IFRS

STAFF PAPER

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IASB Meeting

Project	**Business Combinations under Common Control**
Paper topic	Scope of the project

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Purpose of the paper

1. Agenda Paper 23A *Review of related projects* for this month's meeting provides an overview of the issues related to the scope of the Business Combinations under Common Control (BCUCC) research project the staff identified in other projects of the International Accounting Standards Board (Board) and the IFRS Interpretation Committee (Committee). This paper discusses whether issues that remain unresolved should be considered in the scope of the BCUCC project and asks the Board for decisions.

2. This paper should be read together with Agenda Paper 23 *Cover note* and Agenda Paper 23A *Review of related projects*.

Staff recommendation

3. The staff recommend that the scope of the BCUCC project should include transactions involving transfers of businesses or entities where all the combining parties are ultimately controlled by the same controlling party (or parties), and:

   (a) the transactions are preceded by an external acquisition or/and followed by an external sale of one or more of the combining parties; or

   (b) the transactions are conditional on a future sale such as in an initial public offering (IPO).

Structure of the paper

4. The paper is structured as follows:

   (a) background (paragraphs 5–6);

   (b) transitory control (paragraphs 7–26):

      (i) description of the issue;

      (ii) staff analysis and recommendation;

      (iii) question for the Board;

   (c) business combinations conditional on an IPO (paragraphs 27–34):

      (i) description of the issue;

      (ii) staff analysis and recommendation;

      (iii) question for the Board.

Background

5. In June 2014 (see Agenda Paper 14 *Scope of the research project*, June 2014), the Board tentatively decided that the BCUCC project should consider:

   (a) business combinations under common control that are currently excluded from the scope of IFRS 3 *Business Combinations*[1];

   (b) group restructurings; and

   (c) the need to clarify the description of business combinations under common control, including the meaning of ‘common control’.

6. In October 2017 (see Agenda Paper 23 *Scope of the project*, October 2017), the Board noted that:

   (a) ‘group restructuring’ is not a defined term and tentatively decided to clarify that the scope of the BCUCC project includes transactions under common control in which a reporting entity obtains control of one or more businesses regardless of whether IFRS 3 would identify the

[1] Throughout this paper, reference is made to IFRS 3 *Business Combinations* issued in January 2008, unless specifically indicated otherwise.

reporting entity as the acquirer, if IFRS 3 were applied to the transaction; and

(b) the staff planned to discuss with a Board at a future meeting application questions on the meaning of 'common control'. This paper discusses whether those application questions should be considered in the BCUCC project.

Transitory control

Description of the issue

7. IFRS 3 describes a business combination under common control as 'a business combination in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and *that control is not transitory*' [emphasis added] (paragraph B1 of IFRS 3).

8. Accordingly, when all the combining entities or businesses are ultimately controlled by the same controlling party (or parties) both before and after the business combination, the assessment as to whether that control is 'transitory' determines whether the transaction:

    (a) is considered a business combination under common control; and

    (b) falls in the scope of IFRS 3.

9. If control over the combining entities or businesses by the same party (or parties) is considered 'transitory', the business combination:

    (a) does not satisfy the description of business combination under common control; and

    (b) is accounted for applying the acquisition method set out in IFRS 3.

10. If control over the combining entities or businesses by the same party (or parties) is not considered 'transitory', the business combination:

    (a) satisfies the description of a business combination under common control; and

    (b) is excluded from the scope of IFRS 3 and accounted for applying the requirements in paragraphs 10–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*—the reporting entity develops and applies an accounting policy that results in useful information.

11. IFRS 3 does not elaborate on the meaning of 'transitory control'. Paragraph BC28 of the Basis for Conclusions on IFRS 3 *Business Combinations*, issued in March 2004 and superseded in 2008 by the revised IFRS 3, explained the reasons for the Board to require common control not to be 'transitory'. In particular, the Board decided to require common control not to be 'transitory' to avoid business combinations between parties acting at arm's length being 'structured through the use of "grooming" transactions [with the intention to avoid the application of the requirements in IFRS 3], so that, for a brief period immediately before the combination, the combining entities or businesses are under common control'.

