STAFF PAPER

29–30 January 2014

IFRS Interpretations Committee Meeting

Project	IFRS 3 *Business Combinations*		
Paper topic	Identification of the acquirer in accordance with IFRS 3 and the parent in accordance with IFRS 10 in a stapling arrangement		
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Introduction

1. In September 2013, the IFRS Interpretations Committee ('the Interpretations Committee') received a submission that seeks clarification on the interaction of the requirements in IFRS 3 *Business Combinations* for identifying an acquirer with the requirements in IFRS 10 *Consolidated Financial Statements* for deciding whether control exists.

2. The objective of this Agenda Paper is to provide the Interpretations Committee with the summary of the issues and with the staff's research and analysis. This Agenda Paper also contains four questions for the Interpretations Committee.

3. This Agenda Paper is structured as follows:

   (a) summary of the issue;

   (b) staff technical analysis;

   (c) summary of the outreach activity;

   (d) assessment of the agenda criteria of the Interpretations Committee;

   (e) staff recommendation;

   (f) Appendix A—illustrative examples;

(g) Appendix B—agenda criteria of the Interpretations Committee and assessment against the criteria;

(h) Appendix C—excerpt from the *IASB Update* for September 2004 and relevant guidance in IFRS 3 as issued in 2008;

(i) Appendix D—submission;

(j) Appendix E—proposed wording for tentative agenda decision.

4. In the following paragraphs, we refer to IFRS 3 as issued in 2004 as ‘IFRS 3 (2004)’ and refer to IFRS 3 as issued in 2008 as ‘IFRS 3 (2008)'.

Summary of the issue

5. Paragraph 43 of IFRS 3 (2008) states that an acquirer sometimes obtains control of an acquiree in a business combination without transferring consideration, such as in a business combination achieved by contract alone. In paragraph 43(c) of IFRS 3 (2008), a stapling arrangement is listed as an example of such a business combination.

6. The submitter describes a stapling arrangement as a contractual arrangement between two or more entities or their shareholders, typically without the transfer of consideration, whereby the equity securities of the entities in a stapling arrangement are stapled together and the entities each have the same owners. The stapled securities are quoted as a single security and cannot be traded or transferred independently. In general, a stapling transaction is entered into for tax purposes.

7. The submitter states that in many of these arrangements no entity in the stapling arrangement has ‘control’ over the other entities. However, the submitter is of the view that even in circumstances in which no entity in the stapling arrangement has ‘control’ over the other entities, when the stapling occurs, an acquirer should be identified for the purposes of IFRS 3 (2008) (see paragraph 6 of IFRS 3 (2008) and the definition of ‘business combination’ in Appendix A of IFRS 3 (2008)). This applies even though an ‘acquirer’ is defined as “the entity that obtains control of the acquiree” (the definition of ‘acquirer’ in Appendix A of IFRS 3 (2008)).

8. On the basis of the above, the submitter asks for clarification about whether an 'acquirer' identified for the purpose of IFRS 3 (2008) is a 'parent' for the purpose of IFRS 10 in circumstances in which the business combination is achieved by contract alone, such as a stapling arrangement, with no entity in the business combination having control as defined in IFRS 10.

Views identified by the submitter

9. For this issue, the submitter has identified two views:

   View 1: the acquirer identified under IFRS 3 (2008) should always be viewed as a parent under IFRS 10. In other words, there is no need to apply paragraph 7 of IFRS 10 in circumstances in which an acquirer is identified but the acquirer does not have control of the other combining entities in the arrangement.

   View 2: the acquirer identified under IFRS 3 (2008) is not necessarily a 'parent' under IFRS 10. In other words, a 'parent' would need to be identified on the basis of the guidance in IFRS 10. Thus, in some cases, neither entity can be identified as the parent and consequently there are no consolidated financial statements that include both of the stapled entities.

10. For further details, please refer to the copy of the submission in **Appendix D** to this Agenda Paper.

Issues identified by the staff

11. In the course of our analysis of this issue, we identified three issues that need to be considered to analyse this issue.

