standard setter¹¹⁷ asked precisely whether there are benefits of having separate accounting treatments for asset acquisitions and business combinations and in case of a positive answer what these benefits are.

Respondents generally acknowledge that in principle it is beneficial to have two different accounting treatments for these two classes of operation. Still, some authoritative institutions are against this view. The Canadian standard setter- Casb- deems that there is no benefit inherent to accounting for business combinations and asset acquisitions in a different way. Also the Norwegian accounting standard board see no reasons for different treatment “in principle”.

Those who recognize the benefits can, however, not agree fully with what proposed by IFRS 3. Allianz, for instance, find the benefits of having two separate accounting treatments for assets vs companies acquisition with respect to goodwill. However, it is critical towards the

¹¹⁷ The first question being the one aiming at identifying the respondent.

different treatment of transaction costs and deferred taxes. Transactions costs are expensed in the case of a business combination and capitalized when it comes to asset acquisition, this discrepancy does not appear to be justified. As to deferred taxes, they can give rise to goodwill¹¹⁸ which in that case cannot represent the future benefits expected to arise from the acquired business. In some cases goodwill could result exclusively from the recognition of deferred taxes as GDF notes. Rio Tinto, a mining company, finds the requirement to recognize goodwill as a result of deferred taxation particularly inappropriate in their industry¹¹⁹. This is due to the timing mismatch between the unwinding of the deferred tax liability and goodwill impairment which has to be recognized at some point given that the life of an acquired mine is finite.

Example: Company DT acquires company T in 2012, the fair value of the consideration, entirely cash is 1000€. Both DT and T are listed industrial businesses. Company T has one and only one identifiable asset worth 1000€. For simplicity sake let's assume that both DT and T face the same tax rate of 30%. This transaction would be reflected as follows in the consolidated financial statements of DT: (figures in €)

Table 6-10 Deferred taxes and goodwill

	Debit	Credit
Intangible asset	1000	
Goodwill	300	
Deferred tax		300
Cash		1000

In this case goodwill is purely a technical figure recognized in order to comply with the requirements of IFRS 3 about tax recognition. Most correctly a timely and properly performed impairment test should recognize a charge of at least 300€. However there are ways to avoid this loss¹²⁰. At this point the unwinding of the deferred tax liability will follow its own path entirely disconnected from the future life of goodwill.

¹¹⁸ Many respondents lament this fact-see in particular Grand Thornton- in some cases goodwill arises in large part as a result of recognizing a deferred tax

¹¹⁹ See also Rio Tinto annual report 2012 p. 201 “*The majority of the goodwill arising on consolidation represents the amount calculated in accordance with the requirement in IFRS 3 to recognise a deferred tax liability on the difference between the provisional fair value of newly consolidated assets and liabilities and their tax base*”.

¹²⁰ See dedicated publications for practitioners such as Grant Thornton *Deferred tax- A finance director's guide to avoiding the pitfalls pp. 40-42*

In order to clarify what has to be intended as a business the revised standards in its appendix defined the latter as an “integrated set of activities and assets capable of being conducted and managed for the purpose of providing a return”. A part of the same second question asked what are the main implementation challenges in applying this definition to determine whether what is being acquired is a business. Difficulties in this matter are evident in real estate, extracting, financial services and pharmaceutical industries. In the latter industry, Sanofi considers the definition too broad and notes that license agreements of a single product coupled with a manufacturing agreement could fall within the new definition of business. In practice acquisition of shares with the transfer of control over an entity is the main factor which indicate that the company is dealing with a business. GlaxoSmithKline as well lament the broadness of the definition of business. Similarly Bayer points out that definition of a business is somewhat vague so that specifically the acquisition of an important intangible asset might be interpreted as a business. Astra Zeneca, for its part, indicates that whenever they can evidence key and significant processes being transferred, they consider the transaction to be a business combination and the absence of key and significant processes would therefore indicate an asset acquisition. They consider that the transfer of a significant number of employees oftentimes indicates the transfer of key and significant processes. According to Roche the main practical implementation issue relates to the “definition of a business” and whether a group of assets constitute a “business”. Typically, in the pharmaceutical industry a common type of acquisition involves the intellectual property right to a molecule or pharmaceutical device. Usually the seller set up a legal entity around the product mainly out of tax reasons. What formally is then the acquisition of the business holding the asset, it is in substance a mere single asset acquisition. (Some transactions that Roche deal with are structured in such a way that the vendor assigns a single asset (usually intellectual property right around a compound, molecule or technology) into a legal entity (often for tax reasons of the vendor). Roche then acquire the shares in this newly formed legal entity which holds the asset).

The implementation of the definition of business entails judgment and discretion as recognized by some respondents. The transfer of processes in any form does not necessarily result in a meaningful differentiation from a plain asset acquisition. For example, Astra Zeneca notes that an asset acquisition with a supply arrangement would likely not constitute a business whereas an asset acquisition with a commercial sales force and an established customer base likely would. However, if manufacturing and supply was unusually complex and highly skilled with replication/outsourcing extremely difficult and costly, the same

company may consider that the transfer of those processes was significant enough to imply a business combination. The guidance provided by IFRS 3 appears also to other respondents flexible enough to allow them to make such key judgments.

Moreover both Astra Zeneca and the German property federation (ZIA)¹²¹ point out that their US colleagues are facing increasing challenge from their auditors over the application of the definition of a business, with an increasing number of transactions being deemed to be a business. They are wary of the risk that this approach could spread to IFRS auditors in the future.

Sanofi shares the same concern *“we see high pressure coming from US stakeholders (specifically interpretation guidances published by audit firms that want to be “authoritative”) to interpret a business as being very broad. In their views any set of activities and assets, as it is “capable of being conducted as a business” is a business”*. They also venture into proposing an explanation for such a drift. In their view the latter might be traced back to the difference between US GAAP and IFRS with respect to intellectual property and research and development expenditures IPR&D. Under the former set of standards in the case of asset acquisitions IPR&D are expensed at transaction closing date if there is no alternative future use, whereas under IFRS they are capitalized (capitalization of upfront amounts). Instead, in the case of a business combination, both sets of standards require the capitalization of IPR&D and measurement at fair value. Therefore, recognizing a transaction as a business combination would enable companies under US GAAP to capitalize IPR&D. And that may be a reason for an extended interpretation for the definition of business¹²². That explanation may be plausible for the pharmaceutical sector where IPR&D expenses play a major role. However, it doesn't explain why this phenomenon is documented also in industries not R&D intensive such as the real estate. In that industry the different interpretation of the definition of business may lead to comparability issues and ultimately to higher values in the balance sheets in US real estate companies as ZIA comment letter suggests.

Difficulties in interpreting the definition of a business arise also in other sectors. The acquisitions of wind farms and solar parks, for example, are classified by Allianz as business combinations. Still, they could also be recognized as asset acquisitions because the inputs are

¹²¹ From The ZIA comment letter: *“With regard to the definition of “a business“, we observe a diversity in practice when applying this term in the real estate industry, particularly in the U.S. and Europe. It seems that in the US the majority of the transactions are accounted for as business combinations whereas in Europe the majority is accounted for as an asset acquisition”*

¹²² According to Sanofi's comment letter a similar treatment of IPR&D expenses would even out the differences in the interpretation of the definition of business registered between IFRS and US GAAP

capable to generate cash flows and don't strongly depend on the ongoing processes acquired. Conversely acquisitions of large shopping centers are considered within the scope of IAS 40 because their purpose from the acquirer's perspective is to generate revenues due to capital appreciation and rent. Nonetheless, a shopping center may also meet the definition of a business because the ability to maintain a profitable tenant portfolio is a key value driver which rests upon the specific know-how and expertise of the management team. In practice the classification of the acquisition as a business combination or as an asset acquisition rests upon its purpose. And the latter coupled with the business objectives of the acquirer should be in Allianz's view the main criterion to discriminate between a business combination and an asset acquisition. EY rephrase the previous case from the real estate industry in terms of input, output and processes in order to illustrate the shortcomings of the revised definition of business contained in the guidance of the revised standard. An entity acquires a land and a fully-leased large commercial center i.e. the inputs and the output represented by the lease income. However, it doesn't acquire the processes involved in lease management and ancillary services but they are provided by the acquiring entity resources. Again, two opposing views coexist. According to the first it is the acquisition of a business since the processes are considered consubstantial (embedded as EY says) with what is acquired, and not just an asset acquisition as the proponents of the second view think noting that no observable processes have been acquired.

6.5.2 Fair value-contingent and equity consideration

Fair value measurement entails some challenging aspects when the consideration paid presents a contingent payment¹²³ or it is done by shares.

Accounting requirements for contingent consideration have been in fact largely criticized by respondents. IFRS 3 in its 2008 version requires companies to fair value contingent payments at acquisition date and to record subsequent adjustments to fair value in the income statement. The consequence is that when the acquired business is going well and meets the conditions of the earn-out agreement, a loss is recognized in the income statement with an increase in the initially recognized liability as counterpart. And this effect appears as counterintuitive to many respondents. Moreover the initial measurement of the contingent consideration is seen as highly subjective and time-consuming. This is a primary source of concern in the healthcare industry where often the consideration includes contingent payment

¹²³ See Cain (2011) for a discussion of the subject.

based on milestones measuring the success of R&D projects acquired. Estimating the outcome of a study and the probability of the subsequent regulatory approval can be a difficult exercise as the respondents in the healthcare sector point out¹²⁴. A poor estimate of the contingent consideration may lead to more adjustments within the term of the earn-out agreement causing an increase in the volatility in the income statement. GlaxoSmithKline notes that in order to avoid that volatility contingent consideration has been excluded from some acquisitions and a different structure has been adopted to reduce the risk inherent in acquiring a business with an uncertain outcome R&D project. To overcome this perceived shortcoming of the standard a proposed solution would be to record under goodwill the counterpart of changes in the liability of the contingent consideration as was the case before 2008 (GlaxoSmithKline and Roche) or instead to adjust the carrying value of the associated intangible asset (AstraZeneca, Bayer, Sanofi).

Example: Company AZ is in the process to acquire company BV in 2014. BV has a good record of well-established products and an equally good array of products in the development phase. They are convinced that once the final test on human subjects will confirm what has been observed in the previous tests. In their view the release of that drug, after the approval by the regulator present particular problems, will prove to be a watershed in the cure for a widespread condition. That innovation coupled with a new diagnostic technique that has just been developed by AZ is poised to become the standard in the field. No other suitor appears to be a better match for BV than AZ. However, the latter doesn't share BV's estimates and this leads to a disagreement of the transaction price. After some negotiations which proved to be inconclusive, the parties agree on making an estimated 20% of the payment contingent upon the successful finalization of the new drug. Assuming a transaction price at 500 M and following the accounting entries detailed in table 6-11 the liability classified contingent consideration results at acquisition date in an increase in goodwill by 100 and an equal increase in liabilities. At the first reporting period date it turns out that the tests on humans are successful and the approval by the food & drug administration is just a matter of time. The appraisers estimate that increased probability of payout results in an increase of the fair value of the contingent consideration by 10. Which translates in an increase in the liability by 10 and recognition of a loss in P&L by the same amount. The next reporting period comes right

¹²⁴ As to R&D intangibles, Roche note that "*the fair value methodology for [valuing] R&D intangible assets is now well established (within the industry) and can be determined amongst external valuation companies and auditors though the process is time intensive, costly and highly judgmental*". For an introduction to valuation of contingent consideration see "Pwc-Valuing-Contingent-Consideration-Using-Option-Pricing.pdf." Accessed May 6, 2016. <https://www.pwc.com/us/en/audit-assurance-services/valuation/publications/assets/pwc-valuing-contingent-consideration-using-option-pricing.pdf>.

after the settlement date. During that time, thanks to a whistleblower it has been uncovered several irregularities in the approval process of the drug, including an officer of the authority accepting a bribe to facilitate the approval. A lawsuit whose outcome is quite uncertain pushes further the perspectives of the commercialization of the drug which are now a mere chimera. AZ is considering whether it is the case of abandoning any commercialization project of that drug. Given these facts the appraiser estimate that no payout is due to BV's shareholders involved in the transaction. That results in a gain recognized in P&L by 110 and a corresponding decrease in liabilities. In table 6-11 I present all the possible cases including the accounting entries corresponding to a payout at settlement date. If the appraiser had estimated the latter at 10, AZ would debit liability by 110 credit cash by 10 and recognize 100 as a gain. Under the treatment proposed by the pharmaceutical companies AZ would have recognized an increase in liabilities by 10 at the first reporting date subsequent to acquisition and an adjustment in the amount of the intangible related to the value of the drug under approval by the same amount. That amount would then be recognized in P&L along with what recognized at acquisition through an amortization scheme matching the revenues in the commercialization phase thereby resolving the so-called "accounting mismatch" under the present treatment.

The example points out the central role played by the appraiser in valuing the fair value of contingent consideration. He is called in to provide his evaluation at acquisition date and at each reporting date until expiration of the earn-out agreement. The inputs his valuation is based upon have to be agreed with the other actors, auditors and management. And when these values are not market inputs they may be subject to management preferences. For example, inputs which lead to an "overestimation" of the initial liability can be favoured when management prefer to avoid recording future losses due to remeasurements of contingent consideration.

Table 6.11 presents the accounting treatment for contingent consideration comparing the current requirement to the one dictated by the previous standard and the one proposed by pharmaceutical companies in their comment letters.

Table 6-11 The comparative evolution of the mechanics of contingent consideration accounting under IFRS

	At acquisition date		At each reporting date		At settlement date	
	Fair value of the contingent consideration		Probability of payout			Payout
Present treatment	Dr. Goodwill/intangible asset		Dr. Loss	↑	Dr. Liability	Yes
	Cr. Liability		Cr. Liability		Dr. Loss	
			Dr. Liability	↓	Cr. Cash	
			Cr. Gain		Cr. Gain	
					Dr. Liability	No
					Cr. Gain	
Proposed tr.	Dr. Goodwill/intangible asset		Dr. Intangible	↑	Dr. Liability	
	Cr. Liability		Cr. Liability		Cr. Cash	
Old tr.	No entry		No entry		Dr. Goodwill	
					Cr. Cash	

6.5.3 Equity consideration

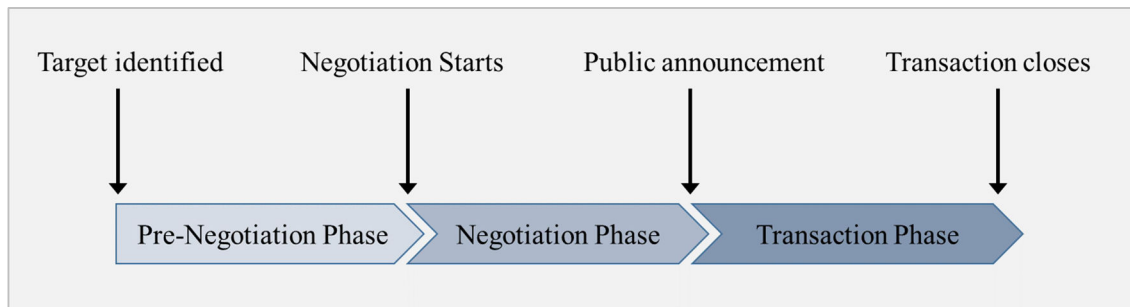
The crucial ingredient in a share for share merger is the exchange ratio¹²⁵. In practice the merging companies have two possibilities. They can agree on a price that the acquirer has to pay per each target share meaning that at the closing of the deal the acquirer issues the number of shares which allow covering the agreed-upon price or they can fix the number of shares that the acquirer has to pay per target share. In the latter case the acquirer may have the incentive to boost its share value during the negotiation phase when the exchange ratio is determined so that it will have to issue less shares per each share of the target. On the contrary, in the former case the acquirer will be better off should the value of its shares increase around the closing of the transaction when the payment is made. The implications of the decision between the two types of exchange rate are better assessed if visualized on a typical transaction timeline such as the one hereafter¹²⁶.

¹²⁵ See §46 (b) Ventrizzo p. 436 for an introduction on the subject. However, it doesn't cover the distinction presented hereafter.

¹²⁶ See slide 44-45 for a timeline example of a merger:

<https://www.sec.gov/Archives/edgar/data/1091756/000095015709000707/ex99-ciii.htm>.

