Project **IAS 27 Consolidated and Separate Financial Statements**

Topic **Presentation of comparatives when applying the 'pooling of interests' method**

Introduction

1. In October the staff received a request for the IFRIC to consider an issue on the presentation of prior periods when applying the 'pooling of interests' for common control business combinations by entities preparing financial statements in accordance with IFRS. The submission is included in Appendix A without modification for reference.

2. In October the staff also received requests for the IFRIC to consider related issues regarding combined financial statements and redefining reporting entities in accordance with IFRS. Those issues are included in Agenda Paper 8B. In the staff's opinion, both Agenda Paper 8B and this Agenda Paper should be reviewed and considered together given the inter-relationship of the issues.

3. The purpose of this Agenda Paper includes:

   (a) Background of the issue;

   (b) Staff analysis and recommendations; and

   (c) Questions for the IFRIC.

Background

4. The IFRIC request relates to business combinations between entities under common control where the acquiring entity uses carry-over basis (book value).

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IFRIC.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRIC or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

Decisions made by the IFRIC are reported in IFRIC *Update*.

Interpretations are published only after the IFRIC and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in IASB *Update*.

(See Agenda Paper 8B for related questions and issues.) The IFRIC request specifically asks:

> Does IAS 27 restrict the application of the pooling of interests method of accounting such that periods prior to the date of the common control transaction cannot be restated on a combined basis?

5. The submission is included in Appendix A without modification for reference.

Staff Analysis and Recommendations

General information

6. The staff notes that IFRS does not provide specific guidance on the accounting for business combinations between entities under common control. Specifically, IFRS 3 *Business Combinations* (revised 2008) excludes from its scope business combinations between entities under common control.

7. In December 2007, the IASB added a project to its agenda on *Common Control Transactions*. At the present time, the project is listed in the 'Research and Other Projects' section of the IASB's Work Plan and the timing of the next steps for the project are not certain.

8. Additionally for reference, this Agenda Paper presumes all transactions are not transitory in nature. The staff notes the IFRIC's March 2006 agenda decision on 'transitory' common control transactions. If the transaction is deemed to be transitory, the staff recommendation is to refer to the March 2006 agenda decision for guidance.

Question 1 – Active Project
Given the Board has a project on Common Control Transactions, does the IFRIC desire to discuss these issues further?

Specific issue analysis

9. IFRS provides no direct guidance for transactions under common control where the transaction meets the definition of a 'business combination' as defined in IFRS 3 (revised 2008). Specifically, IFRS provides no guidance for the

accounting treatment by the acquiring entity as IFRS 3 excludes these transactions from its scope.

10. Paragraphs 10-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provide guidance 'in the absence of an IFRS that specifically applies to a transaction, other event or condition'. Those paragraphs require management to use its judgement in developing and applying an accounting policy that provides relevant and reliable financial statement information. Once an entity has developed an accounting policy, it should be applied consistently to similar transactions.

11. Paragraph 12 of IAS 8 states:

> In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.

12. US GAAP does have guidance specific to common control transactions. ASC 805-50-45-2 (historically paragraph D12 of FAS 141R *Business Combinations*) states, in part:

> The financial statements of the receiving entity shall report results of operations for the period in which the transfer occurs as though the transfer of net assets or exchange of equity interests had occurred at the beginning of the period. Results of operations for that period will thus comprise those of the previously separate entities combined from the beginning of the period to the date the transfer is completed and those of the combined operations from that date to the end of the period…

13. Additionally, ASC 805-50-45-5 states:

> Financial statements and financial information presented for prior years also shall be retrospectively adjusted to furnish comparative information. All adjusted financial statements and financial summaries shall indicate clearly that financial data of previously separate entities are combined. However, the comparative information in prior years shall only be adjusted for periods during which the entities were under common control.

14. When reviewing the requirements in IAS 8, in the staff's opinion, US GAAP does use a similar conceptual framework to develop accounting standards when compared to IFRS. Therefore, the focal point of consideration is based on the

last sentence of paragraph 12 of IAS 8 that stating that recent pronouncements of other standard-setting bodies can be used provided similar conceptual frameworks and 'to the extent that these do not conflict with the sources in paragraph 11.'

15. Paragraph 11 of IAS 8 states (emphasis added):

> In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order.
>
> (a) the requirements in IFRSs dealing with similar and related issues; and
>
> (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.

16. Paragraph 26 of IAS 27 *Consolidated and Separate Financial Statements* states, in part (emphasis added):

> The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date as defined in IFRS 3. Income and expenses of the subsidiary shall be based on the values of the assets and liabilities recognised in the parent's consolidated financial statements at the acquisition date…

17. In the staff's opinion, even though the scope of IFRS 3 does not include business combinations between entities under common control, the definition of a business combination as defined in IFRS 3 (revised 2008) is still met and therefore the reference in paragraph 26 of IAS 27 to 'acquisition date' as defined in IFRS 3 (revised 2008) is relevant.