Issue 1: whether an entity needs to hold an investment in another entity in order to control that other entity

12. We understand from our outreach that some have questioned whether an entity can be a parent if it does not have an investment in the other entity. We are told that this is an important underlying issue. We will analyse this issue first because that analysis will facilitate understanding of the 'control' notion in IFRS 10, which, in our view, is central to the issue raised in the submission.

Issue 2: whether a combining entity always obtains control as defined in IFRS 10 in a business combination under IFRS 3 (2008)

13. We think that the submission assumes that most stapling arrangements would be viewed as a business combination as defined in IFRS 3 (2008), even if no entity has control over the other entities in the arrangement. The submitter notes that paragraph 43(c) of IFRS 3 (2008) lists a stapling arrangement as an example of business combinations achieved by contract alone. The submitter also observes that paragraphs 6-7 of IFRS 3 (2008) could be interpreted as requiring the identification of an acquirer by applying the indicators in paragraphs B14-B18 of IFRS 3 (2008) (See **Appendix C** to this Agenda Paper) even when no combining entity has control, as defined in IFRS 10, over the other combining entities.

14. We are also aware that practice has been significantly influenced by statements made by the IASB in the *IASB Update* for September 2004 (See **Appendix C** to this Agenda Paper). We will consider the statements made in that edition of the *IASB Update*, which was written in the context of IFRS 3 (2004). We will also consider the effect of changes to IFRS 3 made in 2008.

Issue 3: whether the acquirer identified under IFRS 3 (2008) should always be viewed as a parent for the purpose of IFRS 10

15. This is the main question raised in the submission. The submitter asks whether an acquirer identified for the purpose of IFRS 3 (2008) is automatically viewed as a parent for the purpose of IFRS 10 without assessing the requirements in IFRS 10.

Staff technical analysis

16. We acknowledge that there could be a variety of types of stapling arrangements in practice. However, to help in understanding the discussion, we have set out in **Appendix A** to this Agenda Paper an example of a stapling arrangement that we found in practice (**Example 3**). We have also included an example of a so-called roll-up transaction by two entities (**Example 1**) and a reverse acquisition involving two entities (**Example 2**). We think that understanding the application

of IFRS 3 (2008) and IFRS 10 to those transactions can help us understand how IFRS 3 (2008) and IFRS 10 should be applied to stapling arrangements.

17. In the following paragraphs, we will analyse the issues identified in paragraphs 11-15 using the examples mentioned above.

Issue 1: does an entity need to hold an investment in another entity in order to control that other entity?

18. Some have observed that IFRS 10 consistently refers to investors and investees when describing the assessments needed to determine whether one entity is a parent of another. They cite, among other requirements in IFRS 10, the definition of control of an investee, which states that "an investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with […]" (Appendix A Defined terms of IFRS 10). This observation has led some to think that an entity can only be a parent of another, and thus prepare consolidated financial statements, if there is an investor-investee relationship between them.

19. We disagree with this view because we think that the terms 'investor' and 'investee' are used in a general sense for the identification of a parent-subsidiary relationship. In other words, those terms are used for distinguishing a potential parent and potential subsidiary, because the criteria of the control should be assessed from the perspective of the potential parent.

20. Paragraph 7 of IFRS 10 states that an investor has control over the investee if the investor has all of the following:

(a) power over the investee;

(b) exposure, or rights, to variable returns from its involvement with the investee; and

(c) the ability to use its power over the investee to affect the amount of the investor's returns.

21. For criterion (a) (the 'power' criterion), IFRS 10 indicates that an investor generally obtains power over an investee from the voting rights granted by equity instruments. However, paragraph 11 of IFRS 10 states that "in other cases, the

assessment will be more complex and require more than one factor to be considered, for example when power results from one or more contractual arrangements." Paragraph B15 of IFRS 10 explains that the rights associated with the power criterion could include:

(a) rights to appoint, reassign or remove members of key management; and

(b) decision-making rights specified in a management contract.