Figure 6-1 Timeline of a typical acquisition



Three and only three respondents –Deloitte, PwC and EY- mentioned that they encountered difficulties in the application of IFRS 3 with respect to dealing with share for share payments and the first case is the one concerned i.e. the parties agree on a fixed exchange ratio. In that case the price fluctuates according to the bidder’s stock price, therefore the moment when the consideration is measured is crucial for the impact of the transaction on the acquirer’s financial statements. A price run up around the measurement date might be crystallized on the acquirer’s balance sheet for reasons not due to the transactions; conversely a badwill may be recognized should the acquirer’s stock price plummet around the measurement date. According to IFRS 3 §8¹²⁷ the latter coincides with the date on which the acquirer obtains control of the target, whose determination rests upon the parties and ultimately the auditors. However, that requirement was questioned by some respondents in the audit sector. Their argument is that measuring the consideration on the acquisition date may not correspond to what was intended by the parties, therefore they are left with the determination of a more appropriate measurement time. Deloitte and EY are in line on the point. The former notes that *“while we believe that establishing the fair value of amounts at the date of acquisition has conceptual merit, in some circumstance, the information obtained from measuring equity instruments transferred as consideration on the date control is obtained (rather than on the date of announcement or date that the number of shares to be transferred in consideration) may be affected by movements in the share price resulting from factors unrelated to the business combination. This is particularly true when a period between the agreement date and the acquisition date is prolonged (due to regulatory approval, for example)”*. Similarly, the latter points out that *“in many instances, there is a delay between the announcement of a business combination transaction and the date control is obtained. When the consideration is*

¹²⁷ See also IFRS 3 §18 The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.

in the form of equity shares in a listed entity, the share price will often reflect the market's expectation of the transaction occurring, and the value of expected synergies, prior to the date control is acquired. This means measuring the equity at the fair value on the date of the acquisition may not accurately reflect the transaction that was agreed between the parties".

The previous two quotations are taken from the respondents answers to question 3 on fair value. In his answer to question 4 on the separate recognition of intangible assets from goodwill and negative goodwill PwC observes that "*shares prices [which] fluctuate significantly subsequent to fixing the exchange ratio*" in some cases resulted in negative goodwill and they question whether the recognition of the latter in the income statement is appropriate under those circumstances.

Another common difficulty arises when the shares transferred as a consideration undergo a trading restriction for a given period after the completion of the acquisition. And such a restriction happens oftentimes. In such a situation the value attached to the consideration by the acquirer exceeds the value agreed by the parties. The question is then whether this excess value computed for acquisition accounting purposes should be ascribed to goodwill or should instead be registered as a debit in shareholders' equity¹²⁸.

6.5.4 Step acquisition

The required use of fair value has also been criticized by respondents in the ambit of the so-called "step acquisitions". IFRS 3 does not define step acquisitions but provides an example of what they are meant to be.¹²⁹

Mining companies appear to be highly critical to the requirement to restate previously-held non-controlling-interests of the target at fair value measured at acquisition date. This leads to the recognition of a gain or loss in the income statement which is not attributable to the performance of the entity, and in case of a gain the revalued previously-held non-controlling interest may incur in an amortization or impairment, thus having a bearing also on the following periods. A telling example about the consequences of step acquisition accounting is presented in AngloAmerican's comment letter. It deals with the acquisition of De Beers by

¹²⁸ Another challenge relates to per-share fair value in the measurement of noncontrolling interest. When a control premium is included in the per-share acquisition price at which the parent company acquired control, IFRS requires that noncontrolling interest be measured using per-share fair value excluding this premium. However, as a practical matter, this premium is frequently difficult to calculate

¹²⁹ See IFRS 3§41 *An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the acquisition date. For example, on 31 December 20X1, Entity A holds a 35 per cent non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40 per cent interest in Entity B, which gives it control of Entity B. This IFRS refers to such a transaction as a business combination achieved in stages, sometimes also referred to as a step acquisition.*

Anglo American which was completed in 2012 with the purchase of a 40% stake in the former. That newly-acquired equity stake coupled with a pre-existing 45%¹³⁰ equity interest acquired in 2001 granted AngloAmerican control over De Beers. In order to comply with the standard Upon the acquisition of control AngloAmerican was bound to recognize a 2.7 billion\$ gain with respect to the 45% non-controlling interest being the difference between the fair value of the latter upon acquisition of control and its carrying amount. In the year following the acquisition the depreciation and amortization expense attributable to the fair value increase amounted to 131 million\$. To clarify the nature of the transaction to users the acquirer decided to exclude the gain and the related depreciation expense from the reported ‘Underlying operating profit’ and disclose these amounts under an account named “Special items and remeasurements”. A similar reclassification is carried out by Rio Tinto who shares the concerns of AngloAmerican about step acquisition accounting.

6.5.6 Non amortization of goodwill

The subsequent treatment of goodwill is one of the most controversial requirements in IFRS 3. Some of the reasons for this dissatisfaction are outlined in the summary prepared by the IASB.

In Table 6-12 I present a description of views over goodwill accounting and impairment test collected from the comment letters. ICAEW is the only respondent which supports the accounting for goodwill and impairment testing as it is currently. Among the 23 preparers respondents one fourth support a modified version of the impairment test, be it an indicator triggered impairment or simplified disclosures. The remaining three fourths either support amortization tout court or amortization coupled with an indicator triggered impairment test. Among non-preparers it is not always possible to elicit a univocal opinion since their view is based on its turn on surveys (national standard-setters). In table 6-12 I indicate their view when it is explicitly stated as their own.

Two respondents stand out due to the peculiarity of their opinions. The first is Allianz. The German insurance and asset management company is a notable case of a proponent mandatory amortization of identifiable intangible asset coupled with an offsetting of goodwill against the acquirer’s equity.¹³¹ They support this position suggesting that it would not represent business combinations less faithfully than the two main other methods and it would

¹³⁰ That interest was acquired shortly after AngloAmerican listing in London in 2001. DeBeers and AngloAmerican had cross holdings for many years before that date.

¹³¹ It may be noteworthy to observe that the comment letter review prepared by the IASB has not mentioned this comment.

be the less costly one¹³². Offsetting goodwill against the acquirer's shareholder equity it is quite a strong view and might have appeared to the IASB as too anachronistic or isolate to be included in the summary or feedback statement. And yet, isolated views are sometimes picked up by both documents. Interestingly, another German company LINDE AG, a world leading gases and engineering company active in more than 100 countries worldwide, share the Allianz's view. They don't consider the impairment test useful at all. "It is again an overly complex exercise with only very limited informational content". They would be in favour of making goodwill subject to regular amortization that is charged against a separate OCI account and kept outside the income statement. Ultimately that would amount to writing off goodwill against equity. Standard chartered non-amortisation hold management to account only in the near-term, am would do the same and recognizing that" the benefits ascribed to goodwill are not indefinite". BBVA

The critical attitude by some companies towards the requirement for impairment test and goodwill accounting may, in some cases lead to consequences when it comes to deciding whether to adopt IFRS or not for firms which have this option. Under this respect, SIX Exchange regulation, the agency responsible for the enforcement of the issuers listed on the Swiss national stock exchange, notes that the dissatisfaction related to the impairment test under IFRS was mentioned by several issuers under its competence as a reason for transitioning from IFRS to Swiss GAAP¹³³. That treatment can be considered as a vestige from the past, it may be what Stolowy, Richard, Ding call the weakened static phase-write-off of goodwill against equity-which prevailed in Germany till the eighties-a much longer period than the other countries analysed in that study or it may be the new that has been superimposed to what is felt by the companies as the true approach.

Non-amortisation of goodwill is the main concern of the Asian-oceanian standard-setters group, a consortium of 26 member standard-setters from the Asia-Oceania region. In their cover letter it appears as their first issue to reconsider in IFRS 3. According to many AOSSG members going back to amortization of acquired goodwill would significantly improve the usefulness of financial information.

The Chinese standard setter goes on to suggest an additional disclosure to make up for the shortcomings of the information produced by the present treatment. "*We suggest consider*

¹³² They would discard the present impairment-only approach since it entails the costs associated to impairment-testing and it doesn't assure that acquired goodwill is ultimately recognized in the income statement. Also the amortization solution is discarded given the arbitrariness of any amortization pattern with respect to the cost of a business combination.

¹³³ See instead De Simone (2016) for descriptive statistics of the voluntary adopters according to the database Amadeus.

additional disclosure requirement for the entities, that if the goodwill and intangible assets with indefinite useful lives would have been amortised within certain period (sic), what would be the potential impact to the financial statement”

The Korean points out that many stakeholders favour the amortization approach and note the “amortization expenses before the adoption of IFRS is much higher than the amount of impairment losses after adoption” but make clear that this fact would not justify per se a dismissal of the current approach. The Accounting standards board of Japan, for its part, makes it clear that its comment letter does not contain official positions but the views of Japanese stakeholders received during the outreach activities are disclosed. When questioned about their views on the impairment test almost all preparers suggested reintroducing the amortization and impairment approach.

Table 6-12 Constituents’ view over impairment test

Respondent	Type	View over impairment test	Favourable to an impairment test
AFRAC Austrian financial reporting and auditing committee	Accounting bodies	We are not in favour of prohibiting the regular amortisation of goodwill	0
Association of Chartered certified accountants ACCA	Accounting bodies		
CPA Australia	Accounting bodies	Improve the current impairment model	
FEE Federation of European accountants	Accounting bodies	Some FEE members still support the impairment-only approach	
HongKong Institute of certified Public accountants	Accounting bodies		
ICAEW	Accounting bodies	Supportive of the current model of testing goodwill annually for impairment	1
IDW Institut der Wirtschaftsprüfer	Accounting bodies	Amortisation would be the best solution	0
Institute of certified public accountants Kenya	Accounting bodies	The current treatment provides better information than an allocation of the cost through amortization	1
ISCA institute of singapore chartered accountants	Accounting bodies	Mixed views improve impairment	
Japanese Institute of Certified public accountants	Accounting bodies		
Malaysian Institute of certified public accountants	Accounting bodies		
BDO	Accounting firm	Welcome discussion about the two options	

Respondent	Type	View over impairment test	Favourable to an impairment test
Deloitte	Accounting firm		
Duff&Phelps	Accounting firm	Impairment test provides relevant information	1
Grant Thornton	Accounting firm		
KingstonSmith	Accounting firm	No required improvements to impairment testing except reversals in some case	1
KPMG	Accounting firm	Support amortisation-based model with indicator-based impairment	
Mazars	Accounting firm	to be considered again	
MNP LLP	Accounting firm		
PWC	Accounting firm		
ABRASCA Brazilian association of listed public companies	Industry organisation	amortisation "in addition on (<i>sic</i>) the annual evaluation could provide a better solution"	0
ACTEO AFEP association française entreprises privés MEDEF	Industry organisation	Impairment test may be useful but has to be simplified	1
BusinessEurope	Industry organization		
GDV German Insurance association	Industry organisation	linearly amortised	
Real property association of Canada	Industry organization		
SEAG Swedish enterprise accounting group	Industry organisation	All intangibles including goodwill should be amortised	0
SwissHoldings Swiss federation of industrial and service groups	Industry organisation	a systematic amortization approach is preferable	0
ZIA German Property Federation	Industry organisation	Suggest introducing more simple and realistic rules	0
Henderson Global Investors	Investor	impairments are preferred over amortisation in that they provide some insight into the mindset of management	1
Allianz	Preparer	offsetting goodwill against the acquirer equity	0
AngloAmerican	Preparer	Indicator-triggered impairment test	1
AstraZeneca	Preparer	The process of reviewing goodwill for impairment is not particularly useful Indications of no impairment suffice	0
Barrick	Preparer	amortising goodwill is a preferable treatment	0
Bayer	Preparer	support amortisation-based model with indicator-based	0

Respondent	Type	View over impairment test	Favourable to an impairment test
		impairment	
BBVA Banco Bilbao Vizcaya Argentaria	Preparer	go back to the amortized-based model	0
BP	Preparer	Determining the correct assumption behind the computation of the VIU or FVLCTS is challenging	1
Chime plc	Preparer		
Cobham plc	Preparer	we would prefer to see goodwill amortised	0
GDF Suez	Preparer	Reassess the impairment only approach	0
GlaxoSmithKline	Preparer	Indicator-triggered impairment test	
IBM	Preparer		
Keppel corporation	Preparer	advocate amortisation of goodwill	0
Linde AG	Preparer	amortisation charged against a separate OCI account	0
Nestlé	Preparer	Reintroducing amortisation. Nestlé support of the impairment model in the past was influenced by lack of comparability between US GAAP and IFRS.	0
Repsol SA	Preparer	the information derived from impairment testing is more adequate and relevant than the one from systematic amortisation	1
Rio Tinto	Preparer	requirement of impairment testing is unhelpful	0
Roche	Preparer	We welcome the reintroduction of amortization	0
Sanofi	Preparer	Go back to a treatment where goodwill is amortised	0
Standard Chartered	Preparer	we are supportive of amortisation and treating goodwill consistently with other intangibles	0
Syngenta	Preparer	The current accounting treatment of goodwill is preferable to the alternatives used in the past	1
Telecom Argentina	Preparer	impairment with a review of certain criteria for computing the recoverable amount	1
TUV SUD AG	Preparer	The information conveyed by impairment test is useful	1

Respondent	Type	View over impairment test	Favourable to an impairment test
CFA Society UK	Professional association	enhance the usefulness of impairment test	1
SAICA South african institute of chartered accountants	Professional association		
SFAF French Society of financial analysts	Professional association	Amortisation	0
China securities regulatory commission	Regulator	the impairment approach is questionable	
EFRAG	Regulator		
ESMA European Security and Market Authority	Regulator	improve disclosure relative to impairment	
Financial reporting council	Regulator		
Financial reporting council Mauritius	Regulator		
Financial supervisory service Korea	Regulator	in favour of an amortisation-based model with indicator-based impairment	
Japan foreign trade council	Regulator	companies should be permitted to choose between amortisation and impairment of goodwill on the basis of their accounting policies	0
SEBI Securities and exchange board of India	Regulator	non-unfavourable	
SIX Swiss Exchange	Regulator	amortisation-based model with indicator-based impairment	0
Accounting Standard board of Japan	Standard setter	Almost all preparers taking part to the ASBJ's outreach suggested reintroducing the amortisation and impairment approach.	0
Accounting Standard Committee of Germany	Standard setter	there is little acceptance of the impairment-only approach	
ANC French Standard setter	Standard setter	Unconvinced of the relevance of not annually amortising goodwill	0
Australian accounting standard board	Standard setter	amortisation with indicator based impairment	0
Canadian accounting standard board	Standard setter		
China accounting standard committee	Standard setter	complicated to perform, costly, hinging on subjective judgement, not timely	0
Cinif Mexican standard setter	Standard setter		
CPC Brazilian standard setter	Standard setter		
Glenif Group of latin american standard setters	Standard setter		

Respondent	Type	View over impairment test	Favourable to an impairment test
Korea Accounting Standards Board	Standard setter	Many stakeholders have proposed the amortisation approach	
Malasyan accounting standard board	Standard setter		
New Zealand accounting standard board	Standard setter		
Norwegian accounting standard board	Standard setter		
OIC	Standard setter	mixed views among users	
Singapore Accounting Standard council	Standard setter	mixed views	
Swedish Financial reporting board	Standard setter		
Christoph Frohlich_individual	individual		
Dittmar_Munekka_individual	individual		
Frederick Schmachtenberg	individual		
Pearl Tan_individual	individual		
Peter Wells_individual	individual		
American appraisal	other	doubts on the enforcement	0
AOSSG Asian Oceanian standard setters group	other	mixed views among users	0
CFO Forum	other	no practical benefit from impairment test information	0
EFFAS the european federation of financial analysts societies	other	improve impairment test and amortize well-defined intangibles	
MASB Marketing accountability standard board	other	Impairment test should be replaced by accretion test	
the 100 group	other		
Westworth Kemp consultants	other	we are starting to question wether replacing amortisation with impairment has been effective	0

6.6 IASB Feedback statement

On the basis of the comments received the IASB convened to undertake research in what are the most critical areas. High significance demanding further research has been recognized

about the subsequent accounting for goodwill-in respect to both the effectiveness and complexity of testing goodwill for impairment and comparing an impairment-only approach with an amortization and impairment one-. Medium/high significance has been instead attached to reconsidering the definition of a business and the identification and fair value measurement of intangible assets, considering in particular, whether some intangibles could be subsumed into goodwill.

Interestingly the IASB justifies his current approach to subsequent accounting for goodwill on the basis of academic research on value relevance which suggests that there is an association between the impairment loss announcements and share prices of the corresponding company. There are no other justifications in the feedback statement and academic research is employed exclusively in this context.