18. This view (to apply paragraph 26 of IAS 27) creates consistency with guidance on 'similar and related issues' regarding the accounting treatment by the entity disposing of the subsidiary (that is purchased by the acquirer). Current IFRS provides guidance on derecognition of assets and liabilities throughout many standards.

19. Further, the guidance required by IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* requires that while the presentation in the statement of comprehensive income is adjusted, the net impact of the operations of the subsidiary being disposed of are not removed and the related assets and liabilities of the subsidiary being disposed of are not removed from the

statement of financial position. The guidance in IFRS 5 applies both prior and subsequent to the actual disposal date.

20. In the staff's opinion, IFRS has primary perspective for financial statements based on that of the reporting entity for which the financial statements relate. Parent-subsidiary relationships including the notions of common control, push down accounting, etc. is a secondary consideration that should be considered for the financial statements of the reporting entity. In the staff's opinion, the perspective of US GAAP includes a stronger focus on parent-subsidiary relationships when preparing the financial statements of the subsidiary as the reporting entity.

21. An alternative view exists in practice that IAS 27 does not restrict application of the pooling of interests method. The staff have noted supporting rationale for consideration by the IFRIC:

    (a) common control entities are excluded from the scope of IFRS 3 (revised 2008) and therefore, the reference in paragraph 26 of IAS 27 is not relevant,

    (b) IFRS does not mandate symmetrical accounting for both sides of all transactions (albeit that symmetry is often achieved by many IFRSs).

    (c) IFRS currently does not provide guidance on this transaction and therefore entities should apply the provisions of IAS 8 which permit an entity to develop an accounting policy.

    (d) US GAAP does provide specific guidance in this area and it is located in the US GAAP literature on accounting for business combinations (which was a joint project between the FASB and IASB).

22. To expand upon the alternative view, the staff notes that each of the large international accounting firms has guidance referring to IAS 8 and the notion that entities should make an accounting policy election in instances where no guidance exists in IFRS. Each of those firms also provides examples of permitted practices for the application a business combination under common control where the carry-over basis is used. These permitted practices include:

(a) Incorporate the acquired entity's results as if both entities had always been combined, or

(b) Incorporate the acquired entity's results only from the date on which the transaction occurred.

23. In the staff's opinion, the guidance in IAS 27 (and supporting rationale listed in paragraphs 16-20) does 'restrict application of the pooling of interests method' and the business combination between entities under common control should be accounted for prospectively from the date of the acquisition (with no retrospective presentation as if the entity had always been owned by the acquirer).

Question 2 – Application of IAS 27 and 'pooling of interests' method
Does the IFRIC agree with the staff opinion that the guidance in IAS 27 does restrict application of the pooling of interests method such that application should be consistent with the guidance in paragraph 26 of IAS 27?

IFRIC Agenda Criteria

24. The staff's preliminary assessment of the agenda criteria is as follows:

(a) *Is the issue widespread and practical?*

Yes. In the staff's opinion, the issue could arise in many jurisdictions as IFRS do not provide specific guidance on business combinations between entities under common control.

(b) *Does the issue involve significantly divergent interpretations (either emerging or already existing in practice)?*

Yes. In the staff's opinion, the issue involves significantly divergent interpretations as evidenced by the different publications of international accounting firms.

(c) *Would financial reporting be improved through elimination of the diversity?*

Yes. These are often material transactions and consistency is important.

(d) *Is the issue sufficiently narrow in scope to be capable of interpretation within the confines of IFRSs and the* Framework for the Preparation and Presentation of Financial Statements*, but not so narrow that it is inefficient to apply the interpretation process?*

Yes. The issue is sufficiently narrow in scope as it relates exclusively to business combinations between entities under common control and other IFRS (IAS 8, IAS 27, IFRS 5, Framework, etc) provide relevant guidance to support the interpretation.

(e) *If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? (The IFRIC will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the IFRIC would require to complete its due process.)*

Yes. The IASB has a current project on Common Control Transactions; however, it has no current timeline associated with the project.

25. In the staff's opinion, based on the assessment of the agenda criteria, all criteria are satisfied. Therefore, the staff recommends that the IFRIC add the issue to its agenda. Alternatively, if the IFRIC believe the agenda criteria are not satisfied, the staff has proposed wording for a tentative agenda decision. The tentative agenda decision wording is set out in Appendix B.