12. As discussed in Agenda Paper 23A *Review of related projects*, the Committee has received a number of submissions raising questions about the meaning of 'transitory control'. The scenarios discussed in those submissions involved the formation of a new entity (Newco) to effect a combination in preparation for an external sale of the combining entities or businesses, for example via an IPO of Newco.

13. An illustrative example of such a scenario is presented in Figure 1 of Agenda Paper 23A *Review of related projects*. In that scenario:

    (a) Entity A and Entity B are businesses, both controlled by Entity P;

    (b) Entity P forms a Newco to facilitate a sale of part of the group; and

    (c) Newco acquires Entity A and Entity B from Entity P in preparation for Newco's IPO.

14. Some interested parties argue that Entity P’s control over Newco is ‘transitory’. Therefore, the transaction is *not* a business combination under common control and Newco must apply the requirements in IFRS 3 to account for the acquisition of Entities A and Entity B.

15. Other interested parties argue that Entity P’s control over Newco is ‘not transitory’. Therefore, the transaction is a business combination under common control and Newco has an accounting policy choice and must apply the requirements in paragraphs 10–12 of IAS 8.

16. In discussing this scenario, the Committee noted that the issue raised is widespread and diversity in practice exists.

17. The staff note that the question as to whether the controlling party’s (or parties’) control over the combining entities or businesses is ‘transitory’ can also arise in a scenario where the combination is *preceded* by an external acquisition rather than *followed* by an external sale.

18. For instance, as illustrated in the following figure (**Figure 1**), an entity (Entity A) may acquire another entity (Entity B):

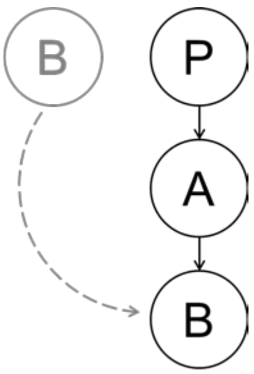
    (a) directly from third parties (**Scenario 1** in Figure 1); or

    (b) from Entity A’s controlling party, Entity P, after Entity P acquired Entity B from third parties (**Scenario 2** in Figure 1).

Figure 1

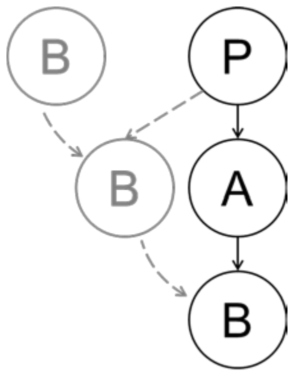
Scenario 1—Entity A acquires Entity B from third parties. Entity A and Entity B are businesses.

The reporting entity is Entity A.



Scenario 2—Entity P acquires Entity B from third parties and, immediately after, Entity A acquires Entity B from Entity P. Entity A and Entity B are businesses.

The reporting entity is Entity A.



19. In **Scenario 1**, Entity A is required to account for the acquisition of Entity B applying the requirements in IFRS 3 (the acquisition method).

20. In **Scenario 2**, the transaction may be accounted for differently depending on whether control over Entity B by Entity P is considered ‘transitory’:

    (a) if Entity P’s control over Entity B *before* the acquisition of Entity B by Entity A is considered ‘transitory’, the transaction is *not* a business combination under common control and Entity A must apply the requirements in IFRS 3;

    (b) if Entity P’s control over Entity B *before* the acquisition of Entity B by Entity A is not considered ‘transitory’, the transaction is a business combination under common control and Entity A has an accounting policy choice applying the requirements in paragraphs 10–12 of IAS 8.

21. Finally, a question about the meaning of ‘transitory’ could also arise when a combination is *both* preceded by an external acquisition *and* followed by an external sale of one or more of the combining entities or businesses.

Staff analysis and recommendation

22. The staff note that the meaning of ‘transitory control’ is important in determining whether a particular transaction falls within the scope of IFRS 3 and thus must be accounted for under the acquisition method or a different accounting method can be applied in accordance with the requirements in paragraphs 10–12 of IAS 8.

23. However, as the BCUCC project progresses, the distinction between business combinations under common control and business combination *not* under common control may not remain relevant if the Board decides that some or all business combinations under common control must be accounted for under the acquisition method set out in IFRS 3. Instead, if the Board decides that different methods should be applied to different types of transactions within the scope of the project, the distinction between those types of transactions would become important (see Agenda Paper 23C *Methods of accounting*).