6.7 Further developments on the definition of business

The consequences of the diverse interpretations of the definition of business have been tentatively addressed by the standard setters. The FASB recognizes that the definition of business is interpreted more broadly in the US than in jurisdictions where IFRS apply. In their view, the reason for this disparity has to be found in the tendency prevailing in the US to recognize a business where there are inputs and any process whereas IFRS significant or sophisticated processes are required for a set of assets to be considered a business¹³⁴. Accordingly, the FASB's decision to require both an input and a substantive process is thought to be conducive to more harmonized practices between IFRS and GAAP. Along with this, also the single or similar asset threshold¹³⁵ should help aligning GAAP practices towards IFRS. The IASB, for its part, supported all that the FASB proposed in order to clarify the definition of business and proposed similar amendments to IFRS 3. In particular, with respect to the nature of processes needed for a set of asset to be classified as a business, "In our view, the proposed additional guidance on substantive process would confirm the predominant

¹³⁴ "AP13C-FASB-Business-Combinations-PIR.pdf." Accessed May 4, 2016.
<http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/September/AP13C-FASB-Business-Combinations-PIR.pdf>.

¹³⁵ "To not consider the set a business if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets ».

practice under IFRS, which is: only significant/sophisticated processes give rise to a business. Consequently, the proposed guidance would be a clarification for many IFRS preparers”¹³⁶.

6.8 Common control issues and the EFRAG discussion paper

Some respondents point out in the “other matter” question that IFRS exclude business combinations under common control from its scope and invite the IASB to undertake research on that topic. Therefore, it is not possible to glean constituents’ opinions on BCUCC from IFRS 3 PIR comment letters except for IBM letter which deals exclusively with that topic. However, in 2012 EFRAG and OIC issued a discussion paper (DP) on accounting for business combinations under common control and invited constituents to submit their answers to a related questionnaire. Thus, I can use the publicly available database of the 28 responses to elicit the main concerns on the issue at least with respect to the discussion paper. The definition of BCUCC, not provided by the DP, constitutes a primal preoccupation. Some respondents wonder whether combinations of entities owned by family members or ultimately controlled by the state have to be considered as under common control. Moreover, even without a clear definition, the consensus is that the transactions subsumed under the common control label are quite diverse one from the other. That’s why many respondents blame the DP for not having tried to develop a taxonomy of these transactions, which could be related to the proposed accounting treatments. The ACCA and KPMG propose a first list of possible taxons and is reported in appendix 4 hereafter.

Another shared concern is the impact of BCUCC on distributable profits. The DP takes the perspective of the initial measurement of a BCUCC on the consolidated financial statements of the acquirer (transferee in the DP jargon) without taking into consideration separate or individual financial statement¹³⁷. As Abfall Service (now FCC Environment) puts it. *“In most jurisdictions the individual financial statements are the basis for the assessment of dividend payments. Accordingly a BCUCC might have a significant impact on the pay-out potential of the affected company. Although it will depend on how such effects are treated in different countries it might be appropriate to clarify if revaluations in the course of BCUCC shall be included or excluded from retained earnings available for distribution.”* That aspect is even more delicate when non-controlling interests are involved as the UK accounting standard

¹³⁶ see §6 “AP13-Definition-of-a-Business.pdf.” Accessed May 4, 2016.

<http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/October/AP13-Definition-of-a-business.pdf>.

¹³⁷ A separate project on separate financial statement was undertaken in 2014 and completed in 2015.

setter notes *“the ASB consider greater consideration of non-controlling interest is required. This is especially true where the individual financial statements are used to calculate profits available for distribution to shareholders; the effect of the BCUCC on distributable profits should be addressed”*. A similar concern is shared among others by the ESMA and FSR-Danske revisorer. Regulating this point is especially important in common control transactions given the strict relationship between consideration paid and equity. In fact the consensus appears to indicate that when the consideration transferred is less than the fair value of the net assets of the acquiree a gain should be recognised in equity and not in the income statement, economically it is equivalent to a contribution from the parent entity (the opposite case would be accounted for as a distribution –to the parent- in the transferee’s financial statement). The comment letter addressed to the IASB from IBM in the ambit of IFRS 3 PIR makes it clear that *“a better reflection of the substance of such transactions may be to record the difference between consideration transferred and the identifiable assets acquired and the liabilities assumed as retained earnings or in a separate equity reserve (rather than newly created internal goodwill).”* – it may be useful to explain these points in pictures- Chiara Del Prete-Head of Accounting Principles and Disclosure at Unicredit- in the ambit of the EFRAG outreach activities expresses the same point *“the excess of the transfer price over the carrying value of net assets transferred represented¹³⁸, from an entity’s perspective, a reallocation of resources by the ultimate parent between different legal entities. Accordingly, such excess does not represent a realised profit for the transferor and it does not meet the criteria for recognition as an asset in the balance sheet of the transferee”*

The two also appear to have the same view over the price formation in common control combinations:

“Therefore, there is no objective negotiation that drives the amount of consideration transferred in business combinations between entities under common control compared to that of a third party acquisition. The amount of consideration paid in a common control transaction is likely to be less a function of negotiation and more so driven by the goals of the parent entity’s legal and/or tax teams.” and *“In 2010 all the Italian banks were combined and merged into the Holding Company for internal reorganisation purposes. –omissis- in the absence of a price formed in negotiation between third parties, the transfer price is in practice typically supported by an independent expert valuation in order to duly consider*

¹³⁸ In cases where minorities are not significant.

creditors' and minorities' interests and for tax implication (particularly for cross-border transactions), also taking into account legal requirements.

Another aspect noted by just one respondent, the CIPFA, the Chartered Institute of Public Finance and Accountancy makes reference to how the regulation on common control transactions can assuage the shortcomings of IFRS 3 in certain sectors. Non-profit entities belong to one of the latter. Most of the combinations in that sector are not acquisitions of an acquired entity by an acquiring entity and the identification of an acquirer required by IFRS 3 would be meaningless. Another one is the public sector that in the UK has embraced IFRS have, in the CIPFA words, *“left government bodies without relevant guidance applicable to the majority of government entity combinations”*.

Finally, several respondents reproached the EFRAG and OIC for not having considered GAAP which already provide guidance on the matter such as Hong Kong, US, UK and Canadian GAAP. In Canada BCUCC are seen as a subset of related parties transactions which is why a dedicated standard was never developed. The Canadian regulation 3840, Related Party Transactions, was applied by public companies before the adoption of IFRS and it is still being applied by private companies.

In Table 6.13 I provide a first overview of the letters.

Table 6-13 Letters overview

Respondent	Type	Where	Main takeaway/gist
Association of chartered certified accountants ACCA	Accounting bodies	UK/Global	Limited inasmuch it does not attempt to provide a taxonomy of BCUCC and does not consider transactions other than BC
Chartered institute of public finance and accountancy	Accounting bodies	UK	The distinction between mergers and acquisitions in FRS 6 should be relevant in developing a correct approach
Institute for the accountancy profession in Sweden	Accounting bodies	Sweden	BCUCC comprehend diverse types of transactions different from those regulated by IFRS 3. Companies should be able to choose between the predecessor method and an analogy of IFRS 3
ICAEW	Accounting bodies	UK/Global	*
South african institute of chartered accountants	Accounting bodies	South Africa	The DP should also consider separate financial statements

Respondent	Type	Where	Main takeaway/gist
BDO	Accounting firm	Belgium/global	
Deloitte	Accounting firm	USA/global	The DP does not consider guidance already developed in other GAAP and limits itself to some BCUCC
Ernst&Young	Accounting firm	UK/Global	Outreach on users' needs should be carried out to check whether IFRS 3 could serve as a basis for building the appropriate accounting model
Grant Thornton	Accounting firm	UK/Global	Applying the IAS 8 hierarchy does not ensure consistency and limits the accounting possibilities.
KPMG	Accounting firm	Global	*
Mazars	Accounting firm	France/Global	The DP is too focused on the applicability of IFRS 3
PwC	Accounting firm	UK/Global	BCUCC is not defined in the DP which does not consider the scope of these transactions e.g. BCUCC through state ownership.
Abfall Services AG	Preparer	Austria	Issues have been correctly described. Einheitstheorie - on a consolidated basis the group is one closed unit - leads to the use of the predecessor method in Austria
Luxottica	Preparer	Italy	Every BCUCC should be accounted for at historical cost/predecessor value. In case of joint-ventures that rule can be waived.
Austrian financial reporting and accounting committee	Professional association	Austria	BCUCC should be split into two groups, those for which an analogy of IFRS 3 can be applied and those for which it can not
Group of certified Italian accountants in Rome	Professional association	Italy	The principal issue in Italy are separate and individual financial statements. Oic prefers predecessor method
European securities and markets authority ESMA	Regulator	Europe	The DP does not define BCUCC and does not consider separate financial statements
Accounting standard board staff	Standard setter	Canada	The variety of legal structures and combinations subsumed

Respondent	Type	Where	Main takeaway/gist
			under the common control label should be carefully analysed
Dutch accounting standard board	Standard setter	The Netherlands	No definition is given and the impact on separate financial statements and common control transactions are not covered by the DP
Australian accounting standard board staff	Standard setter	Australia	Alternative methods of accounting for BCUCC from first principles absent current IFRS have not been considered.
Norsk Regnskapsstiftelse	Standard setter	Norway	The DP does not provide a definition of common control
Korean accounting standard board staff	Standard setter	Korea	"While Korea is slightly inclined to using fair value, there exists a fundamental issue which is the lack of market forces in BCUCC transactions. Thus, further research should be conducted on the matters of determining the acquirer or recognizing goodwill"
The United Kingdom Accounting standards Board	Standard setter	UK	Predecessor approach should not be limited to cases where the analogy with IFRS 3 breaks down
Autorité de normes comptables	Standard setter	France	Very critical. Too much emphasis given to IFRS 3 and a proper analysis of the different kinds of transactions and of the "related parties" feature is missing.
Polish accounting standard committee	Standard setter	Poland	The DP should also consider cases where the ultimate owners are individuals or entities not required to prepare (consolidated) financial statements
Belgian accounting standards board	Standard setter	Belgium	If there is no substance in the transaction the only method to be applied is the pooling of interests
Comissao de normalizacao contabilistica	Standard setter	Portugal	
Danske revisorer-FSR	Accounting body & Standard setter	Denmark	The analysis should have been informed by a principle-based guidance on related parties transaction and its effect on separate financial statements

6.9 Chapter Conclusions

Fair value measurement remains a complex and controversial area also in the ambit of business combinations. Contingent consideration, remeasurement of previously held interests in step acquisitions, non-controlling interests in the full goodwill option, the computation of the recoverable amount of goodwill are just the most visible cases. As the comment letter analysis clearly shows companies encounter many difficulties in coming to grips with it. In some cases it entails a valuation specialist criticized as costly and not beneficial by many commentators, and that it is just one of the reasons. The IASB is well aware of these shortcomings and one way to counter them has been the signature of the protocols for cooperation between the IFRS foundation and the International valuation standard council in 2014. The common interest of the two institutions is a consistent measurement of fair value for financial reporting. Presently the definition of fair value according to IFRS is different from the definition used in the International valuation standard (see international valuation standard framework paragraph 39- 40¹³⁹). The intended objective of these agreement goes in the direction of consistency in fair value measurement between the two sets of standards “*The IVSC and the IFRS Foundation have a common interest in ensuring that standards and guidance developed by the IVSC through its standard-setting boards on how to measure fair value is consistent, where appropriate, with IFRS (for example IFRS 13), and is comprehensive and well-developed*”. Now, although audit companies have saluted this agreement as a promising step forward, it is not clear whether it is the case also for the other constituents. Probably it is not, especially if the agreement is also meant to cement the use of fair value in impairment testing. And that could also go against some recent development in a US GAAP setting. The FASB has in fact re-established an amortization option for US private businesses and is considering doing the same for public ones (FASB 2014a, FASB 2014b). The analysis of the comment letters also shows that constituents do not have a clear view about the distinction between the entity vs proprietary perspective (Van Mourik 2010) and their implications related to accounting for business combinations under common control. Commentators recognize that these two perspectives are currently neither well developed nor even precisely defined and the entity perspective appears to be favoured within IFRS. Further research could investigate whether the constituents have knowledge be it implicit or explicit

¹³⁹ 39 *Fair value* is the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.

⁴⁰ The definition of fair value in IFRS is different from the above. The IVSB considers that the definitions of fair value in IFRS are generally consistent with market value.

of the distinction between entity and proprietary theory as developed in the accounting literature and how they consider the international accounting standards under this respect. BCUCC for example take many forms and there is a corresponding diversity in users and their needs. If the primary user of the reports is the owner then it may well be that the proprietary perspective is most appropriate. Presenting information in a way that best meets the needs of users should take precedence over consistency with existing IFRS. A study which further analyses comment letter under this respect is therefore warranted.

International comparative analysis of subsequent treatment of goodwill for private companies

In the following table I present a comparative analysis of current goodwill accounting guidance according to US GAAP and IFRS. Two caveats are in order. Firstly, from the practical point of view it would be more appropriate comparing US GAAP to each country's local GAAP instead of comparing the former to IFRS for SME. In fact, while US private companies are required to comply with US GAAP, the same requirement doesn't apply to IFRS for SME. In Europe, for example, private companies could choose whether to adopt IFRS for SME¹⁴⁰ or continue with local GAAP. Secondly, the average private company in the US for which the standards have been conceived is different from the average private company eligible to apply IFRS for SME and that could render the comparison less meaningful.

With these caveats in mind I organize the comparison across the following four points: amortization, impairment test, frequency of impairment, testing level. Starting from 2015 private companies in the US are eligible to adopt the so-called "accounting alternative" under which goodwill has to be linearly amortized over 10 years or less and tested for impairment when special events suggest that the entity's fair value may have fallen below its book value. Furthermore the impairment test doesn't require going through step two currently required for US public companies, which entails the estimation of the implied value of goodwill. That suppression is expected on one hand to reduce the cost burden for companies with a justifiable and acceptable information loss and on the other to be more similar to the one step test under

¹⁴⁰ Private companies in Europe are also allowed to adopt IFRS tout court. Descriptive statistics about the percentage of companies adopting IFRS for SME would be helpful to ensure that it is meaningful to compare the latter to US GAAP for private companies.

IFRS (Topic 350 BC26). On the top of that the amortization-based accounting model is in line with IFRS for SME (Topic 350 BC14). Other standard setters rejected the amortization-model for goodwill on the basis that it is an indefinite life asset (see for example the AcSB, the Canadian standard setter, ASPE 3064, BC115). Instead, there is a convergence on the rejection of the possibility to charge goodwill against earnings or equity. In particular Topic 350 BC21 mentions that the direct charge-off¹⁴¹ would not be consistent with the definition of asset (in line with the Canadian BC116) and would have an adverse impact on the ROE. For sake of comparison I include in the last column of the table the proposed accounting standard issued in May 2016 valid for all US entities except the private ones having adopted the alternative.

Table 6-14 Goodwill accounting for private companies under US GAAP and IFRS

Subsequent treatment of goodwill related items	Topic 350 under the accounting alternative	ED Topic 350	IFRS for SME	ASC 350 ED
Impairment test	Compares the entity's or reporting unit's carrying amount to its fair value, the impairment amount is the difference of the two	Idem	Compares the recoverable amount to the carrying value of the cash-generating unit	Compares the reporting unit's carrying amount to its fair value, the impairment amount is the difference of the two
Amortization	Goodwill has to be amortized on a straight-line basis over 10 years or less if appropriate	Based on the primary asset and not more than 10 years	Shall not exceed 10 years	

¹⁴¹ The direct write-off remains the preferred treatment of some stakeholders, notably KPMG as made clear in the comment letter to ED Topic 350.

