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STAFF PAPER

12 – 13 March 2013

IFRS Interpretations Committee Meeting

IFRS IC Sep 2012/ Nov 2012

Project	**Review of tentative agenda decision**
Paper topic	IFRS 3 *Business Combinations*: accounting for reverse acquisition transactions where the acquiree is not a business

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Introduction

1. In September 2012, the IFRS Interpretations Committee (the Interpretations Committee) discussed two requests to provide guidance on how to account for two reverse acquisition transactions in which the accounting acquiree is not a business. This is because the submitters claimed that IFRS 3 *Business Combinations* does not provide specific guidance for this case and, as a consequence, there is diversity in practice.

2. Our analysis of this issue was included in Agenda Paper 15 of September 2012 and Agenda Paper 6 of November 2012.

3. The Interpretations Committee decided that the accounting for the fact patterns analysed could be resolved efficiently within the confines of existing IFRSs and concluded that neither an interpretation nor an amendment to IFRSs was necessary.

4. In the tentative agenda decision, the Interpretations Committee determined that:

   (a) the transactions analysed are considered to be in substance share-based payments that would be accounted for in accordance with IFRS 2 *Share-based Payment*; and

   (b) an entity would need to develop an accounting policy based on the guidance for reverse acquisitions in paragraphs B19-B27 of IFRS 3, in order to identify the accounting acquirer in the transactions and to measure the consideration transferred. IFRS 3 would be applied, by analogy, in line with paragraphs 10–11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

5. The Interpretations Committee's full tentative agenda decision can be found in the IFRIC Update (November 2012).

Comment letter summary

6. The comment period for the tentative agenda decision ended on 22 January 2013. We received five responses.

7. One respondent[1] agrees with the tentative agenda decision as drafted.

8. One respondent[2] asks the Interpretations Committee to reconsider the tentative agenda decision. This is because the respondent thinks that IFRS 2 *Share-based Payment* should not be applied to the fact patterns analysed; instead, the respondent suggests an amendment to IFRS 3 *Business Combinations*. An amendment to IFRS 3 could provide explicit guidance for reverse acquisitions in which the accounting acquiree is not a business.

9. Another respondent[3] agrees with the Interpretations Committee's conclusion on the issue of accounting for reverse acquisitions that do not constitute a business. However, this respondent noted that an agenda decision would not be enough to address this issue adequately. This respondent thinks that an amendment to IFRS 2 could provide explicit guidance for reverse acquisitions in which the accounting acquiree is not a business.

10. Another respondent[4] recommends a drafting change to the tentative agenda decision to promote more consistency with IFRS 2.

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[1] Ernst & Young

[2] Accounting Standards Committee of Germany

[3] Australian Accounting Standards Board

[4] CICA

11. The remaining respondent[5] agrees with the tentative agenda decision but thinks that more clarity could be provided in its wording, to make it clearer why the tentative agenda decision is affirming that a listed non-operating entity is not a business. According to this respondent, it should be made clearer that the tentative agenda decision was made on the basis of the guidance in IFRS 3. The tentative agenda decision should also state the reasons why a stock exchange listing does not meet the definition of an intangible asset under IAS 38 *Intangible Assets*.

Analysis of issues raised

Provide explicit guidance

12. Two respondents think that explicit guidance for reverse acquisition transactions in which the accounting acquiree is not a business would be more appropriately addressed as an Annual Improvement. This is because they think that an annual improvement would provide more clarity on how to account for the transaction (thereby eliminating any existing diversity in practice).

13. Nevertheless, these two respondents differ on which of the Standards (ie IFRS 2 or IFRS 3) should be amended to include explicit guidance for reverse acquisition transactions in which the accounting acquiree is not a business.

14. One of the respondents agrees with the Interpretations Committee's conclusion that the transactions analysed are share-based payment transactions and with the application of IFRS 3 by analogy. However, this respondent disagrees with the issue of a rejection note and thinks that a clarification should be included as an amendment to IFRS 2 to reduce the existing diversity in practice in relation to the issue analysed.

