STAFF PAPER

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IASB Meeting

Project	**Business combinations under common control**		
Paper topic	Research project status update		
CONTACT(S)	Raghava Tirumala	rtirumala@ifrs.org	+44 (0) 20 7246 6953

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Introduction and background

1. On the basis of the views received during the 2011 Agenda Consultation, the IASB identified 'Business Combinations under Common Control' (BCUCC) as one of the priority research projects. The IASB suggested that the research project should aim to identify common features of different types of restructurings as a first step.

2. The respondents to the 2011 Agenda Consultation were concerned about the absence of specific guidance on accounting for BCUCC which has led to diversity in practice.

3. This paper is the first paper of the BCUCC research project and the objective of this paper is to provide:

   (a) an update to the IASB of:

      (i) the research activities conducted by the staff since the 2011 Agenda Consultation;

      (ii) issues raised by some of the interested parties in relation to this project;

      (iii) staff's tentative plan of the next steps; and

   (b) recap of some recent IFRS Interpretations Committee (Interpretations Committee) Agenda Decisions relevant to this project.

4. In October 2011, the European Financial Reporting Advisory Group (EFRAG) and the Italian accounting standard-setter Organismo Italiano di Contabilità (OIC)

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released a discussion paper (DP) on accounting for BCUCC (hereinafter referred to as the EFRAG DP) with the objective of providing inputs to the early phases of the IASB's work in this regard. Korea Accounting Standards Board (KASB) presented a paper on 'Transactions under Common Control' in the IASB Emerging Economies Group meeting held on 4 December 2012 (hereinafter referred to as the KASB paper). The EFRAG DP and the KASB paper have provided a helpful basis for the research project.

5. This paper includes the following sections:

(a) Staff's approach to research

(b) Summary of recent Interpretations Committee Agenda Decisions relevant to this project

(c) Summary of discussions with interested parties, the EFRAG DP and the KASB paper

(d) Preliminary list of sub-topics for research

The purpose of this paper is only for noting and to solicit any feedback from the IASB on this topic generally.

Staff's approach to research

6. The staff's planned approach to the research project is as follows:

1 Consider the issues discussed in the EFRAG DP, the KASB paper, and the recent Agenda Decisions of the Interpretations Committee relevant to this project

2 Hold meetings with some of the interested parties, mainly the accounting firms and national standard-setters that expressed interest in this project, to gather information about the different types of restructurings and the related accounting issues and challenges.

3 Identify sub-topics for research

4 Prepare research papers to be presented to the IASB

5 Release a discussion paper.

7. Until now, the staff held meetings with some of the interested parties. The staff has asked the interested parties about:

   (a) the different types of restructurings involving entities under common control that the interested parties had seen in the past or known; and

   (b) the issues and challenges that are generally observed in accounting for such transactions.

8. The staff will continue to hold meetings with the interested parties.

Summary of recent Interpretations Committee Agenda Decisions relevant to this project

9. Some of the recent Interpretations Committee Agenda Decisions relevant to this project are summarised in the Appendix. The requests received by the Interpretations Committee are similar to the issues raised by the interested parties summarised herein below.

Summary of discussions with interested parties, the EFRAG DP and the KASB paper

Types of restructurings

10. The most common types of restructurings involving entities under common control are as follows:

    (a) Creation of a New Company (NewCo) and transfer of business to the NewCo (also referred to as spin-offs) in anticipation of a listing of securities or sale of business or debt raising or taking benefit of a tax advantageous territory etc. There are several forms in which these transactions are structured.

    (b) Group reorganisation involving moving of assets or entities within the group mainly driven by tax or financial considerations or for simplification of group structure. Similar to spin-offs, these could take several forms as these reorganisations are driven by varied necessities.

Mergers and amalgamations of group entities are the most common forms of reorganisations.

Issues and challenges

11. Some of the accounting firms suggested that the recent Interpretations Committee Agenda Decisions could provide a good basis for the research project.

12. Most of the accounting firms said that the definition of 'business combination' in IFRS 3 *Business Combinations* should not be changed for the purpose of this project.

13. While some accounting firms appreciated that focusing on BCUCC was a good starting point, all the accounting firms that the staff met highlighted the need to include other transactions between entities under common control in the research project. KASB also expressed similar views.

14. Some of the accounting firms said that most of the issues arise in BCUCC involving capital raising and hence suggested that the research project should focus on such transactions.

15. While some accounting firms suggested that the research project should initially focus on accounting for BCUCC in the consolidated financial statements of the acquirer, most of them suggested that there is a need to address accounting issues in the separate financial statements as well. In its paper KASB highlighted certain accounting issues in the separate financial statements. Those issues are not summarised in this paper.