Frequency of tests	Based on a triggering event	Idem	At each reporting date the entity shall assess whether there is any indication of impairment, if it is the case it shall estimate the recoverable amount	At least annually
Testing level	Entity or reporting unit	entity level	Cash-generating unit level. Acquired entity or the entire group of entities if it is not possible to allocate goodwill on a CGU	Reporting unit

6.10 Chapter References

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6.11 Chapter Appendix 1

In this table I provide a complete view over the entity/proprietary question 1 if the respondent favours the first alternative and the IAS 8 question where 1 means that the respondent think that the BCUCC standard should be developed following the IAS 8 prescriptions i.e. not inconsistent with current IFRSs and 0 otherwise

Table 6-15 Views from the entity/proprietary question

Respondent	Entity	Comments	IAS 8
Association of chartered certified accountants ACCA			0
Chartered institute of public finance and accountancy			1
Institute for the accountancy profession in Sweden	1		0
ICAEW		It should be based on user needs, in some case the proprietary approach is to be preferred	0
South african institute of chartered accountants		do not understand the intention of the question	
BDO	1		1
Deloitte			
Ernst&Young	1	The role of the controlling shareholder should not be ignored	0
Grant Thornton			0
KPMG		Guidance should be developed starting from first principles. The starting point should be to understand the nature of financial statement of an entity within a group and that should appear in the Framework	0
Mazars	1		0
PwC			
Abfall Services AG	1		1
Luxottica	1	Except in cases where a BCUCC affects a joint venture or an entity with third parties	1
Austrian financial reporting and accounting committee	1		1
Group of certified italian accountants in Rome	1		1
European securities and markets authority ESMA	0	BCUCC should be addressed from an investor's perspective	
Accounting standard board staff			0

Respondent	Entity	Comments	IAS 8
Dutch accounting standard board			
Australian accounting standard board staff	1	They note that aspects of the proprietary perspective still exist in IFRS	0
Norsk Regnskapsstiftelse	1		0
Korean accounting standard board staff		It should be recognised not only the perspective of the controlling owners but also of the transferee-entity-	
The United Kingdom Accounting standards Board		Entity perspective is consistent with IFRS but the DP should not be bounded by the latter	0
Autorité de normes comptables			
Polish accounting standard committee			
Belgian accounting standards board			
Comissao de normalizacao contabilistica	1		1
Danske revisorer-FSR	1		0

In the following table in the column Acquirer identified 0 means that the respondent thinks that it is not possible/meaningful to identify an acquirer in BCUCC, 1 otherwise. In the column Analogy with IFRS3 1 means that the respondent answered positively to question 5 below, in the column 5.2 goodwill 0 means that the latter should not be recognized i.e. a positive answer to question 5.2 below.

Table 6-16 Views from the acquirer-identification question

Respondent	Acquirer identified	Analogy with IFRS3 4.9	5.2 GW
Association of chartered certified accountants ACCA			
Chartered institute of public finance and accountancy			
Institute for the accountancy profession in Sweden	0		1
ICAEW	0	0	
South african institute of chartered accountants		0	
BDO	Identification of an acquirer always possible may lack meaning	0	
Deloitte			
Ernst&Young	Identification of an acquirer may lack meaning	Possible	
Grant Thornton	0		

Respondent	Acquirer identified	Analogy with IFRS3 4.9	5.2 GW
KPMG	0	Prohibiting IFRS3 for all BCUCC is not necessarily appropriate	1
Mazars	1	1	1
PwC			
Abfall Services AG	In most cases it can be identified		0
Luxottica	Yes, but it may not be meaningful	0	0
Austrian financial reporting and accounting committee	In most cases it will be possible to identify the acquirer	0	0
Group of certified italian accountants in Rome	Always possible but sui generis		0
European securities and markets authority ESMA			In most cases the effect of BCUCC should be recognised in equity
Accounting standard board staff			
Dutch accounting standard board			
Australian accounting standard board staff	0		
Norsk Regnskapsstiftelse	0		
Korean accounting standard board staff			
The United Kingdom Accounting standards Board	0		1
Autorité de normes comptables	0	0	
Polish accounting standard committee			
Belgian accounting standards board			
Comissao de normalizacao contabilistica	It is as difficult as under IFRS 3		
Danske revisorer-FSR	0		

6.12 Chapter Appendix 2 - Questions in DP on BCUCC – complete with all questions

Question 3.2 – The transferee is a reporting entity It is noted above that the analysis in this DP is taken from the perspective of the transferee (entity perspective) as opposed to the perspective of the owners (proprietary perspective). Do you agree that, to be consistent with existing IFRS, the entity perspective should be dominant when considering BCUCC? If not, why not?

Question 3.3 – Applying the logic of the IAS 8 hierarchy to help develop an approach on how to account for BCUCC

Do you agree with applying the logic of the IAS 8 hierarchy in developing an approach to accounting for BCUCC transactions? If not, what alternative would you propose and how would you reconcile that approach with existing IFRS?

Questions 4.4 – Identification of an acquirer Do you think that with BCUCC it may be difficult in some circumstances to identify an acquirer (View A) or do you believe that an acquirer can always be identified (View B)?

Questions 4.5 – Do you think it is appropriate to apply the measurement principle in IFRS 3 to BCUCC when the analogy to IFRS 3 is valid? If not, why not?

Questions 4.6- Do you believe that goodwill and/or identifiable intangible assets should not be recognised in the balance sheet of the acquirer on the basis that they cannot be reliably measured?

7. PAYMENT METHOD AND FINANCING CHOICE IN FINANCIAL INSTITUTIONS' BUSINESS COMBINATIONS: DOES IT MATTER HOW AN ACQUISITION IS FINANCED?

7.1 Introduction

The mode of financing a business combination can have a relevant bearing on both the choice of the payment medium and the financial soundness of the entity resulting from the former. For example, the Italian bank Monte dei Paschi di Siena took on much debt in order to fund its all-cash acquisition of bank Antonveneta in 2007 which according to some views contributed to its subsequent financial distress (Mackintosh, 2016). Debt-fueled acquisitions may also ultimately have consequences at the aggregate level as it is the case for overseas China's conglomerates purchases which have recently increased

the concerns of the local regulators on the effects of the related spur in debt as noted in Wee (2017). It may therefore be relevant to study the implications of different modes of financing a business combination. The empirical literature used to infer the financing mode from the payment method. Faccio and Masulis (2005) write: *"In making an M&A currency decision, a bidder is faced with a choice between using cash and stock as deal consideration, which have conflicting effects. Given that most bidders have limited cash and liquid assets, cash offers generally require debt financing. As a consequence, a bidder implicitly faces a choice of debt or equity financing"*. However, the implicit assumption that an all-cash or an all-stock offer could generally be a suitable proxy for the source of financing is an oversimplification which may be unwarranted. In fact, while it may be justifiable in the case of an all-stock consideration it does not appear to be so in an all-cash one. In that case a bidder may well

"Per la ypothesi se deve intendere el prosupposito, amesso e concesso fra le parti auctore e adversario, mediante el quale se intende concludere, e negato, non sequita conclusione. E però non se constuma ametterlo se 'l non è possibile". [De la ypothesi]

Luca Pacioli. *De Divina Proportione*. Fontes Ambrosiani 31. Milano, 1956

source the cash required for the operation from an equity issuance, from a debt issuance or from the cash and cash equivalent it disposes of in its accounts.

I relax that implicit assumption in the present study whose main purpose is to investigate the drivers of the payment medium choice in consummated business combinations among financial institutions focusing on the related financing decisions. In doing so, I exploit a dataset that is novel both in terms of scope (number of deals covered, years and countries) and industry sector which comprises financial institutions (including in particular banks and insurance firms). I find that it matters where the consideration is sourced from both for the payment medium choice and the market's reaction at announcement of the business combination. In particular, I find that the amount of equity issued in the year before the acquisition announcement scaled by the acquiring firm lagged total assets is a significant driver of the equity which is then used as a consideration. That finding is robust to a wide array of controls and different model specifications. That result could be read together with a recent paper by de Bodt et al. (2017) who provide evidence of the major role played by the abolition of pooling of interests accounting in the US in the dramatic reduction of the number and volume of M&A paid in equity in that country. Taken together, the results of the present study and theirs would suggest that the abolition of pooling accounting ultimately contributed to the reduction of equity issuances made by US banks. That would be a relevant example of an unintended consequence of the abolition of pooling accounting.

In the present chapter I also investigate whether the source of financing has a bearing on investors' reaction at announcement of the business combination. Employing the methodology of event studies coupled with two nonparametric tests, I provide evidence suggesting that debt-financed acquisitions are associated with higher bidder returns according to both tests in contrast with Schlingemann's (2004).

I also find that all-cash acquisitions financed with financial slack go along with reduced abnormal returns and I try to rationalize and make sense of that finding employing three different possible explanations.

The present chapter contributes to the literature on the determinants of the method of payment choice in business combinations (Gosh and Ruland 1998, Martin 1996, Faccio and Masulis 2005). In fact, I provide evidence suggesting that the amount of equity issued in the year before the acquisition announcement and the amount of debt issued during the six months before the completion of the acquisition are significant drivers of the method of payment choice both statistically and economically. Instead, the literature on the method of payment choice didn't include the financing variables as possible determinants of the former.

On the top of that I use deals involving exclusively financial institutions as a sample which have traditionally been excluded from that literature. I also contribute to the literature that studies the implications of the financing decisions for the gains of the acquirer (Bharadwaj and Shivdasani 2003, Schlingemann 2004, Martynova and Renneboog 2007). Instead of limiting my analysis to the effect of the financing decisions on the bidder gains, I focus on the impact on the method of payment choice allowing for a continuum percentage of cash used as a consideration (not just the distinction between the three cases of full cash payment, full stock payment and mixed payment) and I use the amount of equity and debt issued in some periods before the acquisition announcement or completion as financing variables. Moreover, I include hybrid instruments for US financial institutions.

The rest of the present chapter is organized as follows: section 2 presents the related literature, section 3 the hypothesis based on this literature, section 4 the sample construction and descriptive statistics, section 5 the analysis and its results, and section 6 concludes.

7.2 Related literature

The present chapter is related to the literature that analyses the forces and factors which drive the choice of the payment method in business combinations. I organize the review of the related literature on the payment method choice's drivers around information asymmetries, control issues and behavioral arguments, and I proceed chronologically within the identified factors. Another stream of research the present chapter is related to studies how investments are financed. More generally the present study can also be placed in the stream of literature concerning consolidation in the financial industry.

Carleton, et al. (1983) argue that it is inappropriate to make inferences treating all business combinations as if they were the same irrespective of the exchange medium used.

They employ evidence from the mid-1970s indicating that the probability of stock offer increases in bidder's market-to-book ratio and in the dividend payout ratio. They also mention that tax treatment, accounting treatment, and bidding strategy can affect the use of the stock medium but they are not able to disentangle these factors in their results.

Those shortcomings are partially resolved by the literature that proposed models of acquisition payment choice on the basis of asymmetric information between the target and the competing potential buyers. Hansen (1987) develops a model of bargaining under asymmetric information in which the exchange medium acts as a signal for the acquiring

firm's value. As implied by that model he posits that the use of cash payment is more likely in cases where the target is relatively small with respect to the acquirer. Fishman (1989) obtains similar conclusions even though his model differs from Hansen's (1987) one in that offers are either made in cash or in a risky debt security and are made in a sequential bidding context which allows him to make implications also for cases with multiple bidders. In his model cash offers are made to signal a high valuation for the target, in order to preempt a potential competing bidder. Among the main implications he finds that the probability to observe competing bids is higher after an initial security offer as compared to an initial cash offer. Eckbo et al. (1990) extend the previous models allowing for the use of mixed payments. Their model is also based on two-sided asymmetric information and bidders choose in an equilibrium a mix of cash and stock. They provide evidence based on a sample of 182 takeovers indicating that offers containing both cash and stock result in significantly higher abnormal returns than does a pure-stock offer. In sum, those models show, on the grounds of different motivations, how the presence of informational asymmetries may have a significant impact on bid characteristics in general and on the method of payment in particular. Battigalli et al. (2017) propose a novel theoretical framework which unifies and subsumes the views of the previous analysis. Their model allows them to point out that the both the method of payment and the amount to be paid may depend not only on observable characteristics of the involved parties like for example firm size or the deal materiality but also on each party's beliefs about the opponent's true value. The latter can be influenced by the degree of opacity of the bidder and the target and the model posits that the probability of an all-stock bid increases with the opacity of the target. That prediction is then confirmed by their empirical analysis which is based on 1646 US-based mergers and acquisitions.

The exigency of maintaining corporate control may also have a bearing on the capital structure and the means of payment choice. Amihud et al. (1990) are inspired by the Stulz (1988) model which shows that managers put in place actions in order to avoid losing private benefits of control. Their evidence, based on a sample of 209 acquisitions completed in 1981-1983 paid either in cash or through a stock exchange agreement, supports the hypothesis that the likelihood of an all-cash acquisition is an increasing function of the insiders' ownership percentage in the bidding firm. Martin (1996) refines the results of Amihud et al. (1990), showing that the documented negative relationship between insiders' ownership and the probability of an all-stock combination is valid when the percentage of ownership of the former is in the range 5%-25%. He attributes that result to the fact that the dilution-avoidance incentives of directors and managers of the bidder are highest in that range. His analysis of

his sample of 846 corporate acquisitions also underscores the relevance of the mode of acquisition, the set of investment opportunities of the bidder and the presence of blockholders in the latter as drivers of the method of payment choice. Gosh and Ruland (1998) confirm Martin's (1996) results regarding the non-linear relationship between insiders' stockholdings and the choice of payment. They also find that target management ownership matters when it comes to the determination of the mode of payment. In particular, their analysis, based on a sample of 212 successful acquisitions, suggests that target managers globally owning more than 3% of the target would prefer to receive stock instead of being cashed out and are able to influence the payment choice in that direction in order to ultimately secure job retention. Faccio and Masulis (2005) further corroborate and extend the previous results using a sample of European acquisition announced in the period 1997-2000. In their case, the main explicative variable is the voting stake held by the largest shareholder derived from Faccio and Lang (2002), which in the intermediate range 20%-60% is shown to be a significant driver of the choice to pay for the target shares in cash.

Closely related to the present chapter, Bharadwaj and Shivdasani (2003) show that the source of financing an acquisition do matter both for the characteristics of the acquisition and the market's reaction. In their study regarding the involvement of banks in financing 115 successful cash tender offers in the period 1990-1996 they document that bank-debt-financed tender offers are associated with higher bidder returns, a result they attribute to the screening, certification, and monitoring effect of banks. Also Schlingemann (2004) shows the source of funding has a bearing on bidder's market gains. Considering a sample of 623 all-cash deals in the period 1984-1998 he finds that acquisitions paid for with cash that is likely to have come from equity issues in the fiscal year before the announcement are associated with higher bidder gains. He maintains that the positive returns are due to the resolution of uncertainty regarding the use of funds. The amount of ex-ante debt financing instead does not affect the returns. He argues that this is consistent with the double function of debt which could serve as a monitoring role as well as a restricting role in managerial discretion. In contrast, Martynova and Renneboog (2007) provide evidence derived from the analysis of a sample of European M&A deals in 1993-2001 that those identified as stock-financed cash-paid deals are associated with a negative market reaction in the post-announcement two-month period whereas debt financing appears to be associated with a positive market reaction. They

motivate their result referring to investors being wary of the overvaluation of the shares issued.¹⁴²

The behavioral argument of firms exploiting stock market misevaluation in acquisition was advanced by Shleifer and Vishny (2003). According to their framework overvalued firms use their stock to pay for undervalued or relatively less overvalued targets in order to cash in on the short-term market overvaluation. Di Giuli (2013) finds that acquirers makes seasoned equity offerings around the acquisition date when the consideration is all equity (see table 8 in her paper) and she interprets this as an indication of selling overvalued equity. However, the opportunistic financing hypothesis has recently failed to find empirical support, see Eckbo et al. (2017). They provide evidence, instead, that bidders are more likely to pay in stock when they are related and geographically close to their target and have undertaken a seasoned equity offering around the announcement date¹⁴³.

Tax issues can also be considered when it comes to structure an acquisition as explained by Gilson et al. (1988). However, evidence shows that they do not appear to be able to influence the mode of payment choice in a relevant way- see for example Boone et al. (2014).

Instead, accounting standards proved able to dictate the huge reduction in stock-paid acquisition recorded starting from 2001 mentioned by Boone et al. (2014). Using a difference-in differences test De Bodt et al. (2017) are able to adduce evidence supporting the hypothesis that the huge decline in stock-paid acquisition was mainly driven by the abolition of the pooling-of-interest method dictated by SFAS 141¹⁴⁴. They also find that the presence of the acquirer's CEO variable compensation package was an important channel between pooling abolition and stock-payment reduction in M&A transactions. Clearly, accounting standards, in particular those related to business combinations, are not supposed to change oftentimes, especially in the case of a major overhaul as it was the case with the abolition of

¹⁴² See also Vladimirov's (2015) model of financing bidders in takeover contests where the payment choice is endogenized.

