IFRS Interpretations Committee Meeting

Staff Paper

Agenda reference 3B

Date September 2011

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Project **Agenda decision**

Topic **IFRS 3 *Business combinations*—Business combinations under common control (review of tentative agenda decision)**

## Introduction

1. The IFRS Interpretations Committee (the Committee) received a request for guidance on the accounting for business combinations under common control. More specifically, the submitter provided a fact pattern that illustrated a type of common control transaction in which the parent company ('Entity A'), which is 100 per cent owned by Shareholder A, transfers a business ('Business A') to a new entity ('Newco') formed by Shareholder A.

2. The Committee discussed the issue at its meeting in July 2011 and issued a tentative agenda decision not to take the issue on to its agenda.

3. The full staff analysis that was presented at the Interpretations Committee in July 2011 was set out in agenda paper 6B, which can be found on the public website[1]

4. We received five comment letters, which are analysed in the following paragraphs.

[1]http://www.ifrs.org/Current+Projects/IFRIC+Projects/Tentative+agenda+decisions+currently+available+for+comment.htm

## Comment letters analysis

### *Aspects where there is general agreement among respondents*

5. There was general support among respondents on the following aspects of the Committee's conclusions:

   (a) the issues raised by the submitter are widespread and diversity in practice exists;

   (b) the Committee should not take this issue onto its active agenda at this stage; and

   (c) the accounting for common control transactions is a topic that should be considered by the Board in its future agenda.

### *Summary of views*

6. One respondent fully agreed with the Committee's analysis and conclusion in the tentative agenda decision.

7. Four respondents disagreed with the current wording of the Committee's tentative decision and suggested that the Committee re-consider the drafting of the tentative agenda decisions, for the following reasons:

   (a) Two respondents thought that the agenda decision should not respond to issues in such detail because the agenda decision:

      (i) Might be interpreted inappropriately as a "*de facto* interpretation" and could therefore be prescriptively but inappropriately applied to other types of 'Newco' formations (Respondent 1).

      (ii) Should not provide comments or guidance about the application of IFRSs to the fact pattern described in the submission (Respondent 2).

(b) Two respondents do not think it clear that under IFRS 3 the fact pattern described reflects a 'business combination' under common control because they do not think that there is a business combination.

8. These areas of disagreement are discussed in further detail below.

## Staff analysis

### *Level of detail of agenda decision*

9. One respondent was concerned that the Committee's conclusions could be viewed as a *de facto* interpretation of the accounting for certain common classes of transactions used in spin-offs and asked the Committee to reconsider revising its tentative agenda decision.

10. Another respondent thought that the Committee should:

(a) refrain from providing any analysis on the issue submitted;

(b) not provide comments or guidance about the application of IFRSs to a fact pattern described by a submitter in an agenda decision;

(c) only refer to the IFRS literature used to support the Committee's technical analysis; and

(d) explain which of the agenda criteria were not met.

*Proposed modifications to the tentative agenda decision*

11. To avoid reading the Committee's agenda decision as a *de facto* interpretation, one of the respondents suggested amending the second paragraph of the agenda decision by quoting the definition of a business combination under common control and by omitting the Committee's specific analysis of the fact pattern, as follows:

> The Committee noted that ~~the fact pattern described by the submitter reflects a business combination under common control in accordance with~~ <u>paragraph B1 in IFRS 3 defines a business combination under common control as "…a business combination in which all of the combining entities or businesses are ultimately</u>

controlled by the same party or parties both before and after the business combination, and that control is not transitory." ~~because it is the same party (Shareholder A) that controls the combining entities both before and after the transfer of Business A. The Committee also noted that the possibility of an IPO occurring after the transfer of Business A to Newco should not impact the classification of this transfer as is a business combination under common control~~.

*Our view*

12. As we stated in paragraphs 25–27 from agenda paper 3A of September 2011, we think that determining the right level of detail in agenda decisions is a controversial area. While some might consider that increasing the level of detail may contribute to the transparency of rejection decisions, others believe that detailed agenda decisions lead to non-authoritative 'quasi-interpretations'.

13. We think that although there is sufficient guidance in IFRSs to address the issue submitted, we think that the application of IFRSs to the fact pattern submitted requires a reasonable level of judgment and therefore could be subject to different interpretations. In our opinion, the Committee should avoid unnecessary detail that could be understood by readers as a non-authoritative interpretation.