16. The issues and challenges highlighted by the interested parties, the EFRAG DP and the KASB are summarised below.

Definition of common control	• There are practical challenges in identifying 'common control', particularly when control is exercised by group of individuals or family members. • The scope of 'common control' could possibly be restricted to transactions within a group controlled by a single ultimate parent entity.

Identifying a business combination	• Determining the substance of transactions between entities under common control is generally challenging. • A parent is generally in a position to override any contractual arrangements between group entities. • Determining whether the transferred group of assets constitutes a business is generally difficult. There could be unidentifiable elements in the transferred group.
Identifying the acquirer	• A NewCo can rarely be considered as an acquirer under the existing guidance in IFRS 3 and hence will not be able to apply acquisition accounting. However, entities prefer to use acquisition accounting in the books of account of NewCo, particularly when capital raising is involved. Views being taken by regulators in different countries are inconsistent. • An issue related to the formation of NewCo is determining whether control is transitory. • Identifying the acquirer in group reorganisations is challenging. There could be situations where a legal acquirer may not be considered as 'acquirer' under IFRS 3 thereby failing the end objective of the reorganisations.
Determining the acquisition date	• When applying pooling of interests method, there are differing views on the date from which pooling of interests method should be applied. One view is that the pooling of interests method involves presentation of consolidated financial statements of the combined entity as if the entities had always been combined. The other view, which is consistent with IFRS 10 *Consolidated Financial Statements*, is that the consolidated financial statements of the combined entity are not restated for the periods prior to combination.
Measurement principles	• Determination of fair value of consideration is generally challenging. There could be transfer of business/ assets between group entities without consideration. • When using pooling of interests method, an issue relating to the use of carrying amounts is whether the carrying amounts of the acquired entity are those that are reported in the consolidated financial statements of the parent or those at the level of the financial statements of the combining entities. KASB conducted an unofficial survey of some national standard-setters and accounting firms. The participants had differing views on the source of the carrying amounts used in accounting for BCUCC. • Related to the above point is the issue of push-down accounting. Can subsidiaries (including NewCos) use

	fresh-start accounting (using the fair value adjustments pushed down by the parent) for their individual/ separate financial statements? • The measurement principles may be based on the composition of users of the financial statements and their needs. Where there is a significant non-controlling interest or other investors, accounting for the transactions between entities under common control at fair value would be an appropriate accounting choice.
Goodwill or a gain from a bargain purchase	• Most of the accounting firms said that BCUCC or group restructurings should not result in recognition of goodwill or gain from a bargain purchase. The difference between the consideration and the net assets may be recognised in equity. • EFRAG and KASB discussed the possibility of using a modified acquisition accounting whereby goodwill and/or intangible assets are not recognised.

Preliminary list of sub-topics for research

17. Based on the information gathered by the staff, the following is the preliminary list of sub-topics for research:

    (a) What are the entities that are directly affected due to the absence of specific guidance on accounting for BCUCC?

    (b) What are the most common forms of restructurings in a group under common control? The staff will aim to collate a pictorial representation of the various forms of restructurings.

    (c) Analysis of the definition of 'common control'

    (d) Are the features of BCUCC different from other business combinations?

    (e) Use of push down accounting

The staff requests the IASB to provide feedback

Appendix – Summary of recent Interpretations Committee Agenda Decisions relevant to this project

A1. Some of the recent Interpretations Committee Agenda Decisions relevant to this project are summarised below.

Topic	*IFRIC Update*	*Agenda Decision*
‘Transitory’ Common Control	March 2006	The Interpretations Committee considered an issue regarding whether a reorganisation involving the formation of a new entity to facilitate the sale of part of an organisation is a business combination within the scope of IFRS 3. It was suggested to the Interpretations Committee that, because control of the new entity is transitory, a combination involving that newly formed entity would be within the scope of IFRS 3. The Committee noted that, to be consistent, the question of whether the entities or businesses are under common control applies to the combining entities that existed before the combination, excluding the newly formed entity. Accordingly, the Committee decided not to add this topic to its agenda. The Committee also considered a request for guidance on how to apply IFRS 3 to reorganisations in which control remains within the original group. The Committee decided not to add this topic to the agenda, since it was unlikely that it would reach agreement in a reasonable period, in the light of existing diversity in practice and the explicit exclusion of common control transactions from the scope of IFRS 3.
Combined financial statements and redefining the reporting entity	January 2010	The Interpretations Committee received a request for guidance on whether a reporting entity may, in accordance with IFRSs, present financial statements that include a selection of entities that are under common control, rather than being restricted to a parent/subsidiary relationship as defined by IAS 27. The Committee noted that the ability to include entities within a set of IFRS financial statements depends on the interpretation of 'reporting entity' in the context of common control. The Committee noted that in December 2007 the IASB added a project to its research agenda to examine the