¹⁴³ See also Jensen (2005) for an interesting critique of the Shleifer and Vishny (2003) argument based on the agency costs of overvalued equity. He notes that "[Shleifer and Vishny] allow markets to make mistakes in valuation of companies, but assume that managers are perfectly informed and rational. However, because they also assume that mergers have "no long run real consequences" their very useful analysis misses the point that I am emphasizing here: how mistaken market valuations create organizational forces that destroy long run value." He also mentions the example of Nortel which exploited its overvalued stock to acquire real asset at less than their economic value in 1997-2001 and according to the arguments in Shleifer and Vishny would have benefited its shareholder even if the price would later fall. However, as Jensen shows "the eventual price decline suffered by Nortel involved far more than the elimination of its overvaluation; it involved a significant destruction of Nortel's core value, mainly through acquisitions and overinvestment." Another issue with the Shleifer and Vishny's framework is that it does not account for mixed offers as pointed out by Betton et al. (2008) "Mixed offers are an enigma in the model of Shleifer and Vishny (2003)".

¹⁴⁴ See also Ali and Kravet (2016).

the pooling method. Their importance, however, cannot be overstated in particular when it comes to make sense of the temporal evolution of the mode of payment choice phenomenon. The present chapter is also related to studies on financing choice between debt and equity see Hovakimian et al. (2001) and the determinants of the capital structure of financial institutions, Gropp and Heider (2010). More generally the present study can also be placed in the stream of literature concerning consolidation in the financial industry, for a complete review of that literature see for example Berger et al. (1999) and DeYoung et al. (2009).

7.3 Hypothesis based on related literature

7.3.1 Source of financing

In order to establish a link between the mode of financing and the method of payment adopted in a business combination, it would ideally be useful to retrieve a piece of information which allows to find the precise provenance of each euro employed in the payment. However, that information is in practice oftentimes not available and even if it were it would be unverifiable. Therefore, I build two variables (EQUITY_IS, DEBT_IS in the main specification) which, in the context of the model presented hereafter, would permit to infer the existence of that link. Those variables are constructed in two steps. Firstly, I match each acquiring entity to the amount of equity¹⁴⁵ (debt) issued (raised) in the offering in the 365 days before the announcement of the transaction excluding fees and other expenses and including any amounts not sold directly by the issuing entity. Secondly, I sum those amounts and I normalize the latter using the lagged value of total assets of the issuing entity in the relevant fiscal year.¹⁴⁶ Those two variables would contribute to allow me to assume away the correspondence cash offers debt financing and equity offers equity financing (Table 7-1) made in the relevant literature and consider instead the other possibilities (Table 7-2).

¹⁴⁵ I include both private and public equity issues.

¹⁴⁶ As a further refinement properly adjusted financing variables would account for the number of acquisitions made by a given acquirer in a given time interval, the relative size of the targets in those acquisitions and how the latter are temporally grouped.

Table 7-1 General assumptions

Mode of payment	Mode of financing
Equity payment	Equity
Cash payment	Debt
Mixed payment	Equity&Debt

Table 7-2 Possibilities considered

Mode of payment	Mode of financing
Equity payment	Equity (both existing and newly issued)
Cash payment	Issued Debt Existing Cash Issued Equity
Mixed payment	A mixture of the previous ones without the exclusion of equity

Besides those financing modalities there could be others that may be relevant for institutions in the financial sector. One is loans made by other financial institutions or by state entities. Hybrid instruments are another example like convertible bonds. In the financial sector demand deposits are a major source of funds for banks and insurance premia are a relevant funding source for insurers.

The literature has proposed some frameworks which allow to make sense of the financing decisions of a firm. The pecking order theory is one important framework in that matter. That theory assumes that capital structure decisions are driven by information asymmetry between the managers of the issuing firm and market participants, see Myers (1984) and Myers and Majluf (1984). In its strong form the theory posits that firms would make use of equity just as a last resort. In other words equity would be the last in the pecking order after cash available, debt and convertible debt. In a modified version advanced in Myers and Majluf (1984) the theory doesn't exclude the trade-off between adverse selection costs and the costs of increased bankruptcy risk due to debt issuance. According to that version of the theory firms may issue equity instead of debt in order to reduce the liquidity risk and ensure debt capacity for future investments.

Jensen's (1986) free cash flow theory has, instead, some implications for the market reaction of a takeover on the basis of the source of funding. In his framework the issuance of debt reduces "the agency costs of free cash flow by reducing the cash flow available for spending at the discretion of managers", (Jensen, 1986, p.324). This control and disciplining function

of debt would lead to the hypothesis that debt-financed-acquisitions would result in higher gains than stock-financed-ones¹⁴⁷.

On that basis I expect financing variables to matter both in relation with the method of payment choice and in relation with the market reaction at the announcement of the transaction. It is, however, necessary to verify that that relationship is not affected by the inclusion of other variables proposed by the literature, which are considered hereafter.

7.3.2 Price to book-bidder investment opportunities

One of such variables is the Price-to-book ratio. Jung et al. (1996) (see table 2 in their paper) report a higher use of equity financing for bidders with a higher price-to-book defined as the ratio between the market value of equity plus the book value of total assets minus the book value of equity and the book value of assets. They also find that price-to-book has a considerable explanatory power on the basis of its positive impact on the pseudo-R squared. A high price-to-book is interpreted as an indicator of substantial investment opportunities. In the context of mergers, the prospect of future investment opportunities of the bidder may also make the seller less reluctant to accept equity as a form of payment as shown by Faccio and Masulis (2005)¹⁴⁸ and Boone et al. (2014). A high price-to-book may also be a sign of overvaluation which would be exploited by bidder's managers using equity as a currency in the merger payment. In either case there are no evident reasons to suppose that the influence of price-to-book (PRICEBOOK) on the method of payment would be different in transactions among firms in the financial sector. In what follows I define price-to-book as price as a percent of book value per share and it is measured at the end of the fiscal year before the acquisitions' announcement.¹⁴⁹

7.3.3 Relative deal size

I control for the size of the target relatively to the size of the acquirer with the variable REL_SIZE. I measure the relative size as the deal value¹⁵⁰ divided by the book value of total

¹⁴⁷ Moreover, Harford (1999) documents that acquirers with large cash availabilities make value-destroying acquisitions.

¹⁴⁸ They define price-to-book as the market value of equity plus book value of debt over the sum of book value of equity plus book value of debt prior to the bid.

¹⁴⁹ Book value is calculated using financial period end common equity and common shares outstanding values.

¹⁵⁰ i.e. the total consideration accrued to the sellers which includes only the price paid for equity and not the assumption of any obligations of the entity sold. I also consider measuring the deal value including the effect of assumption of the target's outstanding debt obligations.

assets of the acquirer. A relatively large target may entail more risks for the acquirer who may consequently want to exploit the risk-sharing contingent-like features of a payment in equity coupled with increased costs for a longer due diligence. On the other hand an equity payment for a relatively large target may result in the creation of a new blockholder especially in the case of a target concentrated ownership and a corresponding weakened power for the original bidder blockholder and that would lead to the use of cash. In order to address the latter possibility I include an additional control variable, detailed hereafter, which would allow me to capture the second effect. Therefore, I expect that the former effect will prevail in the empirical analysis.

7.3.4 Leverage

Leverage is another pervasive variable in the empirical literature studying the drivers of the method of payment choice and firms' capital structures. The evidence on its effects is mixed. Kooyul et al. (1996) document an insignificant effect of leverage, as measured by long-term debt to total assets, on the firms' choice to issue equity instead of debt. Similarly Martin (1996) finds that leverage¹⁵¹ of the bidder has no effect on the method of payment choice. However, both Faccio and Masulis (2005) and Boone et al. (2014)¹⁵² report a higher incidence of payments in stock for firms with a high leverage. They justify their finding noting that highly leveraged acquirers would incur higher cost in issuing new debt with respect to less leveraged firms and that would result in avoiding payments in cash which they assume derived primarily from new debt-issuances. I also include leverage as a control variable defined as $1 - \text{Equity} / \text{Total assets}$ measured at the end of the fiscal year before the acquisition announcement.

7.3.5 Top blockholder control

Controlling shareholders may enjoy private benefits from the power they can exert on the firm they control. It can therefore be conjectured that they may be unwilling to forgo those benefits as it may be the case with the creation of another blockholder. The latter occurrence may be favored when the consideration is in equity especially in presence of a blockholder in the target firm whose size is relatively large with respect to the bidder. Therefore, the

¹⁵¹ Computed as “*the difference between the acquiring firm's debt-to-capital ratio and the average debt-to-capital ratio for its industry based on the 2-digit Standard Industrial Classification (SIC) code*” i.e. adjusted for the industry mean.

¹⁵² Measured to capture the post deal debt and as long and short-term debt scaled by book value of assets respectively.

shareholder structure of the bidder might have a bearing on the method of payment choice and may drive out the possible effect of the financing variables. In order to control for that possibility I build the variable OS_TOP which associates to a given bidder's parent the percentage of shares outstanding owned by the largest shareholder in the month before the acquisition announcement. However, the effect of the presence of blockholders may be relevant only when the percentage of share subscribed by the top shareholder is not too small or too large i.e. below a given cutoff and above another cutoff. In fact if it were above that cutoff the blockholder may not going to lose control anyway and if it were below either she didn't have control even before the acquisition or if she did have control it may mean that the latter it is not derived from the ownership of the bidder's shares. In any case in order to account for that possibility of control issues being relevant only over an intermediate range I build two indicator variables based on the variable OS_TOP, OS_20_60 which is valued 1 if OS_TOP is between 20% and 60% and 0 otherwise, and OS_15_p95 which is defined on the basis of the percentiles. I use Factset to retrieve the percentage of shares outstanding subscribed by the largest shareholder.

I also control for some variables strictly related to the target firm.

7.3.6 Listed sellers

The variable SELLER_L is valued 1 if the acquired firm is listed and 0 otherwise. A seller who would wish to cash in on the divestiture of one of her unlisted controlled firms may prefer to be paid in cash and use the proceeds to finance in part an acquisition for example. Also a buyer would prefer an all-cash consideration for an unlisted firm especially in light of the control issues mentioned in the previous paragraph in that the ownership structure of an unlisted company is generally more concentrated than that of a listed one. However, a stand-alone unlisted firm may be smaller, younger and ultimately more opaque than a listed firm which would mean a high asymmetric information about the value of its asset. And that would make the bidder more favorable to a stock consideration on the basis of the models seen in the related literature section.

7.3.7 Cross border deals

A seller who is located in a country different from the buyer's one may be wary to accept equity as a consideration in that either he may not be familiar about the equity market the buyer is listed on and that would cast some doubts on the value of the latter's shares or in

general he may prefer to hold domestic equities as the home bias in equities first documented by French and Poterba (1991) would suggest. I account for that possibility adding a CROSSBORDER dummy variable valued 1 if the deal is cross-border and 0 otherwise.

7.3.8 Other issues

Other factors besides those considered above may in part account for the variability of the method of payment choice and may drive out the hypothesized effect of the financing variables. Firstly, from the geographical point of view, there are various levels of creditor and shareholder rights across countries and that may have a bearing on the debt-equity financing choice. Different countries may also implement different merger control policies which can influence merger characteristics beyond preventing anticompetitive deals as documented by Carletti et al. (2016) in the European banking sector. Secondly, from the temporal point of view, the incentives to issue debt instead of equity may vary over the years. During a period of stock overvaluation such as the dot-com bubble around the year 2000 for example there may have been a preference for stock whereas in a periods when debt is highly demanded debt may be the preferred form of financing. Therefore, I add variables in order to address those issues in the empirical analysis.

7.4 Sample construction and descriptive statistics

The construction of the dataset is the result of five steps. Firstly, I obtain the list of mergers and acquisitions involving financial institutions completed in the period 01/01/1999-30/04/2017 from SNL Financial¹⁵³ Mergers&Acquisitions. Secondly, I use the dataset containing all capital issues and I write a code which allows me to match to each buyer the equity issues and debt issues made by the latter in the period comprised between the day of announcement and one year before that date. Once I run the code I obtain a missing value if the buyer in the Mergers&Acquisitions dataset is not included in the capital issues dataset, and the sum of the amount issued in that period both of equity capital and of debt separately if instead the buyer is included in the latter dataset. Thirdly, I match the lagged accounting variables contained in the dataset on company fundamentals. Fourthly, I retrieve from Factset

¹⁵³ SNL financial is a subsidiary of S&P Global Inc. since 2015 (see Bray, 2015). S&P Global Inc. (prior to April 2016 McGraw Hill Financial, Inc., and prior to 2013 McGraw Hill Companies) is an US listed corporation headquartered in New York City. Its main areas of activity are financial information and analytics. It is the parent company of S&P Global Ratings, S&P Global Market Intelligence, and S&P Global Platts, and is the majority owner of the S&P Dow Jones Indices joint venture.

the data on the ownership share subscribed by the acquirer's largest shareholder at the end of the month before acquisitions' announcement and I combine those data with the dataset built in the previous steps. Finally, I use CRSP accessed through WRDS in order to get data on US stock prices and indices. Besides the screens mentioned before, I require that the buyer is a public firm and obtains control of the target in the transaction. I also require that the deal's announcement is followed by consummation and the information on the method of payment is available¹⁵⁴. Then I extract the information related to the percentage of equity and cash paid from the data field description of consideration which reports the disclosure made directly by the acquirers. At the end of that process I obtain a sample of 5669 consummated deals whose descriptive statistics are presented in the next paragraph.

Figure 7-1 shows the geographic scatter of the deals in the sample by acquirer's country. Given the high frequency of M&A transactions in the USA, I exclude the latter in figure 7-2 where the United Kingdom is followed by Canada in the deals count. Table 7-3 reports the number of deals in the sample for each couple of buyer's country and seller's country. About one in every five deals is cross-border.

¹⁵⁴ I do a crosscheck with SDC from Thomson One.

Figure 7-1 Geographic repartition

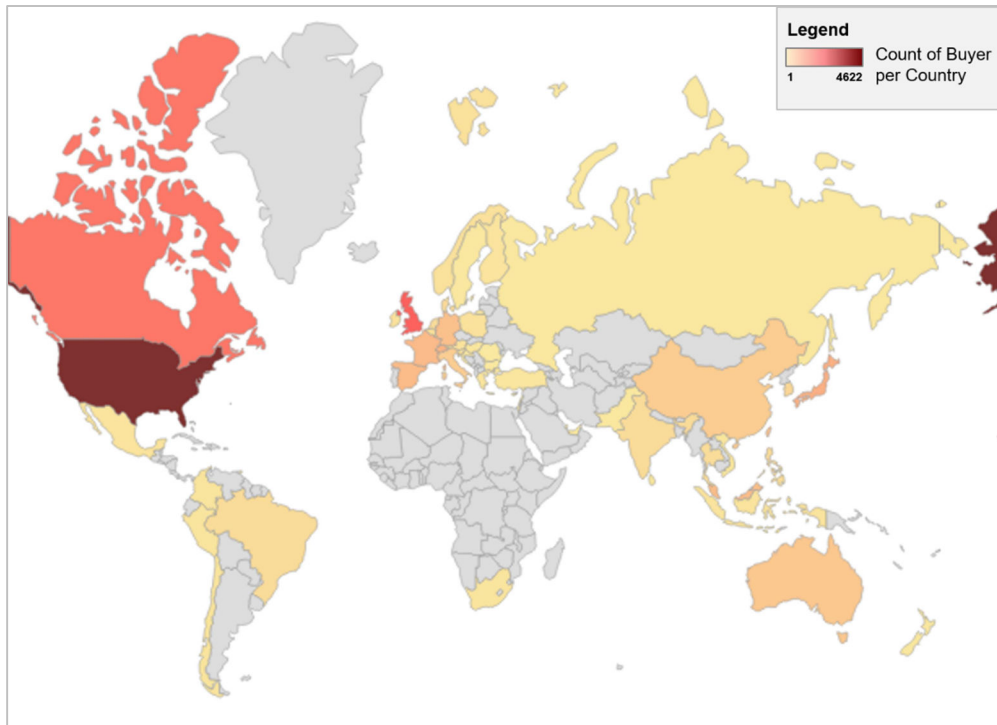
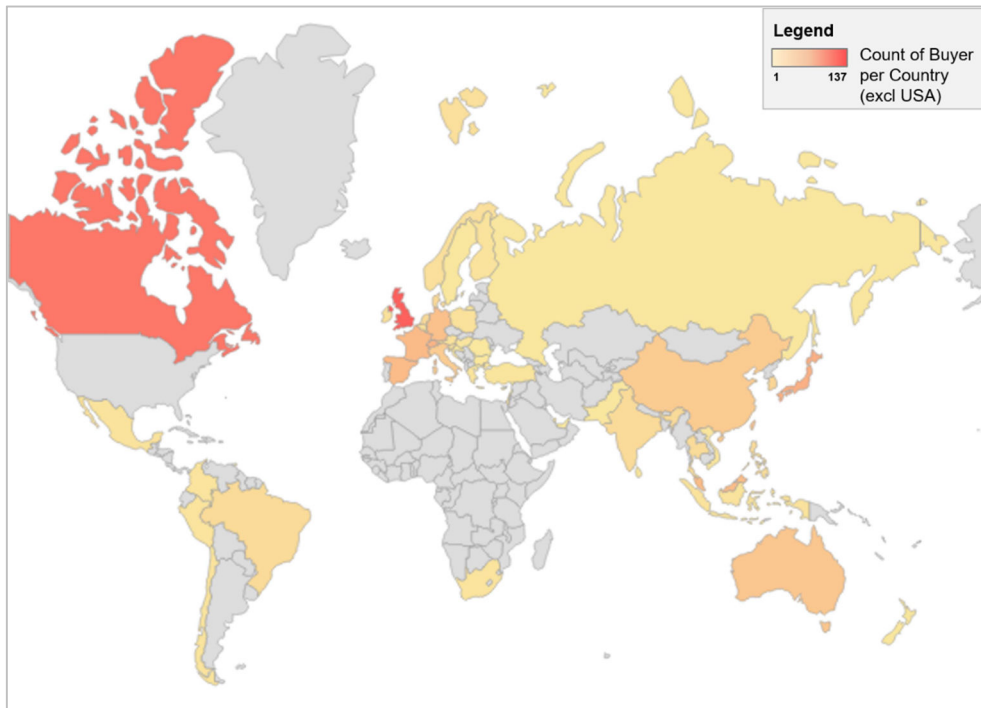


Figure 7-2 Geographic repartition excluding the USA



In table 7-4 I present the temporal repartition of the deals classified by method of payment.

