
Business Combination Under Common Control (BCUCC) - What Kind of Disclosure is Enough? The Polish Experience

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Abstract:

Purpose: The assessment of the scope and quality of disclosures about BCUCC, which are excluded from the scope of IFRS, published by Polish public companies in their annual financial reports prepared following IFRS.

Design/Methodology/Approach: The research uses qualitative and quantitative methods. The research methodology was based mainly on critical analysis of the literature on the subject, quantitative methods, content analysis of financial statements, and synthesis of results.

Findings: Most Polish public companies that did not account for BCUCC using IFRS provided at least minimal scope of disclosures necessary for users of financial information to decide the effects that BCUCC had on the information presented in the financial statement. Companies that applied the Accounting Act to substitute for the lacking IFRS solution related to BCUCC provided a higher level of disclosure than other companies.

Practical Implications: The use of national accounting regulations may provide a better quality of disclosures about BCUCC.

Originality/Value: This paper provides insight into how the problem is dealt with in practice and may be used to form a commentary on the current IASB project focusing on BCUCC.

Keywords: Business combination under common control, BCUCC, IFRS, public companies, accounting for business combinations, disclosure.

JEL Classification: G34, M41.

Paper Type: Research Paper.

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1. Introduction

The role of disclosures in financial statements and how they may affect users of financial information and companies themselves are not a new issue. It became even more critical with the growing globalization of financial markets. Considering differences between national regulations of different countries, it became a matter of importance to find a solution that would provide uniform accounting regulations, ensuring that similar events will be presented similarly. Together with providing the framework for transparency, accountability, and efficiency for financial markets worldwide, it became the main reason behind the creation of IFRS.

Whereas IFRS does provide such a framework and has been adopted in many countries worldwide, they do not solve all the problems related to accounting and financial reporting as some economic phenomena are excluded from their scope. One of them is business combinations under common control, which IFRS 3 defines as a specific type of business combination. The same party or parties ultimately control all the combining entities or businesses before and after the business combination. It is also stated that the control may not be transitory.

It could be argued that the approach dictated by IAS 8 should be enough to ensure the appropriate presentation of all economic phenomena in financial statements. However, at the same time, it offers the possibility of using any method that an entity may deem as the most appropriate for accounting for BCUCC. Similar problems affect the scope of the disclosure.

The paper aims to assess the scope and quality of disclosure about BCUCC, which Polish public companies presented in their financial statements prepared following IFRS. The authors hypothesize that despite the lack of detailed regulations, most Polish public companies disclose enough information about BCUCC to allow users of financial information to assess how the BCUCC affected the financial data presented in the annual financial reports. Additionally, the use of the national GAAP offers a higher quality of information presented even if not all requirements set by the Accounting Act are met.

In the paper, the authoress presents the current state of research about information disclosure and BCUCC. The next part of the paper focuses on how IFRS and the Accounting Act treat the matter of BCUCC to provide some background for the empirical research. The paper also analyses empirical data gathered from published financial statements (called financial reports later) of Polish public companies listed on the Warsaw Stock Exchange and New Connect (an alternative trading market), prepared following IFRS. The research focused on disclosures made by these companies for a specific group of BCUCC (legal mergers) in 2009-2019.

The research methods used include critical analysis of the literature on the subject, content analysis of financial statements, and synthesis of results.

2. Literature Review

The quality of the reporting information and its effects on various aspects of the business activities of every entity has been widely discussed in the literature. For example, Patton and Verardo (2012) concluded that the financial report of a company might provide valuable information about its peers and the entire economy, which could be used to revise the expectations about their profitability. However, to achieve it, good quality of financial reports is necessary.

Another research investigated the relationship between the qualitative characteristics of accounting information, transparency, and risk (Nichita and Țurlea, 2015). It also explored the possibility of developing good practices in risk reporting and suggested a framework for risk reporting with the primary goal of improving good practices in the risk management field. Furthermore, the improvement of accounting information quality may be linked with the decrease in systemic risk (Xing and Yan, 2018).