Topic	*IFRIC Update*	*Agenda Decision*
		definition of common control and the methods of accounting for business combinations under common control in the acquirer's consolidated and separate financial statements. The Committee also noted that describing the reporting entity is the objective of Phase D of the IASB's Conceptual Framework project. The Committee also received a request for guidance on whether a reporting entity may, in accordance with IFRSs, be redefined to exclude from comparative periods entities/businesses that have been carved-out of a group. The Committee noted that the Board's common control project referred to above will also consider the accounting for demergers, such as the spin-off of a subsidiary or business. Consequently, the Committee decided not to add these issues to its agenda.
Presentation of comparatives when applying the 'pooling of interests' method	January 2010	The Interpretations Committee received a request for guidance on the presentation of comparatives when applying the 'pooling of interests' method for business combinations between entities under common control when preparing financial statements in accordance with IFRS. The Committee noted that IFRS 3 excludes from its scope 'a combination of entities or businesses under common control'. The Committee noted that resolving the issue would require interpreting the interaction of multiple IFRSs. Consequently, the Committee decided not to add this issue to its agenda.
Business combinations involving newly formed entities: Factors affecting identification of the acquirer	September 2011	The Interpretations Committee received a request for guidance on the circumstances or factors that are relevant when identifying an acquirer in a business combination under IFRS 3. More specifically, the submitter described a fact pattern in which a group plans to spin off two of its subsidiaries using a new entity (‘Newco’). Newco will acquire these subsidiaries for cash from the parent company (Entity A) only on condition of the occurrence of Newco’s initial public offering (IPO). The cash paid by Newco to Entity A to acquire the subsidiaries is raised through the IPO. After the IPO occurs, Entity A loses control of Newco. If the IPO does not take place, Newco

Topic	*IFRIC Update*	*Agenda Decision*
		will not acquire the subsidiaries. The Committee observed that the accounting for a fact pattern involving the creation of a newly formed entity is too broad 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 IASB is planning to address at a later stage. Consequently, the Interpretations Committee decided not to add the issue to its agenda and recommended the IASB to consider the fact pattern described in the submission as part of its project on common control transactions.
Business combinations and common control transactions	September 2011	The Interpretations Committee received a request for guidance on accounting for common control transactions. 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 to be relevant in analysing the transaction under IFRS 3. The Committee observed that the accounting for common control transactions is too broad to be addressed through an interpretation or through an annual improvement. The Committee also noted that the issues raised by the submitter have previously been brought to the Board's attention. 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 IASB is planning to address at a later stage. Consequently, the Interpretations Committee decided not to add the issue to its agenda and

Topic	*IFRIC Update*	*Agenda Decision*
		recommended the IASB to consider the fact pattern described in the submission as part of its project on common control transactions.
IAS 28 and IFRS 3 —Associates and common control	May 2013	In October 2012, the Interpretations Committee received a request seeking clarification of the accounting for an acquisition of an interest in an associate or joint venture from an entity under common control. The submitter's question is whether it is appropriate to apply the scope exemption for business combinations under common control, which is set out in IFRS 3 Business Combinations, by analogy to the acquisition of an interest in an associate or joint venture under common control. The Interpretations Committee observed that paragraph 32 of IAS 28 Investments in Associates and Joint Ventures has guidance on the acquisition of an interest in an associate or joint venture and does not distinguish between acquisition of an investment under common control and acquisition of an investment from an entity that is not under common control. The Interpretations Committee also observed that paragraph 10 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors requires management to use its judgement in developing and applying an accounting policy only in the absence of a Standard that specifically applies to a transaction. The Interpretations Committee also observed that paragraph 26 of IAS 28 states that many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10 Consolidated Financial Statements. That paragraph further states that the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture. The Interpretations Committee also observed that paragraph 2(c) of IFRS 3 states that IFRS 3 does not apply to a combination of entities or businesses under common control. The Interpretations Committee observed that some might read these paragraphs as contradicting the guidance in paragraph 32 of IAS 28, and so

Topic	*IFRIC Update*	*Agenda Decision*
		potentially leading to a lack of clarity. The Interpretations Committee was specifically concerned that this lack of clarity has led to diversity in practice for the accounting of the acquisition of an interest in an associate or joint venture under common control. The Interpretations Committee noted that accounting for the acquisition of an interest in an associate or joint venture under common control would be better considered within the context of broader projects on accounting for business combinations under common control and the equity method of accounting. The Interpretations Committee also noted that the IASB, in its May 2012 meeting, added a project on accounting for business combinations under common control as one of the priority research projects as well as a project on the equity method of accounting as one of the research activities to its future agenda. Consequently, the Interpretations Committee decided not to take this issue onto its agenda.