15. This respondent thinks that the clarification could:

[5] Deloitte

(a) explain the interrelationship of IFRS 2 and IFRS 3 when accounting for reverse acquisition transactions in which the accounting acquiree is not a business;

(b) provide transition guidance to clarify whether, for example, entities that had previously applied IFRS 3 would be required to apply IFRS 2 retrospectively on the basis of the guidance in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; and

(c) address concerns about the lack of clarity in the definition of a 'business' in IFRS 3. This respondent notes that that this issue is similar to the issue analysed by the Interpretations Committee (and considered as an annual improvement) in regards to the interrelationship of IFRS 3 and IAS 40 *Investment Property* when classifying property as investment or owner-occupied property because both issues appear to arise out of uncertainty in the definition of a 'business'.

16. The other respondent disagrees with the Interpretations Committee's conclusion that IFRS 2 applies to the fact patterns analysed. This respondent thinks that IFRS 2 should not be applied by analogy. Instead, this respondent thinks that a clarification should be added to paragraph B19 of IFRS 3 to explain how to account for transactions in which the accounting acquiree is not a business.

Staff analysis

17. In response to the respondents' suggestion to propose an annual improvement (either to IFRS 2 or IFRS 3), we note that during its deliberations a majority of members of the Interpretations Committee noted that the two fact patterns analysed were too narrow and limited to specific circumstances and thought that it would not be appropriate to develop general guidance based on specific fact patterns.

18. In addition, the Interpretations Committee observed that the accounting for the fact patterns analysed could be resolved efficiently on the basis of existing IFRSs and considered that an interpretation or an amendment to IFRSs was not necessary. We continue to agree with the view expressed in the tentative agenda decision that in the absence of an IFRS that specifically applies to the fact patterns

analysed, an entity should develop and apply an accounting policy in line with paragraphs 10 –11 of IAS 8 that would be based on the guidance in IFRS 3 to determine which entity is the accounting acquirer to then apply the guidance in IFRS 2.

19. In view of the above we disagree with the respondents' comments that more explicit guidance should be included (either in IFRS 2 or in IFRS 3) through an annual improvement.

Provide more clarity on the nature of the stock exchange listing

20. One of the respondents recommends a drafting change to the tentative agenda decision to promote more consistency with IFRS 2. This respondent thinks that indicating that (emphasis added) the statement that "a stock exchange listing does not meet the definition of an intangible asset" is not consistent with paragraph 8 of IFRS 2. This is because this paragraph refers to services received that "do not qualify for recognition as assets" as shown below:

> When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition **as assets**, they shall be recognised as expenses"

21. This respondent thinks that indicating that "a stock exchange listing does not meet the definition of an asset" is more consistent with paragraph 8 of IFRS 2.

22. Another respondent thinks that the agenda decision should state the reason why a stock exchange listing does not meet the definition of an intangible asset in accordance with IAS 38.

Staff analysis

23. We concur with the first respondent that the wording of the agenda decision should be consistent with the guidance in IFRS 2. However, stating that a "stock exchange listing is not an intangible asset" is also correct as we have analysed in a previous paper (refer to our analysis in paragraphs 45 –49 of Agenda Paper 15 of September 2012).

24. We disagree with the second respondent’s comment to provide more detail on why a stock exchange listing does not meet the definition of an intangible asset because we think that this is not the focus of the agenda decision.

25. To address the respondents’ concerns we suggest that the agenda decision should mention that:

(a) in accordance with other IFRSs or with the Conceptual Framework the service received (ie the stock exchange listing) does not qualify as an intangible asset or as any other type of asset that should be recognised in accordance with IFRSs.

(b) paragraph 8 of IFRS 2 states that when “the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses”.

Provide more clarity on why the acquiree is not a business

26. One respondent agrees with the agenda decision but thinks that more clarity could be provided. This respondent thinks that the fact that “a listed non-operating entity is not a business on the basis of the guidance in paragraph B7 of IFRS 3,” is merely an assumption, instead of being a conclusion that has been reached based on the description of the transaction. This respondent thinks that the description of the fact pattern does not include enough detail to reach this conclusion.