14. Consequently, in line with **Approach A** (as described in paragraph 29 of agenda paper 3A (September 2011)), we think that the agenda decision on the issue submitted should:

(a) refrain from explaining the application of specific paragraphs in IFRSs to the fact pattern analysed;

(b) clearly state that the fact pattern submitted cannot be analysed either through an agenda decision or through an interpretation or through an annual improvement;

(c) give the reasons why the agenda criteria were not met; and

(d) indicate that the transaction could be better analysed within the context of another broader project (if the Board has any plans to address a related project at a later stage).

***It is unclear that, in accordance with IFRS 3, the fact pattern described reflects a* business combination *under common control***

15. The tentative agenda decision observes that paragraph B1 in IFRS 3 could be applicable to the fact pattern analysed because it is the same party (Shareholder A) that controls the combining entities both before and after the transfer of Business A (refer to our staff analysis in paragraphs 12–15 of agenda paper 6B of July 2011). Paragraph B1 of IFRS 3 is quoted below (emphasis added):

> B1 This IFRS does not apply to a business combination of entities or businesses under common control. **A business combination involving entities or businesses under common control is a business combination** in which all of 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.

16. Some respondents believe that the current wording of the agenda decision could lead readers to believe that:

    (a) the fact pattern analysed is considered a business combination and acquisition accounting *must* be applied; and

    (b) Newco can be considered the acquirer.

17. Those respondents think that a practical implication of such misinterpretation is that Newco formations could be used as structuring mechanisms to achieve the re-basing of the carrying amounts of assets and liabilities but the same transaction effected without the use of a Newco formation would not result in such re-basing.

18. Other respondents think that the fact pattern analysed does not meet the definition of a business combination because, for those entities that choose to apply IFRS 3 by analogy in accounting for such combinations, one would conclude it is Business A and not Newco that should be the acquirer. They go on to point out that because Newco does not contain a business, Business A has not acquired a business and therefore there has not been a business combination.

19. Respondents' views are explained in a couple of excerpts from their comment letters (emphasis added):

(Respondent 1)

"However, we do not believe that it is clear under IFRS that the fact pattern described reflects a **business combination under common control.** This is because if it were within the scope of IFRS 3, one would conclude that the Newco **was not** the acquirer. This conclusion would then mean that the transferred business is the acquirer and the acquiree is Newco. However, since Newco as the acquiree is **not** a business**, the transaction would not be a business combination."**

(Respondent 2)

"One of the difficult areas in common control transactions is identifying the acquirer; this is because of the involvement of a controlling shareholder. However, in the fact pattern presented we believe that Business A would be the acquirer based on B18 of IFRS 3: if a new entity is formed to effect a business combination, then one of the combining entities that existed before the business combination is identified as the acquirer. In this example that would be Business A. Accordingly, since Business A is the acquirer, Newco would be the acquiree in an IFRS 3 analysis. However, since the acquiree is not a business, **there is no business combination".**

*Proposed modifications to the tentative agenda decision*

20. Consequently, one respondent suggested that, to avoid misinterpretations of the fact pattern analysed, the Committee should replace the phrase in the second paragraph of the agenda decision:

> "a business combination under common control in accordance with paragraph B1 in IFRS 3"

with:

> "a combination of entities or businesses under common control in accordance with paragraph 2(c) of IFRS 3".

21. In addition, the same respondent believed that the Committee should, in the second paragraph of the agenda decision, clarify that the acquisition of Business A by Newco was not conditional upon an initial public offering occurring and suggested the following clarification:

> "The Committee also noted that the possibility of an IPO occurring after the transfer of Business A to Newco should not impact the classification of this transfer as a ~~business~~ combination <u>of entities or businesses</u> under common control<u>, unless the transfer is conditional upon the IPO occurring.</u>"

*Our view*

22. We acknowledge the respondents' view that the fact pattern analysed is not a 'business combination' as in the scope of IFRS 3. We also agree that the agenda decision could refer instead to paragraph 2(c) of IFRS 3 to acknowledge this view. We however, note that paragraph 2(c) of IFRS 3 is further referred to paragraphs B1–B4 that provide application guidance for **business combinations** of entities under common control (BCUCC). We also think that the exclusion of BCUCC from the scope of IFRS 3 does not prevent entities from applying IFRS 3 by analogy as we discussed in paragraphs 16–21 in agenda paper 6B (July 2011).