22. For criterion (b) (the 'exposure to variable returns' criterion), IFRS 10 explains that exposure to variable returns exists when the returns from involvement have the potential to vary as a result of the investee's performance, and that such returns can be only positive, only negative or both positive and negative (paragraph 15 of IFRS 10). IFRS 10 takes a fairly broad view of returns, and gives the following as examples, among others:

(a) dividends and other distributions;

(b) remuneration for servicing assets or liabilities, tax benefits; and

(c) returns not available to other interest holders, for example synergistic benefits from using assets of the two parties together, gaining access to proprietary knowledge.

23. For criterion (c) (the 'ability to affect the returns' criterion), IFRS 10 is concerned with the ability of the entity to use its power to affect its returns from the other entity.

24. We note that none of the three criteria require an investment relationship in order to establish control over another entity. Further, we note that Appendix A of IFRS 10 defines a parent as "an entity that controls one or more entities." In other words, it is control that determines whether an entity is a parent and not the existence of an investment.

25. On the basis of this assessment, we are of the view that an entity does not need to hold an investment in another entity in order to have control of that other entity, and thus establish a parent-subsidiary relationship in the context of IFRS 10. Consequently, if a combining entity has no investment in the other combining entities in a stapling arrangement, the combining entity could meet the definition

of a parent and consolidate the other combining entities under IFRS 10 provided it has control of those other entities.

Question for the Interpretations Committee

Question 1
Does the Interpretations Committee agree that an entity does not need to hold an investment in another entity in order to control that other entity?

Issue 2: does a combining entity always obtain control as defined in IFRS 10 in a business combination under IFRS 3 (2008)?

The IASB's statement in September 2004

26. We learnt that the *IASB Update* for September 2004 (see **Appendix C** to this Agenda Paper for more detail) indicates the IASB's view on this issue under IFRS 3 (2004) (emphasis added) :

> **Business combinations (phase I)**
> The Board considered at this meeting the comment letters received on the Exposure Draft of *Proposed Amendments to IFRS 3 Business Combinations by Contract Alone or Involving Mutual Entities.*
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> …
>
> **Other issues raised by respondents**
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> *Combinations by contract alone without the obtaining of an ownership interest*
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> Some respondents were not sure which transactions included in the descriptor 'by contract alone without the obtaining of an ownership interest'. For example, respondents questioned whether the following features would imply that a combination was not by contract alone without the obtaining of an ownership interest:
>
> - *Stapling transactions* By legal form these are not 'by contract alone without the obtaining of an ownership interest', because the shareholders of each of the combining entities receive, as a notional amount, equity instruments (ie ownership interests) in the other combining entity that are then 'stapled' to their existing shareholdings. However, in economic substance such transactions can be regarded as no different from a dual listing.
>
> …
>
> *Identifying an acquirer and the interaction between IFRS 3 and IAS 27*
>
> A business combination is defined in IFRS 3 as 'the bringing together of separate entities or businesses into one reporting entity'. The Board's view is that as with any 'traditional' business combination, when separate mutual entities are brought together into one reporting entity or when separate entities are brought together solely as a result of contractual arrangements without the obtaining of an ownership interest, the result generally is that one of the combining entities ends up with the ability to direct the financial and operating policies of the other combining entity so as to obtain benefits from its activities. <u>Nevertheless, the Basis for Conclusions on IFRS 3 leaves open the possibility that a business combination (however rarely) might not involve one of the combining entities obtaining control of the other combining entity (or entities).</u>

Some constituents suggested that if a business combination did not involve one of the combining entities obtaining control of the other combining entity (or entities), the entity identified as the acquirer for purposes of applying IFRS 3 would not meet the definition in IAS 27 *Consolidated and Separate Financial Statements* of a 'parent' (ie an entity that has one or more subsidiaries). Therefore, the acquirer would not be required to prepare consolidated financial statements.

The Board was concerned by this suggestion and noted that:

- IFRS 3 defines the acquirer in a business combination as 'the combining entity that obtains control of the other combining entities or businesses'.
- 'control' has the same definition in IFRS 3 as in IAS 27 (ie the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities).
- the intended interaction between IFRS 3 and IAS 27 is that an entity that is identified as the 'acquirer' of another entity in accordance with IFRS 3, is a 'parent' for the purposes of IAS 27. Therefore, it is required to prepare consolidated financial statements that include on a line-by-line basis the assets, liabilities, income and expenses of the subsidiary. In other words, the requirement in IAS 27 for a parent to prepare consolidated financial statements applies to all entities that are, in accordance with IFRS 3, identified as an acquirer of another entity.