Saha and Bose (2021) examined the link between a level of IFRS disclosure requirements and a weighted average cost of capital and cost of debt capital. They debated the relative costs and benefits of IFRS disclosure and concluded that the IFRS disclosures they examined provided economic benefits to users by reducing firms' cost of capital. Vaz da Fonseca and Nascimento Juca, (2020), examined the influence of taxes on Foreign Direct Investment using a bibliometric analysis.

The research focused on assessing disclosures also exists. Glaum *et al.* (2013) analyzed their compliance with IFRS requirements for a large sample of European companies mandatorily applying IFRS, focusing on disclosures by IFRS 3 and IAS 36. In both cases, they found substantial non-compliance. Their research pointed to many factors influencing the level of compliance, e.g., the importance of goodwill positions, prior experience with IFRS, or type of auditor. They also concluded that accounting traditions and other country-specific factors continue to play a role despite common reporting standards under IFRS. A similar conclusion about the link between disclosures scope and cultural factors appears in another research (Abdullah *et al.*, 2015).

Some authors agree that more focus should be put on a more robust enforcement regime to improve current disclosure practices adopted by companies preparing their financial reports following IFRS (Saha and Bose, 2021; Hellman *et al.*, 2018; Abad *et al.*, 2020). However, research insisting on the opposite also exists. It argues that the current scope of the disclosure may be too broad, which in result contributes to lower compliance with obligatory disclosure scope (Devalle and Busso, 2016).

Taking into consideration the exclusion of BCUCC from the scope of IFRS 3, it is not surprising that the BCUCC and methods used to account for them also became the subject of research (Biancone, 2013; Fiume *et al.*, 2015; Janowicz, 2017; 2018; Küting and Wirth, 2020).

Some research aims to compare IFRS and national regulations, an example of which may be the comparison drawn between Chinese GAAPs and IFRS (Heng and Noronhac, 2011). A more detailed analysis of Chinese accounting practices for BCUCC was conducted by Baker, Biondi, and Zhang (2010). Their study stressed the difference between the treatment of BCUCC in Chinese standards and IFRS and provided evidence of how the change in an accounting method may affect the financial data. In their earlier research paper, the same authors argued the validity of using the pooling of interest method in BCUCC, using Chinese GAAPs as an example (Baker, Biondi, and Zhang, 2008).

There is research that goes even further. Bonacchi *et al.* (2015) analyzed the relations between methods of accounting used for BCUCC and issuing a public debt after the business combination. The authors found a positive correlation of the event with the use of the purchase method.

Finally, Chen *et al.* (2020) investigated the value relevance of two different accounting methods (predecessor vs. acquisition) for BCUCC in China. After analyzing the collected data, they concluded that net income under the predecessor method is of higher value relevance than that under the acquisition method, which seems to be driven by two factors. One of them is related uncertainties in fair value estimation surrounding the BCUCC. The other factor relates to net incomes under the predecessor method being better to predict future earnings and future operating cash flows than under the acquisition method.

3. Research Methodology

As IFRS 3 explicitly excludes business combinations under common control from its scope, the general route pointed by IAS 8 should be applied instead. According to it, the entity may (IAS 8, sections 10-12):

- use IFRS 3 for this business combination, or
- adapt their own approach to the issue, using their professional judgement and the compliance with The Conceptual Framework for Financial Reporting.

IAS 8 does not require the use of national regulations, although they may be taken into consideration. However, the Accounting Act demands the obligatory use of the Polish accounting regulations in such cases (the Accounting Act, article 2(3)). This, in turn, allows the use of the pooling of interests-method to account for BCUCC.

Analyzing both sets of accounting regulations it should be assumed that Polish public companies which prepare their financial statements following IFRS/IAS should use the Accounting Act regulations in the case of BCUCC. However, evidence to the contrary exists (Janowicz, 2017). The Accounting Act requirements should also be used for disclosures; however, not always the regulations are applied in practice (Janowicz, 2018).