24. Accordingly, the staff think it is not necessary for the Board to focus on clarifying the meaning of ‘transitory control’. Instead, the staff think that the Board should focus on ‘filling in the gap’ in the accounting requirements for business combinations and take into account any known application questions.

25. On that basis, the staff recommend that the scope of the BCUCC project should include transactions involving transfers of businesses or entities where:

    (a) all the combining parties are ultimately controlled by the same controlling party (or parties); and

    (b) the transaction is preceded by an external acquisition or/and followed by an external sale of one or more of the combining parties.

26. As discussed in Agenda Paper 23 *Scope of the project* presented to the Board in October 2017 (see Figure 2 in Agenda Paper 23 *Scope of the project*, October 2017), the project will focus on the accounting by the entity that ‘receives’ the combining entities or businesses.

Question for the Board

Question 1—transitory control
Does the Board agree with the staff recommendation that the scope of the BCUCC project should include transactions involving transfers of businesses or entities where: (a) all the combining parties are ultimately controlled by the same controlling party (or parties); and (b) the transactions are preceded by an external acquisition or/and followed by an external sale of one or more of the combining parties?

Business combinations conditional on an IPO

Description of the issue

27. As discussed in Agenda Paper 23A *Review of related projects*, some interested parties have asked how to account for a business combination that is conditional on an IPO. An illustrative example of such a scenario is presented in Figure 2 of Agenda Paper 23A *Review of related projects*. In that scenario:

    (a) the combination involves entities or business controlled by the same party and is effected through formation of a Newco;

    (b) Newco is created by the controlling party and issues a prospectus offering to issue shares for cash;

    (c) with the funds raised through the IPO, Newco acquires entities or businesses from the controlling party; and

    (d) the combination takes effect only if Newco's IPO is successful.

28. As discussed in Agenda Paper 23A *Review of related projects*, some interested parties take the view that this combination is not under common control, hence Newco must apply IFRS 3. They argue that either:

    (a) the business combination takes place after Newco's IPO, hence the controlling party no longer controls the combining entities at the time of the combination; or

(b) the controlling party controls the combining entities at the time of combination but its control over Newco is 'transitory'.

29. Other interested parties take the view that the combination is under common control and an accounting policy choice exists in accordance with paragraphs 10–12 of IAS 8. They argue that Newco is formed by the controlling party to facilitate the sale of part of the group and that is the critical factor in the analysis. They further argue that the controlling party's control over Newco is not 'transitory'.

30. In discussing this question, the Committee noted that this fact pattern is not widespread in many jurisdictions but in those jurisdictions where this fact pattern exists, there is significant diversity in practice.

Staff analysis and recommendation

31. The staff note that the question that arises in the scenario discussed in paragraph 27 of this paper is the same question discussed in the 'transitory control' section (paragraphs 7–26 of this paper). That is, the question is whether the business combination is under common control and thus whether the reporting entity has an accounting policy choice in accordance with paragraphs 10–12 of IAS 8 or whether it instead needs to account for the combination applying the acquisition method set out in IFRS 3.

32. As discussed in paragraphs 23–24 of this paper, the staff think that the Board should not focus on clarifying the distinction between business combinations under common control and business combinations *not* under common control because this distinction may not remain relevant as the BCUCC project progresses. Instead, the Board should focus on 'filling in the gap' in the accounting requirements for business combinations and take into account any known application questions.

33. On that basis, the staff recommend that the scope of the BCUCC project should include transactions involving transfers of businesses or entities where:

    (a) all the combining parties are ultimately controlled by the same controlling party (or parties); and

    (b) the transactions are conditional on a future sale such as in an IPO.

34. As noted in paragraph 26 of this paper, the project will focus on the accounting by the entity that 'receives' the combining entities or businesses.

Question for the Board

Question 2—transactions conditional to an IPO
Does the Board agree with the staff recommendation that the scope of the BCUCC project should include transactions involving transfers of businesses or entities where: (a) all the combining parties are ultimately controlled by the same controlling party (or parties); and (b) the transactions are conditional on a future sale such as in an IPO?