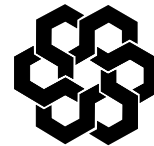


30 Cannon Street, London EC4M 6XH, England
Phone: +44 (0)20 7246 6410, Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: http://www.iasb.org

International Accounting Standards Board

This document is provided as a convenience to observers at Standards Advisory Council meetings, to assist them in following the Council's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

Note: These notes are based on the staff paper prepared for the Council. Paragraph numbers correspond to paragraph numbers used in the Council paper.

INFORMATION FOR OBSERVERS

SAC Meeting: **June 2007, London**

Project: **IASB Work Programme**
Common control transactions
(Agenda Paper 5C)

Purpose of this paper

1. The IASB has received requests to add to its agenda a project on business combinations between entities or businesses under common control, and common control transactions more generally.

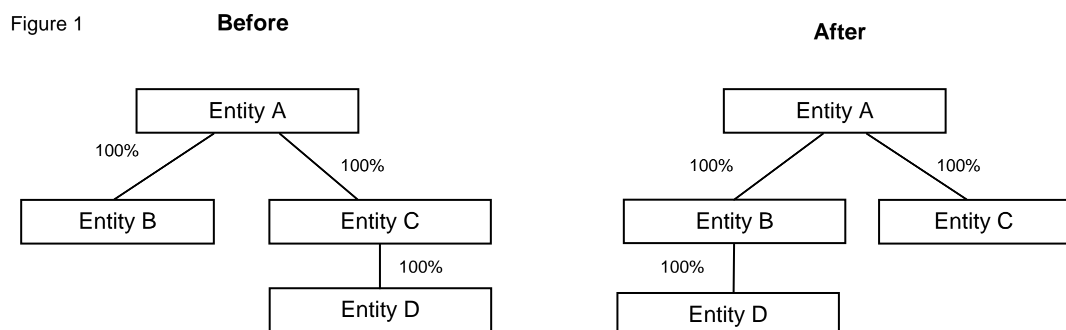
2. The purpose of this paper is to provide SAC members with a brief introduction to the nature of the problems associated with the accounting for common control transactions. The staff are currently developing an agenda proposal which they expect to present to the SAC in November.

What is a combination between entities under common control?

3. A combination is between entities or businesses under common control when the controlling party before and after a business combination is the same. A common example is the case of a group restructuring. These restructurings

might be carried out for a number of reasons, for example tax efficiencies, regulatory requirements, release of distributable reserves from 'dividend traps' or in preparation of a spin-off.

4. For example, assume that entity A owns 100% of the voting interest of entities B and C. Entity C owns 100% of the voting interest in entity D. Entity B acquires all voting interests in entity D from entity C. All entities meet the definition of a business.



5. This transaction is a common control transaction because entities B, C and D are under the control of entity A before and after the transaction. This type of restructuring might be used in preparation, for example, for the sale by initial public offering of entity B and its subsidiaries (including entity D), commonly referred to as a spin-off transaction.

What is the problem?

6. IFRSs do not provide any guidance about the accounting for business combinations between entities or businesses under common control. Such transactions are presently excluded from the scope of IFRS 3 *Business Combinations*. As a consequence, divergence in practice has arisen on the accounting treatment for those transactions.

7. In the example, entity A's financial position remains unchanged before and after the transaction. Most constituents believe therefore that entity A's financial statements should not be affected by a common control transaction.

8. However, entity B might be required to prepare consolidated financial statements by local laws and regulations or it might choose to do so. The

question is how the acquisition of entity D should be accounted for in the consolidated financial statements of entity B.

9. The following accounting methods are commonly advocated in practice:

   (a) *Acquisition method*: The common control transaction would be accounted for as if it were a business combination between unrelated parties. In the example, entity B would recognise entity D's assets and liabilities at their acquisition date fair values.

   (b) *Fresh start method*: All parties involved in the common control transaction are controlled by the same party or parties who can structure the transaction according to their wishes. As a consequence, identifying one entity as the acquirer and another entity as the acquiree might not always be representationally faithful. Under the fresh start method all assets and liabilities of the newly formed group would be measured at their fair values. In the example, both, entity B's and entity D's assets and liabilities would be measured at their acquisition date fair values.

   (c) *Uniting of interests method*: According to this view, the assets and liabilities of the involved parties should not be remeasured and rather the acquiree's book values be carried over in the acquirer's financial statements. However, it is not clear which book values should be carried over into the acquirer's financial statements. In the example, entity B could recognise entity D's assets and liabilities at their carrying values in:

      i. Entity A's consolidated financial statements;

      ii. Entity C's consolidated financial statements; or

      iii. Entity D's individual financial statements.

10. In addition to the basic issue described in paragraphs 6 to 9 the IASB has been made aware of several additional issues that could be addressed in a project on common control transactions, for example:

(a) *Non-controlling interest*: Should the existence of non-controlling interest affect the accounting for common control transactions?

(b) *Definition of a common control transaction*: Should the definition of a common control transaction be amended, e.g. to clarify the accounting for transitory common control or common control exercised by a group of individuals?

(c) *Separate financial statements*: How should a common control transaction be accounted for in the acquirer's separate financial statements?

Is there a real need to address this subject?

11. Common control transactions are not addressed in IFRSs. Many constituents have made the IASB aware that there is significant diversity on how common control transactions are accounted for in practice and have requested that the IASB provide guidance on this matter.

12. The IASB intended initially to include common control transactions in the scope of phase II of the business combinations project. However, the project scope of phase II was limited to application issues of the purchase method.

13. The IFRIC has deliberated issues related to common control transactions in 2002 and 2005. In 2002 the IFRIC discussed a staff analysis on the general concepts underpinning the accounting for common control transactions. The IFRIC did not reach a conclusion on the issues presented by the staff.

14. In 2005 the IFRIC considered whether a reorganisation involving the formation of a new entity to facilitate the sale of part of an organisation is a common control transaction and therefore excluded from the scope of IFRS 3.

15. The IFRIC also considered a request for guidance on how to apply IFRS 3 to reorganisations in which control remains within the original group (common control transactions). The IFRIC declined to add this project to the agenda on the basis that it is unlikely that the IFRIC would reach agreement in a

reasonable period, in light of existing diversity in practice and the explicit exclusion by the Board of common control transactions from the scope of IFRS 3. Therefore, a project on common control transactions would have to be undertaken by the IASB.

Next steps

16. In developing the agenda proposal the staff plans to:

    (a) undertake further research on the extent of diversity in the accounting for common control transactions in practice;

    (b) assess which issues could be addressed by other IASB projects, such as the:

        i. IASB Conceptual Framework project (Reporting Entity);

        ii. IASB project on Consolidations;

        iii. IASB project on Related Party Disclosures; and

        iv. IFRIC project on Demergers and Other In Specie Distributions

    (c) identify a project scope that addresses constituents' concerns and ensures the technical feasibility of the project;

    (d) analyse whether the project scope meets the due process criteria for adding a project to the IASB's agenda:

        i. the relevance to users of the information involved and the reliability of information that could be provided;

        ii. existing guidance available;

        iii. the possibility of increasing convergence;

        iv. the quality of the standard to be developed; and

        v. resource constraints.