23. We disagree with the respondents' proposal to clarify that the acquisition of Business A by Newco was not conditional upon the IPO occurring, because this event was not part of the fact pattern analysed by the Committee (refer to Issues 1 and 2 in agenda paper 6B from July 2011). We should note, however, that the fact pattern analysed in agenda paper 6A from July 2011 does refer to an acquisition conditional to an IPO occurring and should not be confused with the fact pattern analysed in agenda paper 6B.

## Staff recommendation

24. We think that in line with **Approach A** (as described in paragraph 29 of agenda paper 3A (September 2011)), the agenda decision on the issue submitted should:

    (a) refrain from explaining the application of specific paragraphs in IFRSs to the fact pattern analysed;

    (b) clearly state that the fact pattern submitted cannot be analysed either through an agenda decision or through an interpretation or through an annual improvement (ie the Committee has no current plans for addressing the accounting for BCUCC);

    (c) give the reasons why the agenda criteria were not met; and

(d) indicate that the transaction could be better analysed within the context of another broader project (ie the Committee should recommend that the Board addresses the fact pattern described in the submission as part of its project on common control transactions).

25. In addition, as one of the respondents suggested, we should clarify in the last paragraph of the agenda decision that transactions related to BCUCC have been brought forward several times to the Committee's attention.

26. We recommend that the Interpretations Committee should finalise the agenda decision with proposed changes shown in Appendix A.

| **Question 1 – Final agenda decision** |
|---|
| 1. Does the Interpretations Committee agree with our recommendation to make some modifications to the tentative agenda decision as stated in paragraph 24 to finalise it?<br><br>2. Does the Committee have any further comments on the wording for the final agenda decision in Appendix A? |

# Appendix A—Proposed wording for tentative agenda decision

A1 The staff propose the following wording for the tentative agenda decision:

**IFRS 3 *Business Combinations*—business combinations involving newly formed entities: business combinations under common control**

The Interpretations Committee received a request for guidance on accounting for business combinations under common control. More specifically, the submission describes a fact pattern that illustrates a type of common control transaction in which the parent company (Entity A), which is wholly owned by Shareholder A, transfers a business (Business A) to a new entity (referred to as 'Newco') also wholly owned by Shareholder A. The submission requests clarification on (a) the accounting at the time of the transfer of the business to Newco; and (b) whether an initial public offering (IPO) of Newco, which might occur after the transfer of Business A to Newco, is considered relevant in analysing the transaction under IFRS 3.

The Committee observed that ~~noted that the fact pattern described by the submitter reflects a business combination under common control in accordance with paragraph B1 in IFRS 3 because it is the same party (Shareholder A) that controls the combining entities both before and after the transfer of Business A. The Committee also noted that the possibility of an IPO occurring after the transfer of Business A to Newco should not impact the classification of this transfer as is a business combination under common control.~~ the accounting for a fact pattern involving common control transactions is too complex in practice to be analysed through an agenda decision or to be addressed through an interpretation or through an annual improvement. The Committee determined that the specific fact pattern submitted would be better considered within the context of a broader project on accounting for common control transactions, which the Board is planning to address at a later stage. The Committee also noted that the issues raised by the submitter have previously been brought to the Board's attention and the accounting for business combinations under common control is a topic for consideration in determining the Board's future agenda.

~~The Committee also observed that paragraph B1 in IFRS 3 explicitly excludes business combinations between entities under common control from its scope.~~

~~The Committee noted that the issues raised by the submitter are widespread and that diversity in practice exists. However, the Committee thinks that the accounting for business combinations under common control is too broad to be addressed through an interpretation and that the Board has planned to address the accounting for business combinations under common control at a later stage.~~ Consequently, the Committee [decided] not to add this issue to its agenda.

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Mr Wayne Upton
Chairman
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Our ref MT/288
Contact Mary Tokar

11 August 2011

Dear Mr Upton

**Tentative agenda decisions: IFRS 3 *Business Combinations* – business combinations involving newly formed entities**

We appreciate the opportunity to comment on the IFRS Interpretations Committee's publication in the July 2011 IFRIC Update of the two tentative decisions relating to Newco formations prior to an initial public offering (IPO):

- business combinations under common control; and
- factors affecting identification of the acquirer.