Staff analysis

27. We agree that the agenda decision does not include enough detail on why the Interpretations Committee reached the conclusion that in the fact patterns analysed, the listed non-operating entity was not a business. We, however, think that adding much more detail in this respect is not needed. This is because the focus of the agenda decision should be on how to account for the transaction on the basis that the acquirer is not a business.

28. During its deliberations, the Interpretations Committee noted that the accounting acquiree was not a business because, on the basis of the guidance in paragraph B7 of IFRS 3, the elements that had been acquired by the accounting acquirer were

only inputs (eg cash and listing status) and no processes had been applied to those inputs to create outputs, which would be required for the accounting acquiree to constitute a business. The Interpretations Committee thought that these particular inputs, on their own, were not sufficient to represent a business.

29. We observe that the focus of the agenda decision is appropriately the accounting for the transaction on the basis that the acquirer is not a business. Consequently, we do not think that the agenda decision should provide further detail on why the listed non-operating entity is not a business.

Staff recommendation

30. We recommend confirming the tentative agenda decision with some minor drafting changes. We have set out the wording for the final agenda decision in **Appendix A** of this paper for the Interpretations Committee's approval.

Question for the Interpretations Committee

Question for the Interpretations Committee
Does the Interpretations Committee agree with the wording for the agenda decision shown in Appendix A?

Appendix A—Finalisation of agenda decision

A1. We propose the following wording for the agenda decision:

IFRS 3 *Business Combinations* and IFRS 2 *Share-based Payment*—Accounting for reverse acquisitions that do not constitute a business

The Interpretations Committee received requests for guidance on how to account for transactions in which the former shareholders of a non-listed operating entity become the majority shareholders of the combined entity by exchanging their shares for new shares of a listed non-operating entity. However, the transaction is structured such that the listed non-operating entity acquires the entire share capital of the non-listed operating entity.

In the absence of an IFRS that specifically applies to this transaction t~~T~~he Interpretations Committee observed that the transaction~~s~~ analysed has~~ve~~ some features of a reverse acquisition under IFRS 3 because the former shareholders of the legal subsidiary obtain control of the legal parent. Consequently, it is appropriate to apply by analogy, in accordance with paragraphs 10–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, the guidance in paragraphs B19–B27 of IFRS 3 for reverse acquisitions. Application of the reverse acquisitions guidance by analogy results in the non-listed operating entity being identified as the accounting acquirer, and the listed non-operating entity being identified as the accounting acquiree. The Interpretations Committee noted that in applying the reverse acquisition guidance in paragraph B20 of IFRS 3 by analogy, the accounting acquirer is deemed to have issued shares to obtain control of the acquiree.

The Interpretations Committee also noted that on the basis of the guidance in paragraph B7 of IFRS 3, the listed non operating entity is not a business. The Interpretations Committee observed that on the basis that the listed non-operating entity is not a business ~~Consequently,~~ the transactions analysed are not business combinations and are therefore not within the scope of IFRS 3. Because the transactions analysed are not within the scope of IFRS 3, the Interpretations Committee noted that they are therefore share-based payment transactions that should be accounted for in accordance with IFRS 2.

The Interpretations Committee observed that on the basis of the guidance in paragraph 13A of IFRS 2, any difference in the fair value of the shares deemed to have been issued by the accounting acquirer and the fair value of the accounting acquiree's identifiable net assets represents a service received by the accounting acquirer. This service received is that of a stock exchange listing for its shares. The Interpretations Committee observed that the service received in the form of a stock exchange listing does not meet the definition of an intangible asset or of any other asset that should be recognised in accordance with other IFRSs and with the Conceptual Framework.

The Interpretations Committee also observed that on the basis of the guidance in paragraph 8 of IFRS 2 which states that "when the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses", the cost of the service received is recognised as an expense.

On the basis of the analysis above, the Interpretations Committee determined that, in the light of the existing IFRS requirements, neither an interpretation nor an amendment to IFRSs was necessary and consequently ~~[~~decided~~]~~ not to add this issue to its agenda. As a result of this, the Interpretations Committee does not expect diversity in practice to continue.