Table 7-4 Yearly deal repartition

Completion Year	Stock only	Cash only	Mixed payment	Total
1999	178	110	37	325
2000	162	117	45	324
2001	103	98	63	264
2002	47	114	63	224
2003	41	111	80	232
2004	57	159	128	344
2005	33	162	116	311
2006	39	178	123	340
2007	28	212	118	358
2008	33	221	78	332
2009	27	139	31	197
2010	27	203	40	270
2011	31	183	53	267
2012	26	223	78	327
2013	33	210	61	304
2014	34	223	110	367
2015	51	246	117	414
2016	36	243	89	368
2017	20	51	30	101
<i>Total</i>	1,006	3,203	1,460	5,669

Overall about 56% deals were all-cash, 26% involved both cash and stock whereas 18% were all-stock. However, those percentages largely varied across the years. The exchange of equity shares was the predominant method of payment in the period 1999-2001 with 54% of the deals paid in stock in 1999 and about 50% in 2000 followed by cash and mixed payments. Then, starting from 2002 the frequencies of the method of payment swapped places and payment in cash became predominant reaching the top at 75% in 2010 while mixed payments increased up to 37% in 2004 partly compensating for the steady decline in all-stock payments which plummeted to their minimum in 2007 when only 7,8% of the deals consummated adopted that form of payment. These values are substantially in line with those reported by de Bodt et al. (2017) for non-financial firms. Moreover, given the dominance of US buyers in my sample, I can attribute the reversal in stock payment in 2002 to the abolition of the pooling-of-interest method dictated by the FASB in 2001. However, the fact that the minimum in the percentage in stock payments by non-financial institutions is reached later than those by financial institutions may indicate that the latter were more involved in the

consequences produced by the subprime mortgage crisis commenced in August 2007 and were aware of its effects.

The drilldown on transactions with a bank acquirer shown in table 7-5 is even more clear-cut.

Table 7-5 Banks only

Completion Year	Stock only	Cash only	Mixed payment	Total
1999	148	49	28	225
2000	120	57	29	206
2001	78	44	41	163
2002	35	52	54	141
2003	25	53	60	138
2004	44	68	90	202
2005	22	64	81	167
2006	28	70	91	189
2007	20	84	92	196
2008	29	73	46	148
2009	16	46	11	73
2010	12	53	8	73
2011	22	48	30	100
2012	14	72	37	123
2013	24	63	48	135
2014	26	87	70	183
2015	40	84	87	211
2016	29	81	71	181
2017	17	15	28	60
<i>Total</i>	749	1,163	1,002	2,914

In 1999 the deals paid in equity by a bank acquirer were more than three times those paid only in cash and those paid in equity in 2000 were more than two times those paid cash that year. From 2002 the same trend change mentioned before is observed. However, here the mixed payment appear to play a more relevant role in that it partly took the place the stock payments had in the years before 2002. In fact mixed payments were the dominant form from that year up to 2008 when they gave place to cash payments as the most common form of payment used by banks. The previous literature already recognized the relevance of stock payments for banks. Becher (2000) reports in his table 7 that in the period 1991–1997 69% of acquisitions by a listed bank acquirer were paid in stock versus 52% for all public firms. Also Houston and Ryngaert (1997) mention similar values. In principle, banks should have looked favorably upon stock payments in that they generally prevent the reduction of their capital ratio typical of cash offers and are more suitable to the generally longer delays required by the merger control regulation which makes it difficult for the acquiring bank to consummate a deal rapidly with cash.

Table 7-6 reports the number, mean and median for the main explanatory variables by method of payment. On average cash payers appear to issue more debt than stock payers who instead make more equity issues than the former during the year before announcement of the transaction, which could be in line with the presence of a relationship between the mode of financing and the payment method. Moreover, cash-payer acquirers are larger (around 95 billion euros versus 57 billion euros) and have a substantially higher return on average assets as shown by the ROAA variable (about 3.1% versus 0.9%) which in part accounts for their greater cash availability (see the CASH_EQ variable) also with respect to total assets compared to stock-only payers. The latter have a higher price-to-book ratio compared with cash-payers¹⁵⁵ and are more leveraged as indicated by the corresponding variable measuring the debt-asset ratio. On average the top shareholder in cash payers holds about 7.6% of shares compared with 5.7% for top shareholders in stock payers acquirers and that may be consistent with entrenched blockholders' use of the method of payment to prevent the possibility of losing control and the related benefits after the transaction's completion.

Financial institutions appear to be more reluctant to pay in stock for a target that is located in another country. As shown by the CROSSBORDER variable overall about one of every five deals is cross-border but that percentage falls to 3% for all-stock payers and jumps to 31% for all-cash payers¹⁵⁶. Acquirers paying in both equity and cash are smaller than the other categories and appear akin to stock-payers in terms of the CROSSBORDER variable (only 6% are cross-border). However, acquirers who use a mixed payment are similar to cash payers with respect to the mean of the variables OS_TOP, PRICEBOOK, ROAA and are between stock and cash payers with respect to average leverage. It may be that under the label "mixed payment" are grouped transactions that are not simply a mixture of the other categories but possess their own distinctive characteristics.

¹⁵⁵ Damodaran (in his website accessed in 2017) reports a price-to-book around 196% for the financial services industry in general in January 2017 and 145% for banks.

¹⁵⁶ Faccio and Masulis (2005) report a much higher percentage for stock only payers i.e. 31%. It may be that financial institutions are more reluctant to pay in stock for their foreign targets also for regulatory reasons.

Table 7-6 Descriptive statistics by payment method (See Appendix 1 for variable definitions)

PYMT mode	Variable name	N	mean	median
Stock only	GR_AMNT_DEBT_IS_365	1006	539641	0
	GR_AMNT_EQUITY_IS_365	1006	250819	0
	PRICEBOOK	1006	215.5654	195.996
	LEVERAGE	1006	86.652750	90.6124
	TOT_ASSETS000	1006	57755706	3452295
	ROAA	1006	0.9083992	1.127664
	CASH_EQUIV000	1006	4800571	149678
	OS_TOP	527	5.78422	5.04910
	CROSSBORDER	992	0.0352823	0
	SELLER_LISTED	1006	0.2256461	0
Cash only	GR_AMNT_DEBT_IS_365	3203	662961	0
	GR_AMNT_EQUITY_IS_365	3203	211250	0
	PRICEBOOK	3203	201.35950	165.68410
	LEVERAGE	3203	76.40964	86.00188
	T_ASSETS000	3203	95142337	4157988
	ROAA	3203	3.15742	1.44347
	CASH_EQUIV	3203	10062654	237935
	OS_TOP	2263	7.64321	7.15150
	CROSSBORDER	3066	0.3134377	0
	SELLER_LISTED	3203	0.2316578	0
Mixed payment	GR_AMNT_DEBT_IS_365	1460	303940	0
	GR_AMNT_EQUITY_IS_365	1460	79366	0
	PRICEBOOK	1460	202.92460	180.66070
	LEVERAGE	1460	81.36625	88.98837
	T_ASSETS000	1460	17840913	2334567
	ROAA	1460	2.13052	1.16910
	CASH_EQUIV	1460	1761546	103749
	OS_TOP	963	7.52514	7.46420
	CROSSBORDER	1446	0.0643154	0
	SELLER_LISTED	1460	0.3109589	0
Total	GR_AMNT_DEBT_IS_365	5669	548614	0
	GR_AMNT_EQUITY_IS_365	5669	184306	0
	PRICEBOOK	5669	204.28350	175.57060
	LEVERAGE	5669	79.50387	88.61466
	T_ASSETS000	5669	68599556	3145530
	ROAA	5669	2.49385	1.26019
	CASH_EQUIV	5669	6990988	164753
	OS_TOP	3753	7.35187	7.08690
	CROSSBORDER	5504	0.1978561	0
	SELLER_LISTED	5669	0.2510143	0

Overall, the descriptive statistics suggest that the proposed financing and control variables may be relevant in explaining the method of payment choice and are generally consistent

with the arguments expounded in the previous section. Nonetheless, in order to estimate the effects of changes in those variables on the method of payment and assess their pertinence an analysis is warranted, which I present in the next section.

7.5 Methodology and results

As a first step I estimate the following model using ordinary least squares (OLS)¹⁵⁷ adding one control variable at a time in order to assess how that modifies the magnitude and statistical significance of the financing variables.

$$(1) \text{ Cash in consideration}\%_{it} = \beta_0 + \beta_1 \frac{\text{Debt_Issue}_{it-1}}{\text{TotalAsset}_{it-1}} + \beta_2 \frac{\text{Equity_Issue}_{it-1}}{\text{TotalAsset}_{it-1}} + \beta \text{ Control variables}_{it-1} + [\text{Year FE} + \text{Country FE}] + \varepsilon_{it}$$

And in terms of the variables:

$$(1') \text{ CONS_CASH}_{it} = \beta_0 + \beta_1 \text{DEBT_IS}_{it-1} + \beta_2 \text{EQUITY_IS}_{it-1} + \beta \text{ CONTROLS}_{it-1} + [\text{YEAR FE} + \text{COUNTRY FE}] + \varepsilon_{it}$$

Where the percentage of cash paid in the consideration is measured for the bidding firm i who announced the deal at time t and analogously for the other variables whose definitions are reported in table 7-13 in appendix 1. Table 7-7 presents the results. Without the inclusions of the control variables (column 1) the amount of debt issues in the year before the announcement scaled by total asset (DEBT_IS) has a significant and positive effect on the fraction of the consideration paid in cash whereas the effect related to the amount of equity issued is insignificant consistent with debt being issued to fund a cash bid. Adding the price-to-book variable doesn't substantially change the effects just reported. In contrast, the sign of the estimated coefficient of EQUITY_IS becomes significantly negative after the inclusion of LEVERAGE suggesting that stock-payer bidder tend to make at least a substantial equity offering in the year preceding the transaction announcement. Also the effect of LEVERAGE is negative and significant consistent (t-stat<-19) with indebted financial institutions prefer to use an exchange of stock as payment finding it difficult to issue more debt. Faccio and Masulis (2005) report a similar effect of leverage whereas de Bodt et al. (2017) in their table 4 and Eckbo (2017) for their US sample of non-financial institutions find that acquirer

¹⁵⁷ From some overall tests, conclusions not significantly different can be obtained by the use of a Tobit model instead of OLS.

leverage decreases the probability¹⁵⁸ of full stock payments. Adding LT_ASSET, however, makes DEBT_IS lose its statistical significance. Larger firms are more inclined to use cash and avoid the use of stock as a consideration than smaller firm also for possibly eluding the generally higher preemptive rights as noted by legal scholars. The acquirer size variable has a notable explanatory power in that if it is omitted the adjusted R^2 falls by more than one-third.

Table 7-7 Baseline specification

The table reports the coefficient estimates from ordinary least squares regressions (OLS). The dependent variable is CONS_CASH i.e.% of the consideration at completion paid in cash. All variables are defined in Appendix 1, Table 7-13. The sample is 5,669 completed M&A deals by public acquirers in the 1999 to 2017 period. The t-statistics are in parentheses, using robust standard errors. * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
DEBT_IS	0.412*** (3.76)	0.462*** (4.18)	0.218* (2.03)	0.171 (1.62)	0.120 (1.13)	0.154 (1.47)	0.154 (1.47)
EQUITY_IS	0.0228 (0.47)	0.0327 (0.68)	-0.154** (-3.24)	-0.110* (-2.35)	-0.188*** (-3.89)	-0.259*** (-5.34)	-0.255*** (-5.26)
PRICEBOOK		-0.000142** (-3.04)	-0.000375*** (-8.01)	-0.000387*** (-8.46)	-0.000444*** (-9.54)	-0.000518*** (-11.04)	-0.000545*** (-11.56)
LEVERAGE			-0.00601*** (-19.75)	-0.00792*** (-24.64)	-0.00741*** (-22.39)	-0.00647*** (-18.75)	-0.00641*** (-18.63)
LT_ASSETS				0.0388*** (15.84)	0.0376*** (15.35)	0.0363*** (14.90)	0.0380*** (15.48)
ROAA					0.00572*** (6.25)	0.00642*** (7.04)	0.00639*** (7.02)
CASH_EQ						0.00557*** (8.94)	0.00557*** (8.96)
SELLER_L							-0.0610*** (-5.04)
CONSTANT	0.666*** (116.26)	0.694*** (63.85)	1.227*** (42.38)	0.786*** (19.80)	0.764*** (19.21)	0.678*** (16.67)	0.669*** (16.48)
<i>N</i>	5669	5669	5669	5669	5669	5669	5669
R^2	0.003	0.005	0.069	0.108	0.114	0.127	0.131
adj. R^2	0.003	0.004	0.068	0.107	0.113	0.126	0.129

Ceteris paribus, acquirers with a higher ROAA and cash and cash equivalents relatively to total assets have a higher propensity to use payments in cash than acquirers with smaller values of those variables and in the presence of private targets acquirers tend to choose stock

¹⁵⁸ They adopt a linear probability model.

as a consideration. Overall, after the inclusion of those control variables the estimated coefficient of the variable EQUITY_IS is still negative, significant (t-stat=-5.26), economically important and taken together with the coefficient of DEBT_IS is consistent with the tenets of the pecking order framework. In particular, according to the estimated model in column 7 of table 7-7, *ceteris paribus*, an increase in the variable EQUITY_IS by one standard deviation around its mean is associated with a decrease in the predicted percentage of the consideration paid in cash by 3 percentage points. However, omitted variables and other factors can potentially drive out the estimated predicted influence of the financing and control variables. In order to partly assuage these concerns I estimate the model (1) including year and country fixed effects.

As shown in table 7-7 the effect of both financing variables is statistically significant in column 1, 2 and 4. The inclusion of year fixed effects lowers the magnitude and statistical significance of the DEBT_IS variable, though. Therefore, the effect of business cycles and a demand for debt which is stronger in certain years than in others tend to partly drive out the effect on the method of payment choice captured by the DEBT_IS variable. However, a modification of that variable which I'll present in the next section will show that the inclusion of year fixed effects doesn't affect the significance of what substantially measured by that variable

In table 7-8 I also control for year and country fixed effects and for deals where the country of the buyer is different from the country of the seller (CROSSBORDER dummy).

Confirming what pointed out in the previous section, financial institutions are reluctant to make stock-for-stock mergers or employing stock in the consideration when the seller is a foreign firm. By the same token, acquirers tend to employ less stock in the consideration when the seller is private as indicated by the estimated coefficient of the statistically significant SELLER_L dummy variable which is valued 1 if the seller is listed and 0 otherwise. That might be due to the fact that non-listed sellers generally have a more concentrated ownership structure and the use of stock as a means of payment may reduce the control of controlling shareholders of the buyer.