While in both cases we agree with the Committee's decision not to take the issue onto its active agenda at this point, we do not believe that the agenda decisions should respond to the issues at such a level of detail. Further, we are concerned that some of the statements made in the IFRIC Update may be interpreted inappropriately by readers as a directive to follow the specific accounting discussed, especially when coupled with the staff analysis in the public observer notes.

The accounting for business combinations under common control is a complex area because of the wide array of such transactions, either stand-alone or linked with other transactions, that occur in practice. Since in practice the issue of Newco formations is inextricably linked with business combinations under common control, subject to the outcome of the *Agenda Consultation 2011*, we would expect that the Board's project on common control business combinations would address this area as well. Only if the Board decides not to proceed with the common control project would we expect the Committee to consider adding Newco formations to its agenda and issuing a formal interpretation, which would need to include appropriate transitional guidance.

Without a formal project (at the Board or Committee level), any attempts to consider isolated aspects of the accounting are at risk of being applied more prescriptively and more broadly than would be appropriate.

- **Business combinations under common control.** If the wording of the tentative agenda decision is retained, then we believe that it could be read as requiring a Newco to be identified as the acquirer in a business combination under common control. For entities that choose to apply IFRS 3 by analogy in accounting for such business combinations, this means that acquisition accounting would be applied to the acquired businesses. The practical implication is that Newcos could be used as structuring mechanisms to achieve the re-basing of the carrying amounts of assets and liabilities when the same transaction effected without the use of a Newco would not result in such re-basing.

  Further, in our view, in transactions in which a Newco controlled by a Group acquires another Group entity, generally the definition of a business combination is not met and therefore the transaction is not considered a business combination under common control. Our basis for this view is set out in Appendix 1 to this letter.

- **Factors affecting identification of the acquirer.** Regarding the wording of the tentative agenda decision, we believe that the IFRIC Update as written could increase the prevalence of conditional Newco formations in IPOs to achieve a desired accounting outcome without a change in economic substance. In many jurisdictions it will not be difficult to insert a conditional Newco into the listing process, if the desired outcome is that Newco can apply acquisition accounting.

  Conversely, the decision may result in an undesirable outcome for entities that operate in jurisdictions in which the structure addressed by the Committee is prevalent, who do not believe that they should apply acquisition accounting based on the substance of the transaction. We are aware that at least in Australia this structure is not uncommon, and the decision may be interpreted as providing a clear mandate as to how such transactions should be accounted for.

Accordingly, we believe that the final agenda decisions should refrain from offering any analysis of the accounting.

Appendices 1 and 2 to this letter contain our detailed technical responses to the tentative agenda decisions. We have published guidance on Newco formations and would be happy to discuss our comments in more detail.

Please contact Mary Tokar or Julie Santoro at +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited

**Appendix 1: Business combinations under common control**

We agree with the Committee that the fact pattern considered is widespread in practice.

**Is there a business combination under common control?**

In order for there to be a business combination under common control, first and foremost there must be a business combination. In the fact pattern presented we believe that there is not a business combination.

One of the difficult areas in common control transactions is identifying the acquirer; this is because of the involvement of a controlling shareholder. However, in the fact pattern presented we believe that Business A would be the acquirer based on B18 of IFRS 3: if a new entity is formed to effect a business combination, then one of the combining entities that existed before the business combination is identified as the acquirer. In this example that would be Business A.

Accordingly, since Business A is the acquirer, Newco would be the acquiree in an IFRS 3 analysis. However, since the acquiree is not a business, there is no business combination.

As a general comment, when a Newco controlled by the Parent acquires another subsidiary for cash, we believe that B15-B18 rather than B14 should be considered in identifying the acquirer. This is because in substance the transaction has still been effected through the issue of equity instruments, as the transaction was initiated through the issue of equity instruments when the Newco was created.

Another possibility, which might be inferred but is not stated in the IFRIC Update, is that Business A is a group of entities. In that case there might be a temptation by some to identify one entity within Business A as the acquirer, and the other entities within Business A as the acquirees. However, we believe that such an analysis generally would not be appropriate in accordance with IFRS 3. The following example best explains our reasoning:

- Business A acquires Business B (two independent groups) in a business combination.
- In identifying an acquirer, it would be either Business A *or* Business B; we would not conclude, for example, that part of Business A was the acquirer, with acquisition accounting then applied to both Business B and the remaining parts of Business A.