The problem related to the lack of appropriate regulations for BCUCC in IFRS is considered severe enough to inspire projects dealing with the issue. EFRAG has been working on the project to determine what accounting method should be applied to BCUCC, but the project has not been finished. The IASB also works on a similar project. However, the Discussion Paper was published in November 2020, and comment letters are still being collected, so it is too early to discuss the solutions that the IASB may ultimately employ. For now, neither do any guidance for methods nor the scope of disclosure exists in IFRS, and the scope of disclosure offered by the Accounting Act may not meet general requirements set by IFRS.

Considering how accounting regulations relate to BCUCC, the authors focused on BCUCC, which were not accounted for under IFRS 3 guidance. For this research, two hypotheses were formulated.

H1: *Most companies that do not apply IFRS 3 to account for BCUCC provided enough information to give users of financial statements at least a general idea about how the business combination affected the data presented in their financial statement for the year in which BCUCC took place.*

H2: *Companies that chose to use the Accounting Act regulations and applied the pooling of interests-method provided better information of better quality than companies that applied other methods.*

The primary research technique used in this paper is content analysis. Considering how this method is defined in the literature (Weber, 1990; Krippendorf, 2004), it may be described as a codifying text method into various categories. This, in turn, makes it remarkably useful where a significant amount of qualitative information must be analyzed, as it also allows attributing quantitative characteristics to qualitative traits (Yen *et al.*, 2007; Holder *et al.*, 2013).

BCUCC may take many forms, including (but not limited to) legal mergers between companies belonging to the same group, transferring control over a company from one subsidiary to another, or creating a new subsidiary to which control over other subsidiaries is transferred. The authoress, taking into consideration the accessibility of information and financial statements for analysis, focused on legal mergers only. The size of combining companies and the type of their activities do not affect the choice of an accounting method, so these characteristics were not taken into consideration while collecting raw data.

To identify potential research objects, the authors analyzed current reports of public companies, which are obliged by law to announce any planned legal merger and publish draft terms of merger if it was prepared. Next, the collected data was verified to determine which of planned legal mergers were finalized in the period covered by the research (years 2009 - 2019, where 2009 was the year when the conditions for the use of the pooling of interests-methods were changed, allowing its application to

a more significant number of business combinations than before).

The next step focused on analyzing annual financial reports prepared following IFRS for the year in which the merger took place to determine and exclude BCUCC, which were accounted for with the use of acquisition method, as this implied the use of IFRS 3 to account for the business combination. The final sample consisted of 204 separate financial statements containing data about 238 BCUCC.

For each financial report, detailed data about the disclosures made was collected. To account for differences between requirements for different methods of accounting, the authoress focussed on a following set of disclosure, deemed to be the most essential:

- the name of the companies taking part in BCUCC,
- the date at which BCUCC was accounted for,
- the method of accounting used,
- the description of the method used for other methods than pooling of interests-method,
- the information allowing comparability in comparison to previous financial reports of a combined company,
- the reasons for the business combination,
- any other information that companies shared in connection to BCUCC.

To classify and assess the scope of the disclosure for each financial statement analyzed, the following variation of a 5-point (levels) Licker scale was used:

- (none) - no information about BCUCC provided,
- (poor) - the date of the legal merger and the name of the “acquired” company/companies provided,
- (minimal) - information required in level 2 and the method of accounting (and the description of the method used if necessary) provided,
- (acceptable) - information required in level 3 and changes in the comparative data for the previous year provided,
- (satisfying) - information required in level 4 and other information (e.g., reasons for BCUCC, more detailed information about assets and liabilities acquired in BCUCC) provided.

To be classified on a particular level, a company must disclose all information for this level, with no exception made for full or partial disclosure from higher levels. In the authoress’ opinion, level 3 provides the minimal level of disclosure necessary for a basic understanding of the business combination and its effect on the financial statement of the combined company. Level 4 ensures comparability with the previous financial statements of the company. Level 5 would apply to the situation in which most of the required disclosures, if not all, were presented in a financial statement.