In fact, another possibility which could lead to limit the use of stock as a means of payment is related to control issues, in particular in the presence of blockholders. I address that possibility adding OS_TOP in my set of control variables, which makes the number of observations drop to 3753 in column 1 given that I couldn't retrieve the information on the variable OS_TOP for all acquirers.

Table 7-8 Inclusion of year and country fixed effects and cross-border dummy

The table reports the coefficient estimates from ordinary least squares regressions (OLS). The dependent variable is CONS_CASH i.e.% of the consideration at completion paid in cash. All variables are defined in Appendix 1, Table 7-13 The sample is 5,669 completed M&A deals by public acquirers in the 1999 to 2017 period. Also estimated, but not reported, is a constant term. The t-statistics are in parentheses, using robust standard errors. * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$.

	(1)	(2)	(3)	(4)	(5)
	CONS_CASH	CONS_CASH	CONS_CASH	CONS_CASH	CONS_CASH
DEBT_IS	0.219* (2.10)	0.289** (2.78)	0.177 (1.71)	0.288** (2.78)	0.163 (1.59)
EQUITY_IS	-0.243*** (-5.12)	-0.261*** (-5.53)	-0.251*** (-5.35)	-0.257*** (-5.45)	-0.243*** (-5.22)
PRICEBOOK	-0.000487*** (-10.48)	-0.000462*** (-9.71)	-0.000401*** (-8.18)	-0.000492*** (-10.28)	-0.000435*** (-8.90)
LEVERAGE	-0.00557*** (-16.09)	-0.00583*** (-16.73)	-0.00527*** (-14.84)	-0.00578*** (-16.62)	-0.00505*** (-14.26)
LT_ASSETS	0.0175*** (6.67)	0.0136*** (4.83)	0.0125*** (4.47)	0.0155*** (5.47)	0.0154*** (5.52)
ROAA	0.00639*** (7.16)	0.00639*** (7.20)	0.00591*** (6.73)	0.00636*** (7.18)	0.00576*** (6.59)
CASH_EQ	0.00318*** (5.06)	0.00243*** (3.75)	0.00243*** (3.77)	0.00245*** (3.78)	0.00249*** (3.88)
CROSSBORDEI	0.258*** (18.39)	0.211*** (12.65)	0.204*** (12.40)	0.210*** (12.64)	0.202*** (12.30)
SELLER_L				-0.0597***	-0.100***
Year FE	NO	NO	YES	NO	YES
Country FE	NO	YES	YES	YES	YES
<i>N</i>	5504	5503	5503	5503	5503
<i>R</i> ²	0.177	0.197	0.226	0.201	0.235
adj. <i>R</i> ²	0.176	0.188	0.214	0.191	0.223

As table 7-9 shows EQUITY_IS doesn't lose its statistical significance whereas DEBT_IS does. Moreover, not only is OS_TOP statistically insignificant but its estimated coefficient also changes sign after the inclusion of the CROSSBORDER variable¹⁵⁹.

¹⁵⁹ In unreported results available upon request I build a dummy variable valued 1 if the top holder owns between 20% and 50% of the outstanding shares of the bidding firm at the parent company level. Including that variable, whose coefficient results positive and significant at the 5% level, slightly reduces the significance of the EQUITY_IS variable similarly as in table 7-8. The former effect may suggest that control issues kick in when control of the bidder's top holder deriving from the ownership of voting shares is at a such a level as risking being endangered by a stock- paid transaction.

Table 7-9 Inclusion of year and country fixed effect and OS_TOP control variable

The table reports the coefficient estimates from ordinary least squares regressions (OLS). The dependent variable is CONS_CASH i.e.% of the consideration at completion paid in cash. All variables are defined in Appendix 1, Table 7-13. The sample is 3,753 completed M&A deals by public acquirers in the 1999 to 2017 period. Also estimated, but not reported, is a constant term. The t-statistics are in parentheses, using robust standard errors. * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$.

	(1) CONS_CASH	(2) CONS_CASH	(3) CONS_CASH	(4) CONS_CASH
DEBT_IS	-0.0358 (-0.32)	0.0736 (0.65)	0.0742 (0.65)	0.0638 (0.56)
EQUITY_IS	-0.173* (-2.04)	-0.226** (-2.67)	-0.226** (-2.67)	-0.211* (-2.52)
OS_TOP	0.00524 (0.41)	0.00379 (0.29)	-0.00310 (-0.24)	-0.00719 (-0.56)
PRICEBOOK	-0.000284*** (-5.00)	-0.000288*** (-5.01)	-0.000330*** (-5.74)	-0.000363*** (-6.33)
LEVERAGE	-0.00613*** (-14.29)	-0.00629*** (-14.70)	-0.00571*** (-13.10)	-0.00551*** (-12.69)
LT_ASSETS	0.0396*** (13.36)	0.0262*** (7.79)	0.0196*** (5.75)	0.0224*** (6.55)
ROAA	0.00449** (3.22)	0.00440** (3.20)	0.00447** (3.28)	0.00430** (3.17)
CASH_EQ	0.00471*** (6.71)	0.00355*** (4.93)	0.00287*** (3.98)	0.00296*** (4.12)
CROSSBORDER			0.191*** (10.56)	0.188*** (10.47)
SELLER_L				-0.0923*** (-6.77)
Year FE	YES	YES	YES	YES
Country FE	NO	YES	YES	YES
<i>N</i>	3753	3734	3632	3632
<i>R</i> ²	0.170	0.212	0.236	0.246
adj. <i>R</i> ²	0.164	0.197	0.222	0.231

Overall, the results indicate that the choice of the payment method made by the financial institutions involved in a deal in my sample is accompanied by a precise choice of the mode

of financing. In particular, the amount of equity issued in the year before the acquisition announcement is a good predictor of the amount of equity employed as a consideration.

7.6 Further analysis

In order to assess the validity and robustness of the previous results I conduct three additional analysis which entail different specifications of the financing variables, the first two, and of the dependent variable, the third one.

Firstly, I build three new variables. DEBT_FIN valued one if the acquiring firm made at least one debt issuance in the year before announcement of the business combination and issued only debt, EQUITY_FIN valued one if the acquiring firm made at least one equity issuance in the year before announcement of the business combination and issued only equity and MIX_FIN valued one if the acquiring firm made at least one equity issuance and one debt issuance in the year before announcement of the business combination. Those three variables partition the space of deals into four mutually exclusive sets i.e. the one comprising only debt issuances, the one of only equity issuances, the one of both and the one where neither of the two was issued in the year before announcement which can correspond to deals funded thanks to the acquiring firm's financial slack. Table 7-10 presents the result of the OLS regression which includes the financing variables rephrased as the three dummies.

I add one control at a time but for presentation sake I don't report all the cases in that they don't add much to the discussion. In column 4 I also add year and country fixed effects. That inclusion increase the significance of the three financing variables dummies. In particular the estimated coefficients of EQUITY_FIN and MIX_FIN are similar both in magnitude and significance (t-stat -2.67 and -2.97 respectively). That is consistent with acquisitions paid in equity being preceded by an equity issuance in the year before and with acquirers being reluctant to sell shares to raise cash ultimately used in the payment, which gives to the recourse to equity a last resort feature in line with pecking order motives.

Table 7-10 Financing indicator variables

The table reports the coefficient estimates from ordinary least squares regressions (OLS). The dependent variable is CONS_CASH i.e.% of the consideration at completion paid in cash. All variables are defined in Appendix 1, Table 7-13. The sample is 5,669 completed M&A deals by public acquirers in the 1999 to 2017 period. Also estimated, but not reported, is a constant term. The t-statistics are in parentheses, using robust standard errors. * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$.

	(1)	(2)	(3)	(4)
	CONS_CASH	CONS_CASH	CONS_CASH	CONS_CASH
DEBT_FIN	-0.0253 (-1.82)	-0.0233 (-1.67)	0.000365 (0.03)	-0.0265 (-1.90)
EQUITY_FIN	0.0304 (1.77)	0.0291 (1.70)	-0.0123 (-0.77)	-0.0435** (-2.67)
MIX_FIN	-0.00287 (-0.14)	-0.00251 (-0.12)	-0.0278 (-1.47)	-0.0584** (-2.97)
PRICEBOOK		-0.000932* (-2.02)	-0.000469*** (-10.08)	-0.000379*** (-7.77)
LEVERAGE			-0.00556*** (-16.09)	-0.00518*** (-14.64)
LT_ASSETS			0.0190*** (7.05)	0.0157*** (5.35)
ROAA			0.00530*** (6.20)	0.00466*** (5.52)
CASH_EQ			0.00270*** (4.34)	0.00202** (3.17)
CROSSBORDER			0.260*** (18.31)	0.209*** (12.64)
Year FE	NO	NO	NO	YES
Country FE	NO	NO	NO	YES
<i>N</i>	5669	5669	5504	5503
<i>R</i> ²	0.001	0.002	0.173	0.224
adj. <i>R</i> ²	0.001	0.001	0.172	0.211

The variable CASH_EQ, which measures lagged cash and cash equivalents of the acquirer scaled by total assets, is also a significant driver of the percentage of cash used in the consideration in line with what observed for non-financial firms by Faccio and Masulis

(2005), Boone et al. (2014) and de Bodt et al. (2017)¹⁶⁰. However, the coefficient of the variable DEBT_FIN is negative, although not significant, and that may cast some doubts upon the relevance of that variable in explaining the method of payment choice. I therefore introduce an alternative proxy for that variable, which I baptize DEBT_IS_6C whose construction is analogous to what was done for DEBT_IS except that the period in which the debt was issued is comprised between 6 months before the completion date and the latter. In a parallel way I build the variable EQUITY_IS_6C which I then use as a regressor coupled with its debt counterpart in place of the financing variables employed before. I present the results in table 7-11 reported hereafter.

I start out with the acquirer-related controls in column 1 and then add one target-related control at a time. DEBT_IS_6C's coefficient is positive and significant along with the one of EQUITY_IS_6C across the five columns, the former's magnitude is also greater than the corresponding estimates reported in the previous tables. CROSSBORDER has a lot of explanatory power in that its inclusion increases the adjusted R squared by more than 40%. In column 4 I also add the relative size of the target with respect to the acquirer whose estimated influence on the method of payment choice is consistent with the contingent-like-risk-sharing features of an equity payment as in Chemmanur et al. (2009). In unreported analysis I add a merger-of-equals¹⁶¹ dummy variable and unsurprisingly find that it is relevant both in terms of magnitude and significance (coeff. -.5110371 t-stat -11.13) and doesn't affect the estimated influence of the financing variables.

Finally, as a third additional analysis, instead of running ordinary least squares regressions (OLS) I fit a multinomial logit model¹⁶² using CASH_PYMT as the dependent variable, valued 0 for all-stock paid targets, 1 for all-cash ones and 2 for mix payments. All-cash deals are treated as the base outcome. The amount of debt issues during the six months before the acquisition completion by the acquirer scaled by his lagged total assets as measured by the variable DEBT_IS_6C is relevant in particular in explaining the choice of all-stock payment versus an all-cash payment, the coefficient estimate is -7.208 (z-stat<-3). In contrast, EQUITY_IS_6C is a significant driver of the mix-payment versus all-cash choice, the estimated coefficient is 1.472 (z-stat>2.94). Moreover, the model fits the data in a satisfactory manner as indicated by the pseudo R-squared (12.9%). It's slightly lower than the pseudo R-

¹⁶⁰ In contrast, Pinkowitz et al. (2013) report that the probability of using equity is an increasing function of the acquirer's level of cash holdings.

¹⁶¹ A merger of equals involves the merging of two institutions to create a new entity. Usually, in a merger of equals, both parties own roughly half of the resulting institution.

¹⁶² See Greene (2012, 763–766). The full table with the results is not reported but available upon request.

squared reported by Boone et al. (2014) but their estimated model is less parsimonious in that they include 17 variables against the 10 used in my multinomial logit estimation.

Table 7-11 Alternative financing variables

The table reports the coefficient estimates from ordinary least squares regressions (OLS). The dependent variable is CONS_CASH i.e.% of the consideration at completion paid in cash. All variables are defined in Appendix 1, Table 7-13 The sample is 5,669 completed M&A deals by public acquirers in the 1999 to 2017 period. Also estimated, but not reported, is a constant term. The t-statistics are in parentheses, using robust standard errors. * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$.

	(1)	(2)	(3)	(4)	(5)
	CONS_CASH	CONS_CASH	CONS_CASH	CONS_CASH	CONS_CASH
DEBT_IS_6C	0.303* (2.05)	0.415** (2.85)	0.426** (2.93)	0.450** (3.10)	0.382** (2.69)
EQUITY_IS_6C	-0.316*** (-4.44)	-0.307*** (-4.43)	-0.303*** (-4.38)	-0.190** (-2.64)	-0.199** (-2.81)
PRICEBOOK	-0.000520*** (-11.06)	-0.000490*** (-10.53)	-0.000520*** (-11.11)	-0.000507*** (-10.83)	-0.000430*** (-8.77)
LEVERAGE	-0.00638*** (-18.54)	-0.00548*** (-15.86)	-0.00543*** (-15.75)	-0.00579*** (-16.61)	-0.00526*** (-14.71)
LT_ASSETS	0.0368*** (15.11)	0.0179*** (6.81)	0.0197*** (7.46)	0.0174*** (6.52)	0.0138*** (4.88)
ROAA	0.00607*** (6.70)	0.00609*** (6.88)	0.00607*** (6.87)	0.00606*** (6.69)	0.00546*** (6.15)
CASH_EQ	0.00533*** (8.61)	0.00296*** (4.74)	0.00298*** (4.79)	0.00336*** (5.39)	0.00261*** (4.10)
CROSSBORDER		0.259*** (18.49)	0.260*** (18.57)	0.258*** (18.46)	0.203*** (12.40)
SELLER_L			-0.0610*** (-5.12)	-0.0542*** (-4.53)	-0.0946*** (-7.71)
REL_SIZE				-0.282*** (-6.42)	-0.246*** (-5.69)
<i>N</i>	5669	5504	5504	5466	5465
<i>R</i> ²	0.125	0.176	0.180	0.188	0.241
adj. <i>R</i> ²	0.124	0.175	0.179	0.186	0.229
Year FE	NO	NO	NO	NO	YES
Country FE	NO	NO	NO	NO	YES

7.7 Event study analysis

The evidence adduced so far indicates that the method of payment choice and the mode of financing in financial institutions' business combinations are strictly related in less

mechanical manners than what large part of the previous literature assumed for business combinations in general. A natural follow-up question is whether acquiring firm's shareholders care about the mode of financing and respond differently to announcement of acquisitions expected to be financed in different ways. Event study methodology lends itself to answering that question. In order to estimate abnormal returns I use a standard market model: $R_i = a + b R_m + e$. I follow Eckbo et al. (2017) who in their turn follow Betton et al. (2008), and I use [-291; -42] as the estimation window, [-41; -2] as the exclusion period due to run-ups, and [-1; 1] as the event window, with the event date i.e. the acquisition announcement at date 0. I chose the latter interval in that a longer window would also increase the "noise-to-information ratio". Moreover, including the day before announcement would allow for eventual leakage of information whereas the day after allows for possible deal-related delayed trading. I require at least 100 days of daily return data for the estimation of the parameters. For the inferential part I employ two nonparametric tests, the generalized sign and rank tests¹⁶³. Nonparametric tests do not assume that returns are normally distributed and have proved to be "better specified and more powerful in simulation than commonly used parametric tests"¹⁶⁴ especially in the case of multi-country event studies (Campbell et al. 2010). Moreover, when testing a window of several days around the event, the authors just quoted indicate that the generalized sign test must be applied to buy-and-hold abnormal returns. Therefore, I compute the latter instead of computing the more commonly used cumulative abnormal return, (see the appendix for the mathematical formulation of buy-and-hold abnormal returns).

Table 7-12 Event study. Buy and hold abnormal returns, rank test and generalized sign test.

Abnormal returns are estimated from a standard market model. Following Betton et al. (2008) I use [-291; -42] as the estimation window, [-41; -2] as the exclusion period due to run-ups, and [-1; 1] as the event window. ', *, **, and *** indicate statistical significance at the 10%, 5%, 1% and 0.1% level, respectively.

Financing class	Days	N	Mean BHAReturn	Rank test	Generalized sign test
Debt	(-1,+1)	511	0.31%	2.268*	2.479**
Equity	(-1,+1)	211	0.96%	1.103	1.044
Mix	(-1,+1)	180	0.39%	1.687*	1.299'
Other	(-1,+1)	598	-0.66%	-3.298***	-2.136*

¹⁶³ See appendix 2 for the computation of the rank test statistic.