Similarly, we would not conclude that only part of Business A is the acquirer in the fact pattern described in the IFRIC Update.

**Agenda decision wording**

As noted in our covering letter, if the wording of the tentative agenda decision is retained, then we believe that it could be read as requiring a Newco to be identified as the acquirer in a business combination under common control. For entities that choose to apply IFRS 3 by analogy in accounting for such business combinations, this means that acquisition accounting would be applied to the acquired businesses. The practical implication is that Newcos could be used as structuring mechanisms to achieve the re-basing of the carrying amounts of assets and liabilities when the same transaction effected without the use of a Newco would not result in such re-basing.

**Appendix 2: Factors affecting identification of the acquirer**

We agree with the Committee that the fact pattern considered (Newco formation conditional on an IPO) generally is not widespread in practice; however, we are aware that at least in Australia such structures are not uncommon.

**Who is the acquirer?**

The accounting for Newco formations is complex. At some level we can understand a conclusion that Newco is the acquirer in a business combination when the acquisition is conditional on the IPO, which represents a change in control. However, typically there are many issues that need to be considered in respect of Newco formations. The following are some of the issues that we believe need to be addressed in the specific fact pattern considered by the Committee.

- The IFRIC Update discussion appears to conclude that there is linkage between the set up of the conditional Newco and the issue/sale of shares through the IPO to external parties. However, it also could be argued that there is no such linkage: the creation of the conditional Newco is the preferred structure of the existing owners to allow them to IPO at some point in the future, to which the future shareholders after the IPO have no input; on that basis it could be argued that the two transactions are unrelated.

- Is the conditionality in the fact pattern an indicator of the substance of the transaction or a conclusive fact that drives the accounting?

- If the transfer of the subsidiaries to Newco results in a requirement to apply acquisition accounting to those subsidiaries, then why would the same accounting (a step-up in values) not be available when no Newco is involved, e.g. if the business to be listed is already in a holding group structure? In other words, in what instances should the structure of a transaction change the accounting outcome? This is particularly relevant since a Newco has no substance on its own (i.e. it is somebody’s vehicle in any transaction) and could be transitory (e.g. if a downstream merger follows the IPO, such that Newco then ceases to exist).

We acknowledge that these are difficult questions to answer. As emphasised in our covering letter, we believe that this issue is too complex to be dealt with as an agenda decision of the IFRS Interpretations Committee.

**Agenda decision wording**

As noted in our covering letter, we believe that the IFRIC Update as written could increase the prevalence of conditional Newco formations in IPOs to achieve a desired accounting outcome without a change in economic substance. In many jurisdictions it will not be difficult to insert a conditional Newco into the listing process, if the desired outcome is that Newco can apply acquisition accounting.

Conversely, the decision may result in an undesirable outcome for entities that operate in jurisdictions in which the structure addressed by the Committee is prevalent, who do not believe that they should apply acquisition accounting based on the substance of the transaction. We are aware that at least in Australia this structure is not uncommon, and the decision may be interpreted as providing a clear mandate as to how such transactions should be accounted for.

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12 August 2011

Wayne Upton
Chairman
IFRS Interpretations Committee
30 Cannon Street
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UNITED KINGDOM

Dear Wayne

**Tentative agenda decisions:**
- **IFRS 3 *Business Combinations* – business combinations involving newly formed entities: factors affecting identification of the acquirer (Issue 1); and**
- **IFRS 3 *Business Combinations* – business combinations involving newly formed entities: business combinations under common control (Issue 2)**

We wish to provide comment to the IFRS Interpretations Committee (the "Committee") on the above tentative agenda decisions (published in the July 2011 IFRIC Update). We are not convinced that the logic for rejecting Issue 1, as published, is appropriate, for the reasons expressed below.

As a general comment, we think that the fact patterns addressed in the tentative agenda decisions are very broad. Accordingly, we are concerned that constituents will view the Committee's conclusions as a defacto interpretation of the accounting for certain common classes of transactions used in spin-offs. We do not think that this is appropriate as we believe that that the conclusion for Issue 1 is contentious.

Although we acknowledge the Committee's attempts to limit the conclusions to the specific fact patterns described in the submissions, we are concerned that the views expressed by the Committee, in relation to a *conditional* Initial Public Offering ("IPO") and an IPO which *might* occur after the transfer of a business, are inconsistent. We think that both circumstances are likely to be considered business combinations under common control and that they would be accounted for as such in practice[1].