...

27. We understand that when this edition of *IASB Update* was published, many interested parties used it for guidance on the question of how to account for stapling arrangements, both at the date of the stapling and subsequently. Consequently, we understand that the predominant practice under IFRS 3 (2004) and IAS 27 was to account for a stapling arrangement as a business combination. The entity that was identified as the acquirer for the purpose of the business combinations accounting was also identified as the parent for consolidation.

Changes to IFRS 3 and IAS 27 since 2004

28. Since September 2004, there have been amendments to IFRS 3 in 2008 and IAS 27 has been replaced by IFRS 10 in 2011. Consequently, we consider how those changes might affect the analysis published in the *IASB Update* in September 2004.

29. The followings are relevant guidance in IFRS 3 (2004) and IAS 27:

IFRS 3(2004)

Appendix A Defined terms

business combination	The bringing together of separate entities or businesses into one reporting entity.
control	The power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities.
parent	An entity that has one or more subsidiaries.
subsidiary	An entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).

Identifying the acquirer

17 **An acquirer shall be identified for all business combinations. The acquirer is the combining entity that obtains control of the other combining entities or businesses.**

IAS 27 (2004 version)

4 The following terms are used in this Standard with the meanings specified:

…

Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

…

A *parent* is an entity that has one or more subsidiaries.

30. The relevant guidance in IFRS 3 (2008) and IFRS 10 are as follows:

IFRS 3(2008)

Appendix A Defined terms

acquiree	The business or businesses that the acquirer obtains control of in a business combination.
acquirer	The entity that obtains control of the acquiree.
…	
business combination	A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in this IFRS.

Identifying the acquirer

6 For each business combination, one of the combining entities shall be identified as the acquirer.

7 The guidance in IFRS 10 shall be used to identify the acquirer—the entity that obtains control of another entity, ie the acquiree. If a business combination has occurred but applying the guidance in IFRS 10 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–B18 shall be considered in making that determination.

A business combination achieved without the transfer of consideration

43 An acquirer sometimes obtains control of an acquiree without transferring consideration. The acquisition method of accounting for a business combination applies to those combinations. Such circumstances include:

(a) The acquiree repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control.

(b) Minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights.

(c) The acquirer and acquiree agree to combine their businesses by contract alone. The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously. Examples of business combinations achieved by contract alone include bringing two businesses together in a stapling arrangement or forming a dual listed corporation.

IFRS 10

control of an investee	An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
parent	An entity that controls one or more entities.
subsidiary	An entity that is controlled by another entity.

Analysis of changes to IFRS 3 and IAS 27/IFRS 10 since 2004

31. We note that IFRS 3 (2004) defined the terms 'control' and 'parent' in the same manner as IAS 27 did. This fact confirms that the IASB intended to apply the two terms consistently both in IFRS 3 (2004) and IAS 27 as explained in the *IASB Update* for September 2004. We note that IFRS 3 (2008) refers to IFRS 10 for the meaning of control, thus maintaining the consistency between IFRS 3 (2008) and IFRS 10.

32. We also note that there is no difference in the description/definition of the term 'acquirer' between IFRS 3 (2004) and IFRS 3 (2008). In the statements in the *IASB Update* for September 2004, the IASB confirmed that an acquirer in a business combination is a combining entity that obtains control of the other combining entities or businesses. Thus, we think that the term 'acquirer' in IFRS 3 (2004) was carried forward with the same meaning when IFRS 3 was amended in 2008.

33. The definition of a 'business combination' in IFRS 3 (2008) has changed from IFRS 3 (2004). IFRS 3 (2004) defined a business combination as 'the bringing together of separate entities or businesses into one reporting entity'. It did not specify that a business combination involved one entity obtaining control over other combining entities or businesses, notwithstanding the fact that this was implicit from the description of 'acquirer' in IFRS 3 (2004).