4. Results and Discussions

In the process of data analysis, the following methods were identified:

- M1 - the pooling of interests-method, which is well-known and widely used for BCUCC in national regulations, like the Accounting Act; to apply it the carrying amounts of all assets, liabilities, equities, incomes, and expenses of combining companies, taken from their separate financial statements, should be added to each other after adjusting them for the effects of the mutual transactions between the companies and ensuring the same measurement rules,
- M2 - the predecessor accounting method, which in its essence is like the pooling of interests-method, the only difference being the use of the carrying amounts from consolidated financial statements instead of separate ones,
- M3 - a method in which carrying amounts of assets, liabilities, and equities of combining companies, taken from separate financial statements, are added together after adjusting them for the effects of the mutual transactions between the companies and ensuring the same measurement rules,
- M4 - a group of unknown methods for which no identifying information was provided; impossible to be assigned to any other group.

The descriptive statistics calculated for the collected data are presented in Table 1. The mode and median for the whole population fall into the group of minimal disclosure. The mean for the whole sample and standard deviation were also calculated, but their importance is considered secondary. Considering these results, it can be assumed that at least half of the annual financial reports in the sample achieved the minimal scope of the disclosure, which supports the first research hypothesis.

Table 1. *Descriptive statistics for the scope of disclosure for the identified accounting methods*

Methods	n	%	Descriptive statistics for the scope of disclosure					
			mode	median	min	max	mean	std.dev.
total	204	100.0	3	3	1	5	3.196	0.968
M1	90	44.1	3	4	3	5	3.644	0.688
M2+M3+M4	114	55.9	2	3	1	5	2.842	1.010
M2	51	25.0	3	4	3	5	3.647	0.680
M3	14	6.9	3	3	3	5	3.286	0.589
M4	49	24.8	2	2	1	2	1.878	0.328

Source: Own calculation.

To check if the use of the Accounting Act regulations contributes to a higher level of disclosure in BCUCC, the Mann-Whitney U test was used. The following hypotheses were tested in this part:

H0: *The median of disclosure levels for the pooling of interests-method is the same*

as the median of disclosure levels for other methods identified in the study.

H1: *The median of disclosure levels for the pooling of interests-method is different from the median of disclosure for other methods identified in the study.*

The calculated characteristics for the test ($\alpha = 0.05$, no correction for continuity), are as follow:

<i>U</i> statistic	2747
<i>U</i> statistic'	7513
Two-sided <i>p</i> -value (exact)	0.0001
Z statistic (adjusted for ties)	-5.967301
Two-sided <i>p</i> -value (asymptotic)	<0.000001

As in both cases, the calculated *p* is lower than the significance level, H_0 should be rejected. This result points to a significant statistical difference between the scope of the disclosure in analyzed groups. The scope of disclosure made for the pooling of interest's method is more comprehensive than for other methods. In conclusion, it can be assumed that the application of the Accounting Act regulation led to the higher quality of disclosures about BCUCC in the analyzed financial reports.

5. Conclusions

The subject of information disclosures - general and on specific matters, their quality and impact on different reporting entities' business activities are well researched. The research results often point to the advantages of wider scopes of disclosure and analyze the factors that affect non-compliance with them. In comparison, similar research on disclosures about BCUCC seems to be low amount.

In this context, the focus of the study was to provide an insight into the quality of disclosure about BCUCC made by Polish public companies preparing their financial statements following IFRS. The research sample consisted of 204 separate financial statements containing information about 238 BCUCC, which took place in the years 2009-2019.

The analysis of the collected data showed that more than half of the analyzed financial reports contained enough disclosure for users of financial information to have at least a general idea about how the business combination affected financial data presented in the financial statement.

There is also evidence that the application of the Accounting Act rules allowed companies to provide a higher level of disclosure than other companies. In turn, this could lead to the assumption that companies that apply national regulations to account for transactions not covered by IFRS, like BCUCC, may provide financial information of better quality compared to companies that adopted their approach based on their professional judgment.

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