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International Financial Reporting Standards
Interpretations Committee
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22 January 2013

Dear IFRS Interpretations Committee members,

Tentative Agenda Decision – IFRS 3 *Business Combinations* and IFRS 2 *Share-based Payment* – Accounting for reverse acquisitions that do not constitute a business

The global organisation of Ernst & Young is pleased to submit its comments on the above Tentative Agenda Decision, as published in the November 2012 *IFRIC Update*.

The IFRS Interpretations Committee (the Committee) received requests "for guidance on how to account for transactions in which the former shareholders of a non-listed operating entity become the majority shareholders of the combined entity by exchanging their shares for new shares of a listed non-operating entity. However, the transaction is structured such that the listed non-operating entity acquires the entire share capital of the non-listed operating entity."

We agree with the Committee's tentative decision that the reverse acquisition guidance in paragraphs B19-B27 of IFRS 3 should be applied by analogy.

We also agree that, since the listed non-operating entity is not a business, the transaction being analysed is not within the scope of IFRS 3 and should be accounted for in accordance with IFRS 2.

Accordingly, we support the Tentative Agenda Decision as worded in the November 2012 *IFRIC Update*.

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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Wayne Upton
Chairman of the
IFRS Interpretations Committee
30 Cannon Street
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United Kingdom

Berlin, 17 January 2013

Dear Wayne,

IFRS 3 / IFRS 2 – Accounting for reverse acquisitions that do not constitute a business

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the IFRSIC's tentative agenda decision, published in the November 2012 *IFRIC Update* on the above captioned issue.

We understand that transactions in line with the given fact pattern fall into the scope of IFRS 3 *Businss Combinations*, and – in accordance with IFRS 3.B15 – the issuing entity is the acquiree. Such situations are commonly referred to as 'reverse acquisitions'. IFRS 3.B19 further depicts that the accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition. According to the fact pattern provided, this is not the case. Hence, IFRS 3 does not provide guidance as to how to account for such situations (please refer to the last sentence of IFRS 3.B19).

On this basis the IC noted that those types of transactions represent share-based payment transactions that should be accounted for in accordance with IFRS 2. However, according to the tentative agenda decision the guidance of IFRS 2 is to be applied to the transactions considering the guidance in IFRS 3 for reverse acquisitions by analogy.

We challenge this approach and ask the IC to reconsider its tentative conclusion since 'reverse acquisitions' are not part of IFRS 2, but are dealt with in IFRS 3 only and may thus not be applied by analogy to IFRS 2.

Secondly, we suggest the Interpretations Committee consider adding to IFRS 3.B19 explicit guidance how to account for transactions in which the accounting acquiree does not meet the definition of a business. We would prefer such an approach since it would add clarity and pervasive guidance to the IFRS literature instead of mentioning guidance solely in a rejection notice, which is a less prominent place to put it. The Annual Improvements Process of the IASB would be a proper means to process the proposed change.

If you would like further clarification of the issue set out in this letter, please do not hesitate to contact me.

With best regards,

Liesel Knorr
President

Australian Government
Australian Accounting Standards Board

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Chairman
IFRS Interpretations Committee
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Email: ifric@ifrs.org

18 December 2012

Dear Wayne,

Tentative Agenda Decision: IFRS 3 *Business Combinations* and IFRS 2 *Share-based Payment* – Accounting for reverse acquisitions that do not constitute a business

The Australian Accounting Standards Board (AASB) is pleased to provide comments on the IFRS Interpretation Committee's publication in the November 2012 *IFRIC Update* of the tentative decision not to take onto the Committee's agenda the issue of accounting for reverse acquisitions that do not constitute a business.

The AASB agrees with the Committee's conclusion that accounting for a reverse acquisition of a listed non-operating entity by a non-listed operating entity is outside the scope of IFRS 3, as the listed non-operating entity is not a business. The AASB also agrees that such a transaction would be considered a share-based payment transaction accounted for in accordance with IFRS 2.