We say this because we do not think that the references to "ultimate control" and "not transitory" are relevant to the accounting for the absolute control Entity A has over Newco before and after the transfer of businesses, and before the IPO. We believe those phrases are more relevant to structures in which another controlling party exists and either has indirect control through a chain or has an agreement that will provide for access to actual control. It is also not clear to us how the Newco formed for the business combination could qualify as an acquirer under IFRS 3.

Accordingly, whilst we are supportive of the decision by the Committee not to add these issues to its agenda, we are not convinced by the logic provided for Issue 1.

[1] Accounted for by applying the acquisition method or the pooling method as an accounting policy choice.

If the view of the Committee is to stand for Issue 1, we believe that clarification on how 'conditionality' should be regarded in such transactions would be needed to help identify whether the transaction is a business combination under common control or not, and would be needed to distinguish this fact pattern from the tentative agenda decision addressing Issue 2.

We would also like to emphasise that transactions that are the subject of Issue 1 are not uncommon in Australia. However, the views of the Committee under Issue 1 would lead to significant changes in practice, possibly retrospectively, because of the use of the tentative agenda decision. We ask that the Committee re-consider the drafting of the tentative agenda decisions at its September 2011 meeting to address the above concerns.

If you require further information regarding any matters in this letter, please contact me or Nikole Gyles (ngyles@aasb.gov.au).

Yours sincerely

K.M. Stevenson

Kevin M. Stevenson
*Chairman and CEO*

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Mr Wayne Upton
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Email: ifric@ifrs.org

15 August 2011

Dear Mr Upton,

**Tentative agenda decision: IFRS 3: Business Combinations – Business combinations involving newly formed entities: business combinations under common control**

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretation Committee's publication in the July 2011 *IFRIC Update* of the tentative decision not to take onto the IFRIC's agenda requests for Interpretations of IFRS 3, *Business Combinations*, with respect to business combinations under common control involving newly formed entities.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decisions.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0)20 7007 0884.

Yours sincerely,

**Veronica Poole**
Global Managing Director
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21 July 2011

Dear IFRS Interpretations Committee members,

**Tentative Agenda Decision – IFRS 3 *Business Combinations* – business combinations involving newly formed entities: business combinations under common control**

The global organisation of Ernst & Young is pleased to submit its comments on the above Tentative Agenda Decision as published in the July 2011 IFRIC Update.

The IFRS Interpretations Committee was asked for guidance on

> "a fact pattern that illustrates a type of common control transaction in which the parent company (Entity A), which is wholly owned by Shareholder A, transfers a business (Business A) to a new entity (referred to as 'Newco') also wholly owned by Shareholder A. The submission requests clarification on (a) the accounting at the time of the transfer of the business to Newco; and (b) whether an initial public offering (IPO) of Newco, which might occur after the transfer of Business A to Newco, is considered relevant in analysing the transaction under IFRS 3."

The IFRS Interpretations Committee concluded that the fact pattern described by the submitter reflects a **business combination** under common control and decided not to add this issue to its Agenda, because the accounting for business combinations under common control is too broad to be addressed through an interpretation. We agree with the IFRS Interpretations Committee's decision not to add this issue to its Agenda.

However, we do not believe that it is clear under IFRS that the fact pattern described reflects a **business combination** under common control. This is because if it were within the scope of IFRS 3, one would conclude that the Newco was **not** the acquirer. This conclusion would then mean that the transferred business is the acquirer and the acquiree is Newco. However, since Newco as the acquiree is **not** a business, the transaction would not be a business combination.

If the IFRS Interpretations Committee believes that this transaction meets the definition of a business combination, the reasons for that conclusion should be added to the Agenda Decision. Alternatively, we believe that the phrase "combination of entities or business under common control" should be used, consistent with the wording of paragraph 2(c) of IFRS 3.

In addition, we believe that the Tentative Agenda Decision should also clarify that in the fact pattern in the submission, that the acquisition of A by the Newco was not conditional upon the IPO occurring.

Accordingly, we recommend the following revisions to the Tentative Agenda Decision:

> "The Committee also noted that the possibility of an IPO occurring after the transfer of Business A to Newco should not impact the classification of this transfer as a ~~business~~ combination of entities or businesses under common control, unless the transfer is conditional upon the IPO occurring."