Question 3 – IFRIC Agenda Criteria
Does the IFRIC agree with the staff recommendation all of the IFRIC agenda criteria are met and that the IFRIC add the issue to its agenda? If not, does the IFRIC have any comments on the proposed wording for the tentative agenda decision in Appendix B?

[Appendix B has been omitted from this observer note]

Appendix A – IFRIC Submission

A1. The IFRIC submission received by the staff has been included below without modification (except for removal of submitter contact information).

> [The submitter] request[s] IFRIC to address the following issue on preparing financial statements following a pooling of interests, and the application of IAS 27 *Consolidated Financial Statements.*
>
> **The issue:**
>
> Common control transactions are outside the scope of IFRS 3 *Business Combinations.* As there is no other guidance in IFRS on accounting for such transactions, entities may choose a policy based on the hierarchy in paragraphs 10-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. In the absence of IFRS that deal with similar or relating issues and in the absence of guidance in the Framework, an entity may refer to guidance issued by other standard-setting bodies. Therefore, an entity may account for a common control business combination using pronouncements issued by other standard-setting bodies in other countries, as long as that guidance does not conflict with the IFRS Framework or any other IFRS.
>
> US Accounting Standards Codification (ASC) Topic 805 *Business Combinations* (formerly FASB Statement No. 141, *Business Combinations)* provides guidance on accounting for common control transactions using a method similar to the pooling of interests method.
>
> ASC 805-50-45-2 states:
>
>> "The financial statements of the receiving entity shall report results of operations for the period in which the transfer occurs as though the transfer of net assets or exchange of equity interests had occurred at the beginning of the period. Results of operations for that period will thus comprise those of the previously separate entities combined from the beginning of the period to the date the transfer is completed and those of the combined operations from that date to the end of the period. By eliminating the effects of intra-entity transactions in determining the results of operations for the period before the combination, those results will be on substantially the same basis as the results of operations for the period after the date of combination. The effects of intra-entity transactions on current assets, current liabilities, revenue, and cost of sales for periods presented and on retained earnings at the beginning of the periods presented shall be eliminated to the extent possible."

Regarding the restatement of comparative periods, ASC 805-50-45-5 states:

> "Financial statements and financial information presented for prior years also shall be retrospectively adjusted to furnish comparative information. All adjusted financial statements and financial summaries shall indicate clearly that financial data of previously separate entities are combined. However, the comparative information in prior years shall only be adjusted for periods during which the entities were under common control. "

However, paragraph 26 of IAS 27 states:

> "The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date as defined in IFRS 3. Income and expenses of the subsidiary shall be based on the values of the assets and liabilities recognised in the parent's consolidated financial statements at the acquisition date…The income and expenses of a subsidiary are included in the consolidated financial statements until the date when the parent ceases to control the subsidiary."

The issue is: if an entity accounts for a common control transaction using the pooling of interest method, as described in ASC Topic 805, how does the application of IAS 27 *Consolidated and Separate Financial Statements* affect the presentation of these financial statements?

Current practice:

An illustration of each of the views is in Appendix A[A to the original submission].

View A

The requirements of IAS 27 *Consolidated Financial Statements* are not in conflict with the concept of pooling. The financial statements are presented as though the common control transaction occurred at the beginning of the earliest comparative period, consistent with the requirements ASC Topic 805.

In common control transactions, the logic of using the pooling of interests method is that there is no change in control – the ultimate controlling party always controlled the combined resources – it merely changed the location of its resources. The fundamental concept behind a pooling of interests is that there is a uniting of ownership interests:

- no corporate assets are disbursed to shareholders;

- the net assets of the receiving entity are enlarged by the net assets of the separate entities that were combined;
- there is no newly invested capital;
- the ultimate owners have not withdrawn assets from the group; and
- the total resources are not changes.

If the combination is reflected from the date of the transaction, the pooling of interests method is applied in a manner that is inconsistent with its underlying principle. Therefore, if it is believed that the two entities should only be combined subsequent to the date of the common control transaction, then the pooling of interests method of accounting should not be applied.

We also noted that the same concept of consolidating an acquired subsidiary from the date of acquisition in a business combination as stated in paragraph 26 of IAS 27 also exists in US GAAP. Specifically ASC 810-10-65-1 states:

> "When a subsidiary is initially consolidated during the year, the consolidated financial statements shall include the subsidiary's revenues, expenses, gains, and losses only from the date the subsidiary is initially consolidated."

US GAAP clearly supports the presentation of a common control transaction as though it occurred at the beginning of the earliest comparative period, while maintaining a requirement similar to that in IAS 27 when a subsidiary is acquired in a business combination.

View B

The requirements of IAS 27 are in conflict with the concepts of pooling, hence information for the combined entity can be prepared for periods before the common control transaction occurs.