34. IFRS 3 (2004) acknowledged that there could be a business combination not involving a combining entity obtaining control of the other combining entities. Paragraph 4 of IFRS 3 (2004) stated that "the result of nearly all business combinations is that one entity, the acquirer, obtains control of one or more other

businesses, the acquiree." The wording 'nearly all' in this paragraph is no longer used in the description of an acquirer in IFRS 3 (2008).

35. Furthermore, the text in the Basis for Conclusion in IFRS 3 (2004) (paragraphs BC39-42 and BC54-55 of IFRS 3 (2004)) that is referred to in the *IASB Update*, and which discusses the possibility of a business combination in which none of the combining entities obtains control, was not carried forward when IFRS 3 was amended in 2008.

36. The revised definition of a business combination identifies a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses. It goes on to specify that a transaction that is sometimes referred to as a 'true merger' or 'merger of equals' is also a business combination.

37. The first part of the definition of a business combination is now aligned more closely with the definition of an acquirer. The second part of the definition of a business combination refers to 'true mergers' which are not expected to be common, but could occur.

38. For the purpose of the analysis of stapling transactions, we think that we should focus on the first part of the definition; paragraph 43 of IFRS 3 (2008), which was added in 2008 and provides guidance on business combinations achieved without the transfer of consideration (eg stapling arrangements), also refers to the obtaining of control of the acquiree.

39. The changes to IFRS 3, in particular the changes to the definition of a business combination, cause us to question whether the conclusions drawn by the IASB in relation to stapling arrangements and published in *IASB Update* in September 2004 remain valid today. In order to answer this question we will look at how the acquirer is identified in accordance with IFRS 3 (2008) and IFRS 10 for some similar transactions and consider how this could help in the application of IFRS 3 (2008) and IFRS 10 to stapling arrangements.

Application of IFRS 3 (2008) to a 'roll-up' transaction

40. **Example 1** in **Appendix A** of this Agenda Paper gives an example of a roll-up transaction. In this example a Newco, Entity P, is created to effect a combination

of two previously unrelated entities, Entity A and Entity B. The voting interests in Entity A and Entity B are combined into voting interests in Entity P. Having identified that control has been obtained over the combined group of entities, consideration should be given to who has obtained that control.

41. Neither Entity A nor Entity B holds voting rights or other direct rights over the other entity. However, Entity A in the example would probably be identified as the acquirer of the business combination according to the following analysis.

42. Paragraph B13 of IFRS 3 (2008) requires that IFRS 10 is used to identify the acquirer—the entity that obtains control of the acquiree, but that if applying the guidance in IFRS 10 does not clearly indicate which of the combining entities is the acquirer, then the additional guidance in paragraphs B14-B18 of IFRS 3 (2008) shall be applied.

43. Applying the guidance in IFRS 10 alone could lead to identifying Entity P as the acquirer because Entity P has acquired 100 per cent of the voting interests in both Entity A and Entity B. However, paragraph B18 of IFRS 3 (2008) states that a new entity that is formed to effect a business combination and issues equity interests in exchange for the equity interests issued by the pre-existing combining entities is not the acquirer; instead one of the pre-existing combining entities shall be identified as the acquirer. Paragraph B18 of IFRS 3 (2008) requires that the acquirer is identified by applying paragraphs B13-B17 of IFRS 3 (2008). Among this guidance, paragraph B15(a) notes that 'the acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of voting rights in the combined entity'.

44. In this example, the former owners of Entity A can be seen to obtain power over Entity P by having a majority voting rights in Entity P. The return on the ownership interests in Entity P held by the former owners of Entity A is variable, because it depends on the performance of the activity of Entity P. Consequently we think that in this example, Entity A would be identified as the acquirer.

Application of IFRS 3 (2008) to a reverse acquisition

45. **Example 2** in **Appendix A** of this paper gives an example of a reverse acquisition transaction. In this example Entity D arranges to be acquired by Entity C in exchange for the former shareholders of Entity D obtaining a majority of the shares in entity C. The voting interests in Entity D are thus combined with the voting interests in Entity C. Having identified that control has been obtained over the combined group of entities, consideration should be given to who has obtained that control.