However, the AASB notes that outreach through the International Forum of Accounting Standard Setters (IFASS) indicated that there is significant diversity in practice in relation to this issue. The Committee also implicitly acknowledges the existence of diversity in practice in the tentative Agenda Decision by noting that the Committee did not expect diversity in practice to *continue* [emphasis added].

In light of the apparent current existence of diversity in practice, the AASB is concerned that this issue would not be adequately dealt with through a rejection notice, and considers that the issue would be more appropriately addressed as an Annual Improvement. In particular, the AASB considers that because no transition guidance can be provided in a rejection notice, it is potentially unclear whether entities that had previously applied IFRS 3 in accounting for such transactions would be required to apply IFRS 2 retrospectively per IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

The AASB also notes that this issue is similar in nature to the issue of the interrelationship of IFRS 3 and IAS 40 *Investment Property* when classifying property as investment property or owner-occupied property, which is a matter addressed in IASB Exposure Draft ED/2012/2 *Annual Improvements to IFRSs 2011–2013 Cycle*. The AASB notes that, in contrast to our comment about transition above, the IASB has proposed that the amendment would apply prospectively. Both issues appear to arise out of uncertainty about the definition of a ‘business’ in IFRS 3, and the AASB’s submission on ED/2012/2 is likely to express a view that it is timely to address concerns about the lack of clarity in the definition of a business – perhaps as part of the forthcoming post-implementation review of IFRS 3.

Of the two issues, the AASB thinks that the issue addressed in the Committee’s tentative Agenda Decision has the potential to cause significantly more changes to practice than the issue addressed in Annual Improvements. Consequently, the AASB reiterates its view, expressed above, that the issue of accounting for reverse acquisitions that do not constitute a business would be more appropriately addressed as an Annual Improvement.

If you have any queries regarding any matters in this submission, please contact Nikole Gyles (ngyles@aasb.gov.au) or Julie Smith (jsmith@aasb.gov.au).

Yours sincerely,

K.M. Stevenson

Kevin M. Stevenson
Chairman and CEO

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January 23, 2013

(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 and IFRS 2 Share-based Payment—Accounting for reverse acquisitions that do not constitute a business

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 accounting for contingent payments that will be automatically forfeited if employment terminates. This tentative agenda decision was published in the November 2012 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.

The third paragraph of the tentative agenda decision includes the following sentence "The Interpretations Committee observed that a stock exchange listing does not meet the definition of an intangible asset under IAS 38, Intangible Assets". We think it would be clearer to say that a stock exchange listing does not meet the definition of an asset, since it is not the intangible nature of the item that is relevant. This would also be more consistent with the reference to paragraph 8 of IFRS 2 in the following sentence. Paragraph 8 refers to "goods or services……that do not qualify for recognition as assets…" rather than as intangible assets.

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 Mark Walsh, Principal, Accounting Standards at +1 416 204-3453 (e-mail mark.walsh@cica.ca).

Yours truly,

Peter Martin

Peter Martin, CPA, CA
Director,
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Mr Wayne Upton
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22 January 2013

Dear Mr Upton

Tentative agenda decision: IFRSS 3 Business Combinations and IFRS 2 Share-based Payment – Accounting for reverse acquisitions that do not constitute a business

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretation Committee's publication in the November 2012 IFRIC Update of the tentative decision not to take onto the IFRIC's agenda a request for clarification of the accounting for transactions in which the former shareholders of a non-listed operating entity become the majority shareholders of the combined entity by exchanging their shares for new shares of a listed non-operating entity which does not constitute a business.

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 decision, but believe that the tentative agenda decision could be made clearer by:

- specifying that the statement that "on the basis of the guidance in paragraph B7 of IFRS 3, the listed non-operating entity is not a business" is an assumption, rather than a conclusion reached based on the description of the transaction (as currently drafted, the description does not include enough detail to reach that conclusion as it only states that the entity is 'non-operating'); and
- stating the reason why a stock exchange listing does not meet the definition of an intangible asset under IAS 38.

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

Yours sincerely

Veronica Poole
Global IFRS Leader
Technical