This will clarify why the conclusion on the fact pattern in this submission is a common control transaction, as compared to the fact pattern raised in the other submission addressed at the July 2011 meeting ("business combinations involving newly formed entities: factors affecting identification of the acquirer"), where it was concluded that the transaction was **not** under common control.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully

Ernst & Young

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August 17, 2011

(by e-mail to ifric@ifrs.org)

IFRS Interpretations Committee
30 Cannon Street,
London   EC4M 6XH
United Kingdom

Dear Sirs,

**Re: Tentative agenda decision on IFRS 3 *Business Combinations* – business combinations involving newly formed entities: business combinations under common control**

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IFRS Interpretations Committee's tentative agenda decision on the accounting for business combinations under common control. This tentative agenda decision was published in the July 2011 IFRIC Update.

The views expressed in this letter take into account comments from individual members of the AcSB staff but do not necessarily represent a common view of the AcSB or its staff. Views of the AcSB are developed only through due process.

We agree with the Committee's decision not to add this item to its agenda for the reasons provided in the tentative agenda decision. However, we think that the wording of the tentative agenda decision needs to be revised because the Committee should not provide comments or guidance about the application of IFRSs to a fact pattern described by a submitter in an agenda decision. When an issue submitted for interpretation is not added to the agenda, the agenda decision should be restricted to referring to IFRS literature that the Committee thinks should be considered and explaining which of the agenda criteria were not met. Therefore, we think the tentative agenda decision needs to be modified as follows:

- We recommend deleting most of the wording in the second paragraph. The Committee's views about whether or why the fact pattern described by the submitter represents a business combination under common control are not relevant as an interpretation is not being developed. We think the final paragraph adequately explains the Committee's rationale for deciding not to add the issue to its agenda.

- We recommend including a quote of the definition of a business combination under common control in the second paragraph (i.e. instead of only including a reference to paragraph B1 in IFRS 3). We think that an agenda decision should highlight excerpts from the relevant IFRSs that the submitter should consider.

- We recommend revising the wording in the final paragraph to clarify that the Board has no current plans to address the accounting for business combinations under common control and that this topic is one of many topics under consideration for the Board's future agenda.

The Appendix reflects our recommendations and drafting suggestions.

We would be pleased to provide more detail if you require. If so, please contact me at +1 416 204-3276 (e-mail peter.martin@cica.ca), or Kathryn Ingram, Principal, Accounting Standards at +1 416 204-3475 (e-mail kathryn.ingram@cica.ca).

Yours truly,

P. Martin

Peter Martin, CA
Director,
Accounting Standards

## Appendix

We suggest clarifying the tentative agenda decision as follows:

**IFRS 3 *Business Combinations* – business combinations involving newly formed entities: business combinations under common control**

The Interpretations Committee received a request for guidance on accounting for business combinations under common control. More specifically, the submission describes a fact pattern that illustrates a type of common control transaction in which the parent company (Entity A), which is wholly owned by Shareholder A, transfers a business (Business A) to a new entity (referred to as 'Newco') also wholly owned by Shareholder A. The submission requests clarification on (a) the accounting at the time of the transfer of the business to Newco; and (b) whether an initial public offering (IPO) of Newco, which might occur after the transfer of Business A to Newco, is considered relevant in analysing the transaction under IFRS 3.

The Committee noted that ~~the fact pattern described by the submitter reflects a business combination under common control in accordance with~~ paragraph B1 in IFRS 3 defines a business combination under common control as "…a business combination in which all of 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." ~~because it is the same party (Shareholder A) that controls the combining entities both before and after the transfer of Business A. The Committee also noted that the possibility of an IPO occurring after the transfer of Business A to Newco should not impact the classification of this transfer as is a business combination under common control.~~

The Committee also observed that paragraph B1 in IFRS 3 explicitly excludes business combinations between entities under common control from ~~its~~ the scope of the standard.

The Committee noted that the issues raised by the submitter are widespread and that diversity in practice exists. However, the Committee thinks that the accounting for business combinations under common control is too broad to be addressed through an interpretation ~~and that the Board has planned to address the accounting for business combinations under common control at a later stage~~. Consequently, the Committee [decided] not to add this issue to its agenda. The Committee also noted that the issues raised by the submitter have previously been brought to the Board's attention and the accounting for business combinations under common control is a topic for consideration in determining the Board's future agenda.