¹⁶⁴ Salotti (2009)

Firstly, I compute the buy-and-hold abnormal returns for all-cash, mixed and all-equity payments deals in my sample (see appendix 2 for the definition of buy-and-hold abnormal returns). I find that BHAR are 0.55% for all-cash deals, 0.11% for mixed and -0.45% for all-equity deals¹⁶⁵ where the BHAR are computed over the three- day window [-1; 1]. The first and the latter are significant at the 0.1% and 1% level, respectively, (the z-statistics computed in the rank test is 4.350 and -2.504 respectively), whereas the BHAR related to mixed-payment deals are not significantly different from 0 (z-stat -0.285). These results are partly in line with the previous literature. For example in Chang (1998) offers deemed to be paid in equity are associated with poor bidder returns, but only for acquisitions of public firms.

Secondly, I partition all-cash paid transaction into equity and only equity-financed, debt and only debt-financed, debt and equity financed deals plus a residual category, like what done in point 1 of the Further analysis section, i.e. the partition into four mutually exclusive sets is induced by the EQUITY_FIN, DEBT_FIN, MIX_FIN variables computed above. I focus on US acquirers in order to avoid confounding effects. In table 7-12 I present the result of the rank test and generalized sign test for the BHAR computed for each partition. Debt-financed acquisitions are associated with higher bidder returns according to both tests. In contrast, Schlingemann (2004) finds that equity-financed deals are welcomed more favorably by the bidder's shareholders. Interestingly, the rank test statistic is highly significant (0.1% level) for the residual class of deals, also confirmed by the generalized sign test. Most likely, in that case acquisitions are financed by excess cash and the negative market reaction is due the heightened agency costs. This result can also be related to Beltratti and Paladino (2013) who find that paying for a target in cash "is bad for abnormal returns" for their sample of 139 bank M&A in 2007-2010. They point out that their finding is in contrast with the signaling hypothesis and their interpretation is that investors are disappointed by the choice of the acquirer to use cash at times of a credit and liquidity crisis. In their study they don't care where the cash used in the consideration is sourced from. Probably, the cash used by the acquiring banks in their sample was not sourced from loans or debt which are difficulty issued during the crises but from the bank's financial slack. And that, in the light of the present study, would be at the origin of the investors' disappointing reaction. However, another possibility is that the residual class includes some relevant financing means not

¹⁶⁵ Golubov et al. (2016) disentangle the announcement period return in all-stock deals from the return attributable to implied equity issuances and find that stock-financed acquisition of public firms are non-value destructive.

captured by the financing variables. Hybrid securities may be included in that class, and according to my results that would contribute to a lower market reaction. In any case a fully-fledged multivariate analysis with BHAR as the dependent variable would be warranted to shed light on the issue, but that's beyond the scope of the present study.

7.8 Chapter conclusions

The present study examines how financing decisions reflect themselves on the payment method choice in financial institution mergers. In particular, I find that the amount of equity issued by the acquiring firm during the year before the deal announcement is a relevant driver of the amount of equity used as a consideration, both in terms of statistical significance and economic magnitude. That result holds under different model specifications. Not only do financing decisions have a bearing on the payment method but also on acquiring firm's shareholders trading behavior. In fact, the latter act as if they could separate out the payment choice and the underlying financing decisions. The evidence provided using two nonparametric tests notably suggests that they respond favorably at the announcement of the combination when the latter is debt-financed and negatively when it deteriorates the financial slack of the acquiring firm in line with agency costs issues.

Further research could consider other characteristics of the consideration and of the financing decisions. As to the first point, it could distinguish between deals where the consideration is in equity and the number of shares offered to target shareholders is fixed from deals where the price is fixed and the number of shares offered to target shareholders depends on the price of the bidder's equity before the deal is consummated. Instead, as to the second point, also loans and instruments issued by fiduciary issuers might be included besides debt and equity. For example, the bank Monte dei Paschi di Siena issued a FRESH (floating-rate equity-linked subordinated hybrid) instrument in 2008 as a part of its financing strategy for the acquisition of bank Antonveneta. That instrument was issued by The Bank of New York Mellon acting as a fiduciary issuer for Monte dei Paschi and it is not included in my dataset on capital issues as a part of the latter's financing strategy. A further research could assess the implications of using such agreements for sourcing the funds required to finance a business combination.

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7.10 Chapter Appendix 1

Table 7-13 Variable names and definitions

Variable name	Variable definition
CONS_CASH	% of the consideration at completion paid in cash.
GR_AMNT_DEBT_IS_365	Principal amount of debt issued in the offering in the 365-day period before deal announcement, before fees and other expenses, including any amounts not sold directly by the issuer. Measured in thousand euros.
GR_AMNT_EQUITY_IS_365	Principal amount of equity capital issued in the offering in the 365-day period before deal announcement, before fees and other expenses, including any amounts not sold directly by the issuer. If unavailable, the market value of capital raised in the offering is used. Measured in thousand euros.
DEBT_IS	GR_AMNT_DEBT_IS_365 scaled by lagged total assets.
EQUITY_IS	GR_AMNT_EQUITY_IS_365 scaled by lagged total assets.
EQUITY_IS_6C	Equity issued by the entity in the 180-day period before the deal completion as a percentage of total asset in the fiscal year before the deal completion date.
DEBT_IS_6C	Debt issued by the entity in the 180-day period before the deal completion as a percentage of total asset in the fiscal year before the deal completion date.
PRICEBOOK	Lagged price as a percent of book value per share. Book value is calculated using financial period end common equity and common shares outstanding values.
LEVERAGE	Lagged 1-Equity/total assets, as a percentage.
TOT_ASSETS000	All assets owned by the company as of the date indicated, as carried on the balance sheet and defined under the indicated accounting principles measured in thousand euros.
LT_ASSETS	Lagged log of TOT_ASSETS000.
ROAA	Lagged Return on average assets; net income as a percent of average assets.
CASH_EQ	Lagged cash and cash equivalents as defined by the appropriate accounting standard scaled by total assets.
CASH_EQUIV000	Lagged Cash and cash equivalents as defined by the appropriate accounting standard measured in thousand euros.
OS_TOP	It associates to a given bidder's parent the percentage of shares outstanding owned by the largest shareholder in the month before the acquisition announcement.
REL_SIZE	Deal value scaled by lagged total assets as a percentage. The deal value corresponds to total consideration accrued to the sellers. It includes only the price paid for equity, not assumption of any obligations of the entity sold.
DEBT_FIN	Dummy valued one if the acquiring firm made at least one debt issuance in the year before announcement of the business combination and issued only debt.

Variable name	Variable definition
EQUITY_FIN	Dummy valued one if the acquiring firm made at least one equity issuance in the year before announcement of the business combination and issued only equity.
MIX_FIN	Dummy valued one if the acquiring firm made at least one equity issuance and one debt issuance in the year before announcement of the business combination.
CASH_PYMT	Valued 0 for all-stock paid targets, 1 for all-cash ones and 2 for mix payments.
CROSSBORDER	Dummy equal to 1 if the deal is cross-border and 0 otherwise.
SELLER_L	Dummy equal to 1 if the seller is listed and 0 otherwise.

7.10 Chapter Appendix 2

Computation of buy-and-hold abnormal returns

Given an interval consisting of more than one day starting on day T_1 and ending on day T_2 the buy-and-hold abnormal return of firm j over the event window is:

$$BHAR_{j,T_1,T_2} = \prod_{t=T_1}^{T_2} (1 + R_{jt}) - 1 - \left[(1 + \hat{\alpha}_j)^{(T_2-T_1+1)} - 1 \right] - \hat{\beta}_j \left[\prod_{t=T_1}^{T_2} (1 + R_{mt}) - 1 \right]$$

where $\hat{\alpha}_j$ and $\hat{\beta}_j$ are the ordinary least squares estimates of a standard single factor model followed by the security return R_{jt} of firm j on day t using the rate of return R_{mt} of the market index m on day t . The average is then computed over the number N of securities i.e. firms.

Rank test statistic

The computation of the rank test statistics entails, as a preliminary step the ranking of BHAR of a given firm from 1, the lowest, to the number of days included in the event and estimation window, the highest, considering both the estimation period and the event window. Then the rank test statistic is computed as follows

$$TS_{rank} = \frac{\frac{1}{N} \sum_{i=1}^N (K_{i,E} - \bar{K})}{s(K)}$$

Where $K_{i,t}$ is the rank assigned to firm i 's BHAR on day t and E is the event window i.e. I find the average rank over the event window, \bar{K} is the average rank of BHAR and $s(K)$ the estimated standard error of the portfolio mean abnormal rank. Under the null hypothesis of no market reaction the rank test statistics is asymptotically normally distributed $TS_{rank} \sim N(0,1)$.

7 CONCLUSION

In the ambit of business combinations and group of companies, this thesis focuses on some questions of interest at the intersection of accounting, law and corporate finance.

Concerning accounting theory, chapter 2 analyses the perspective of accounting under the historical profile of Italian business economics (*dottrina aziendale*). In particular, it compares how Italian scholars of “Economia Aziendale” of the classical period intended the consolidation difference - that might coincide with goodwill - which is one of the major aspects of accounting for business combinations. Then, the next chapter reconstructs the political and legislative process that brought about the birth of the concept of group of companies in the Italian legal corpus. This part of the work was made possible also thanks to his access to the historical archive of Bocconi University’s library.

Concerning law and accounting policy, a comparative analysis is carried out in chapter 4 which illustrates how the notion of control and its use in consolidated financial statements (group accounts) and business combinations accounting evolved (i) in European law, (ii) under international accounting standards as issued by the IASB –International Accounting Standards Board and (iii) in US GAAP (Generally Accepted Accounting Principles).

Moreover, chapter 5 examines the effects of lobbying on accounting standards on consolidated financial statement issued by the international standard setter. Interestingly, results suggest the existence of a form of regulatory capture of the international standard setter by a category of financial institutions. The former might also inform the debate around IFRS 10, whose post implementation review is on the agenda of the IASB.

Concerning corporate finance, chapter 7 investigates the implications of different financing decisions exploiting a novel and comprehensive dataset on mergers and acquisitions involving financial institutions (banks and insurances) completed during the last two decades. In particular, chapter 7 presents an event study adopting two non-parametric tests for statistical inferences, which suggest the that acquiring firm’ shareholders do care about the mode of financing a business combination (debt, share issues, internal resources or a combination thereof). Results are economically and statistically significant.

The present thesis is subject to some limitations. In particular, regarding the conclusion in chapter 5 that lobbying activities lie at the root of IFRS 10 and its amendment a concern is that the research design used does not allow to rule out an alternative explanation, though the

latter might not be necessarily conflicting with the explanation based on lobbying activities. In order to address this concern interviews can be conducted and a questionnaire or a survey can be administered which might not only further support the present results but also provide a more fine-grained picture on the reception of the new accounting standard and its amendment by the different categories of investment companies (long-term oriented vs short term oriented investors, family firms etc). Chapter 7, for its part, is not free from econometric concerns in particular the possibility of omitted variable and an endogeneity problem. Furthermore, the econometric model does not fully identifies how bank capital regulation might affect the results.

Future studies can address these issues. Moreover, further work might illustrate how the Italian case in chapters 2 and 3 can be used as a relevant benchmark for the international comparison in chapter 4 and lobbying activities in chapters 5 and 6. Finally, the results of chapter 5 can serve as the basis for the questionnaire that can then be submitted to institutional investors in the ambit of a future research project.

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REGROUPEMENTS D'ENTREPRISES ET GROUPES DE SOCIÉTÉS : PERSPECTIVES DE LA COMPTABILITÉ, DU DROIT ET DE LA FINANCE D'ENTREPRISE

Résumé de la thèse

Dans le cadre général des regroupements d'entreprises et des groupes de sociétés, cette thèse porte sur des questions d'intérêt à la croisée de la comptabilité, du droit (notamment les dispositions légales et la réglementation comptable) et de la finance d'entreprise.

En ce qui concerne la théorie comptable, le chapitre 2 étudie comment les chercheurs en économie d'entreprise ont compris les groupes d'entreprises, les comptes de groupe et le processus de leur préparation, en particulier par rapport aux juristes italiens. Ensuite, le chapitre 3 reconstruit le processus politique et législatif qui a engendré la naissance du concept de groupe de sociétés dans le corpus juridique italien.

Concernant le droit et la politique comptable, une analyse comparative est effectuée au chapitre 4 qui montre clairement l'évolution de la notion de contrôle et de son utilisation dans les comptes consolidés (comptes de groupe) et les regroupements d'entreprises (i) en droit européen, (ii) selon les normes comptables internationales publiées par l'IASB (International Accounting Standards Board) et (iii) par rapport aux principes comptables généralement admis aux États-Unis («US GAAP»).

De plus, les chapitres 5 et 6 étudient les effets du lobbying sur les normes comptables concernant les états financiers consolidés et les regroupements d'entreprises publiés par l'IASB. Fait intéressant, les résultats concordent avec une forme de capture du normalisateur comptable international par une catégorie d'institutions financières. En effet, confrontées à un modèle de consolidation prétendument basé sur le contrôle, ces dernières ont plaidé en faveur d'une exception de consolidation fondée sur un modèle de propriété et documentée comme ayant été proposée par les sociétés d'audit américaines dans ce contexte au moins depuis 1995. Ce modèle s'avère avoir trouvé un terrain fertile au sein de l'IASB. En conséquence, d'autres catégories d'institutions financières, telles que les fonds d'investissement à long terme et ceux gérés par une famille tout en préférant un modèle de consolidation différent, ne sont plus autorisées à présenter des états financiers consolidés.

En ce qui concerne la finance d'entreprise, le chapitre 7 analyse les implications de différentes décisions de financement dans un nouveau échantillon de fusions et acquisitions entre institutions financières (banques et assurances) consommées dans le monde entier au cours des deux dernières décennies. En particulier, il étudie (i) la relation entre la méthode de choix de paiement (si le prix est payé en cash, en actions ou une combinaison des deux) et le choix du mode de financement d'un

regroupement d'entreprises (y compris les instruments hybrides) et (ii) la réaction des investisseurs à l'annonce de la combinaison. En ce qui concerne ce dernier point, l'utilisation de deux tests non paramétriques permet de détecter une relation intéressante entre la réaction du marché à l'annonce et les différents modes attendus de financement de la transaction.

**BUSINESS COMBINATIONS AND GROUP OF COMPANIES:
PERSPECTIVES FROM ACCOUNTING, LAW AND CORPORATE FINANCE**

Abstract

In the broad context of business combinations and group of companies, this thesis selects some matters of interest at the crossroad between accounting, law (especially legal provisions and accounting regulation) and corporate finance.

Concerning accounting theory, chapter 2 studies how business economics scholars understood groups of companies, group accounts and the process for their preparation in particular compared to Italian legal scholars. Then, chapter 3 reconstructs the political and legislative process that brought about the birth of the concept of group of companies in the Italian legal corpus.

Concerning law and accounting policy, a comparative analysis is carried out in chapter 4 which clearly shows how the notion of control and its use in consolidated financial statements (group accounts) and business combinations accounting evolved (i) in European law, (ii) under international accounting standards as issued by the IASB –International Accounting Standards Board and (iii) in US GAAP (Generally Accepted Accounting Principles).

Moreover, chapters 5 and 6 investigate the effects of lobbying on accounting standards on consolidated financial statements and business combinations issued by the IASB. Interestingly, results are consistent with a regulatory capture of the international standard setter by a category of financial institutions. In fact, confronted with a consolidation model purportedly based on control, the latter lobbied in favour of a consolidation exception which is based on an ownership view and is documented to have been proposed by US audit companies in that context at least from 1995. That view found a fertile ground within the IASB. As a result, other categories of financial institutions such as long term investment funds and those run by a family preferring a different consolidation model are now prohibited from presenting consolidated financial statement.

Concerning corporate finance, chapter 7 studies the implications of different financing decisions in a novel and comprehensive sample of cases of mergers and acquisitions across and between

financial institutions (banks and insurances) consummated worldwide around almost the last two decades. In particular, it investigates *(i)* the relationship between the method of payment choice (i.e. if the price is paid in cash, stock or a mixture of the two) and the choice regarding the mode of financing a business combination (including hybrid instruments) and *(ii)* investors' reaction at the combination announcement. As to the latter point, the use of two non-parametric tests allows to detect an interesting relationship between the market reaction at announcement and the different expected modes of financing the transaction.