46. Although entity D has not obtained voting rights over entity C, entity D would probably be identified as the acquirer according to the following analysis.

47. Applying the guidance in IFRS 10 alone could lead to identifying Entity C as the acquirer because Entity C has acquired 100 per cent of the voting interests in Entity D. However, among the application guidance in paragraphs B13-B18 of IFRS 3 (2008) on identifying the acquirer, paragraph B15(a) notes that 'the acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of voting rights in the combined entity'.

48. In this example, the former owners of Entity D can be seen to obtain power over Entity C by having a majority voting rights in Entity C. The return on the ownership interests in Entity C held by the former owners of Entity D is variable, because it depends on the performance of the activity of Entity C. Consequently we think that in this example, Entity D would be identified as the acquirer.

Analysis of the application of IFRS 3 (2008) to the above examples and consideration of its applicability to a stapling arrangement

49. We note that paragraph B6(d) of IFRS 3 (2008) states that a combination of businesses in which "a group of former owners of one of the combining entities obtains control of the combined entity" is a business combination. We note that this describes the circumstances in a roll-up transaction (**Example 1**), a reverse acquisition (**Example 2**) and also a stapling arrangement (**Example 3**). Consequently we think that paragraph B6(d) of IFRS 3 (2008) identifies a stapling arrangement such as the one in **Example 3** as a business combination. This is

because in **Example 3** the ownership and voting interests of Entity E and Trust F are contractually combined by the stapling and consequently the former owners of Entity E obtain control over the stapled entities. In other words, the effect of the stapling transaction is to unify the ownership and voting interests of the stapled entities.

50. We note that in **Example 3**, the former owners of Entity E hold a majority of the voting rights of Entity E and Trust F, they have a right to a variable return from their involvement with Entity E and Trust F because of the equity interests they hold in those entities, and the return on investment held by the former owners of Entity E would be affected by the exercise of their voting rights in Entity E and Trust F.

51. We note that having applied paragraph B6(d) of IFRS 3 (2008) to identify that the transactions in **Examples 1, 2 and 3** are business combinations, paragraph 6 of IFRS 3 requires that one of the combining entities is identified as the acquirer. We note that paragraph 7 of IFRS 3 (2008) requires that the guidance in IFRS 10, and if necessary, the guidance in paragraphs B14-B18 of IFRS 3 (2008) is used to identify which of the combining entities is the acquirer. We note that the guidance in paragraph B15 of IFRS 3 (2008) requires consideration of relative voting rights of the former shareholders after the business combination. This is consistent with the focus of the guidance in paragraph B6(d) of IFRS 3 (2008) on the post-combination ownership interests of the former owners of one of the combining entities.

52. Consequently we think that applying the guidance in IFRS 10 and in paragraphs B14-B18 of IFRS 3 (2008) to the stapling arrangement in **Example 3** would identify Entity E as the acquirer because the former owners of Entity E hold a majority of the voting rights in the stapled entities.

53. We note that in **Examples 1, 2 and 3**, the entities that we have identified above as the acquirer for the purposes of IFRS 3 (2008) do not have legal control over the other combining entities. This does not prevent these entities from being identified as the acquirer for business combinations accounting purposes because the objective of IFRS 3 (2008) is to identify the entity that obtains economic

control over the combining entities. Paragraphs BC13, BC96 and BC100 of IFRS 3 (2008) state (emphasis added):