Specifically, the scope of IAS 27 applies to all consolidated financial statements, without any scope exclusions for common control transactions. The fact that this transaction is outside of the scope of IFRS 3 is irrelevant when considering the requirements of IAS 27. Therefore, even though the pooling method is applied, it only affects the values assigned to the assets. Paragraph 26 of IAS 27 must still be applied, which will restrict when the effects of the combination of the entities can be presented.

If this view is not taken, when a subsidiary is transferred from one subsidiary in a group to another subsidiary in the group, then both the transferring subsidiary party and the receiving subsidiary include the results of the transferred subsidiary in their financial statements for the period prior to the transfer.

Reasons for the IFRIC to address the issue:

As described above, there are diverse views regarding the preparation of financial statements in accordance with IFRS when the pooling of interests method is applied to account for a common control transaction. We are aware of preparers, auditors, and regulators that hold each of the views above. The views held by regulators are frequently influenced by their local GAAP. As more countries are adopting IFRS, there is increasing pressure from regulators for financial statements to be in accordance with IFRS as issued by the IASB.

As more countries are adopting IFRS, there is increasing pressure from regulators for financial statements to be in accordance with IFRS as issued by the IASB.

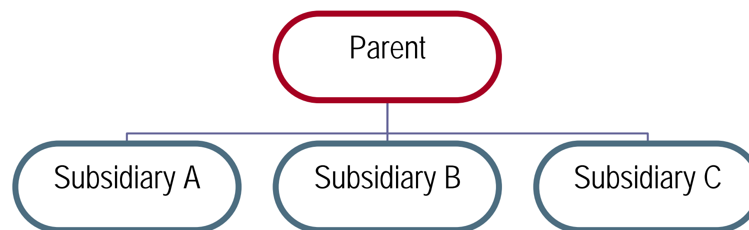
However, as the business community is facing practical issues today, we believe that IFRIC can enhance financial reporting by answering the following question:

1. Does IAS 27 restrict the application of the pooling of interests method of accounting such that periods prior to the date of the common control transaction cannot be restated on a combined basis?

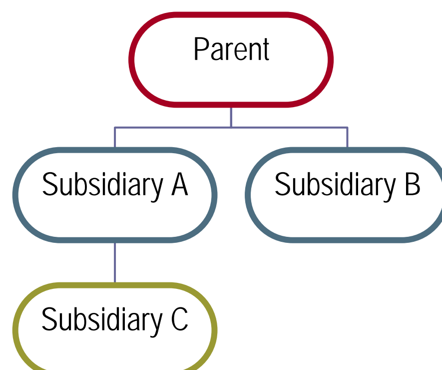
Appendix A[A to the original submission]

Fact pattern:

A group has the following structure from 1 January 2008 to 13 September 2009:



On 13, September 2009, the entity completed a common control transaction whereby Subsidiary A now controls Subsidiary C.



During the entire period (2008 and 2009) Subsidiary A, Subsidiary B and Subsidiary C are all ultimately controlled by the Parent. All subsidiaries are active businesses.

Issue:

How does Subsidiary A present its financial statements for the years ended 31 December 2008 and 2009, under IFRS?

Interpretative analysis of issues:

View A

The consolidated financial statements for the year ended 31 December 2009 of Subsidiary A are presented as if Subsidiary A always controlled Subsidiary C. Thus, the results for the period from 1 January 2009 of Subsidiary A are added to the results for the period from 1 January 2009 of Subsidiary C, with transactions between Subsidiary C and Subsidiary A being eliminated.

The comparative financial statements are also presented as if Subsidiary A always controlled Subsidiary C. Thus, the results for the comparative period from 1 January 2008 to 31 December 2008 of Subsidiary A are restated by adding the results for the period from 1 January 2008 to 31 December 2008 of Subsidiary C, with transactions between Subsidiary C and Subsidiary A being eliminated.

View B

The consolidated financial statements for the year ended 31 December 2009 of Subsidiary A are presented showing Subsidiary A only controlling Subsidiary C from 13 September 2009 and thereafter. Thus, the results for the period from 1 January 2009 to 13 September of Subsidiary C are not added to the results for the period from 1 January 2009 of Subsidiary A. Rather, the results of Subsidiary C from 13 September are added to Subsidiary A's results, with transactions between Subsidiary C and Subsidiary A being eliminated from 13 September 2009 to 31 December 2009.

There is also no change to the comparative financial statements of Subsidiary A from what it previously presented (when it originally issued 31 December 2008 financial statements). That is, transactions with Subsidiary C are not included in the comparative information, and neither are transactions between Subsidiary C and Subsidiary A eliminated for the period from 1 January 2008 to 31 December 2008.