> BC13 Some respondents to the 2005 Exposure Draft also said that it was not clear that the definition of a business combination, and thus the scope of the revised standards, includes reverse acquisitions and perhaps other combinations of businesses. The boards observed that in a reverse acquisition, **one entity—the one whose equity interests are acquired—obtains economic (although not legal) control over the other and is therefore the acquirer, as indicated in paragraph B15 of the revised IFRS 3**. Therefore, the boards concluded that it is unnecessary to state explicitly that reverse acquisitions are included in the definition of a business combination and thus within the scope of the revised standards.
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> BC96 The IASB also observed that in some reverse acquisitions, the acquirer may be the entity whose equity interests have been acquired and the acquiree is the issuing entity. For example, a private entity might arrange to have itself 'acquired' by a smaller public entity through an exchange of equity interests as a means of obtaining a stock exchange listing. As part of the agreement, the directors of the public entity resign and are replaced by directors appointed by the private entity and its former owners. The IASB observed that in such circumstances, the private entity, which is the legal subsidiary, has the power to govern the financial and operating policies of the combined entity so as to obtain benefits from its activities. Treating the legal subsidiary as the acquirer in such circumstances is thus consistent with applying the control concept for identifying the acquirer. **Treating the legal parent as the acquirer in such circumstances would place the form of the transaction over its substance, thereby providing less useful information than would be provided using the control concept to identify the acquirer.**
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> BC100 The IASB also considered whether treating a new entity formed to issue equity instruments to effect a business combination as the acquirer would place the form of the transaction over its substance, because the new entity may have no economic substance. The formation of such entities is often related to legal, tax or other business considerations that do not affect the identification of the acquirer. For example, a combination of two entities that is structured so that one entity directs the formation of a new entity to issue equity instruments to the owners of both of the combining entities is, in substance, no different from a transaction in which one of the combining entities directly acquires the other. Therefore, the transaction should be accounted for in the same way as a transaction in which one of the combining entities directly acquires the other. To do otherwise would impair both the comparability and the reliability of the information.

54. Consequently, we think that the analysis above for **Examples 1, 2 and 3** led to the identification of an acquirer that has economic (although not legal) control over the other combining entities.

Summary of the staff analysis

55. We think that:

    (a) a stapling transaction that unifies the ownership and voting interests of the stapled entities is a business combination because the unified ownership interests represent control of the stapled entities (paragraph B6 of IFRS 3 (2008));

    (b) the conclusion that the stapling arrangement is a business combination means that one of these combining entities must be identified as the acquirer (paragraph 6 of IFRS 3 (2008)); and

(c) paragraphs B14-B18 of IFRS 3 (2008), in addition to the guidance on control in IFRS 10, should be used to identify which of the combining entities is the acquirer. In a stapling transaction that is a business combination, this will likely be the combining entity whose former owners as a group hold the largest portion of the voting rights in the stapled entities. This assessment identifies the acquirer that obtains economic control over the combined entity, even if that entity does not have legal control over the combining entities.

56. Consequently even though a stapling arrangement may not involve one of the combining entities obtaining legal control over the other combining entity(ies), this does not preclude the stapling transaction from being a business combination. Rather, we think that a stapling arrangement that unifies the ownership and voting interests of the stapled entities is a business combination and the acquirer is the combining entity that obtains economic control over the other combining entities.

Question for the Interpretations Committee

Question 2
Does the Interpretations Committee agree that a stapling arrangement could be a business combination even if it does not involve one of the combining entities obtaining legal control over the other combining entity(ies)? Further, does the Interpretations Committee agree that a stapling arrangement that unifies the ownership and voting interests of the stapled entities is a business combination and the acquirer is the combining entity that obtains economic control over the other combining entity(ies)?

Issue 3: should an acquirer under IFRS 3 (2008) always be viewed as a parent under IFRS 10?

57. In Issue 2, we concluded that a stapling arrangement is a business combination if one of the combining entities obtains economic control over the other combining entities, even if it does not obtain legal control.

58. The IASB stated in September 2004 that the intended interaction between IFRS 3 (2004) and IAS 27 is that an entity that is identified as an acquirer of another entity in accordance with IFRS 3, is a parent for the purposes of IAS 27. This statement is derived from the IASB's observations that:

    (a) IFRS 3 (2004) defines the acquirer in a business combination as 'the combining entity that obtains control of the other combining entities or businesses'.

    (b) 'control' has the same definition in IFRS 3 (2004) as in IAS 27.

59. We note that these two observations are still valid under IFRS 3 (2008) and IFRS 10. IFRS 3 (2008) defines an acquirer as 'the entity that obtains control of the acquiree'. In addition, IFRS 3 (2008) refers to IFRS 10 for the meaning of control. We also note that this statement was made when IFRS 3 (2004) left open the possibility that a business combination might not involve one of the combining entities obtaining control of the other combining entities. Thus, we think that the IASB's statement applies more so to the interaction between IFRS 3 (2008) and IFRS 10 because, in our view, there is always 'control' if a transaction meets the definition of a business combination in IFRS 3 (2008).

60. Paragraphs B21-B27 of IFRS 3 (2008) prescribes how to prepare consolidated financial statements of a combined group in a reverse acquisition. Such financial statements are prepared under the name of the legal parent. However, the financial statements represent the continuation of the financial statements of the acquirer identified under IFRS 3 (2008) (accounting parent) except for the capital structure, which reflects that of the legal parent. We think that this guidance is consistent with our view that an accounting acquirer (accounting parent), which obtains economic control, is required to prepare the consolidated financial statements of the combined group of entities.

61. We also note that paragraph 44 of IFRS 3 (2008) provides guidance on the preparation of consolidated financial statements of stapled entities (being an example of a business combination achieved by contract alone). Paragraph 44 of IFRS 3 (2008) requires an acquirer to recognise the amount of the acquiree's net assets as non-controlling interest in the acquirer's post-combination financial

statements. An acquirer that obtained economic control over the other stapled entities would prepare consolidated financial statements of the stapled group of entities as if the acquirer is the continuing entity, with the amount of net assets of the other stapled entities being recognised as non-controlling interest.

62. Using the roll-up transaction in **Example 1** in **Appendix A**, Entity P, as a legal parent, would prepare the consolidated financial statements of the combined group. However, we note that Entity A, the accounting parent, would be deemed as the continuing entity in those consolidated financial statements. This means that the consolidated financial statements represent the continuation of the financial statements of Entity A except for its capital structure, which reflects that of the legal parent, Entity P. Thus, we think that the consolidated financial statements should be viewed as those of Entity A.

63. In the reverse acquisition example in **Example 2** in **Appendix A**, Entity C, a legal parent, would prepare the consolidated financial statements of the group. However, we note that Entity D, the accounting parent/legal subsidiary would be viewed as the continuing entity in those consolidated financial statements. This means that the consolidated financial statements represent the continuation of the financial statements of Entity D except for its capital structure, which reflects that of Entity C. In this regard, we think that the consolidated financial statements should be viewed as those of Entity D.

64. Applying the analysis above to a stapling arrangement, there would be no entity that is a legal parent of the combining entities. However, as discussed above, unifying the equity instruments issued by the combining entities through the stapling arrangement would unify the control over each stapled entity into control over the combined group of entities (and thus stapled entities). We think that the principal difference between a roll-up transaction and a stapling arrangement is whether there is a ‘shell’ holding entity that unites ownership and voting interests in the combining entities or a stapling of equity instruments that unites ownership and voting interests in the stapled entities.

65. Accordingly, we think that a stapled entity that is identified as an accounting acquirer/parent under IFRS 3 (2008) should prepare consolidated financial

statements of the stapled group. This is because that stapled entity has obtained (economic) control over the other stapled entities.

Question for the Interpretations Committee

Question 3
Does the Interpretations Committee agree that an acquirer identified for the purposes of IFRS 3 (2008) should be identified as the parent, and therefore prepare consolidated financial statements of the group, in accordance with IFRS 10?

Summary of the outreach activity

66. In order to gather information about the issue described in the submission, we sent requests to the International Forum of Accounting Standard-Setters (IFASS) and to regulators. Specifically, we asked:

(a) *In your jurisdiction, is it common that a business combination is achieved by contract alone, such as by a stapling arrangement or a dual-listed corporation scheme, with no entity having 'control' over the other combining entities as defined in IFRS 10? If so, please explain the characteristics of the contract briefly.*

(b) *If you answered 'yes' to Question 1, what is the prevalent interpretation on whether consolidated financial statements should be prepared for the combined group? If the prevalent view is that they should be prepared, which entity should be a 'parent' for the purpose of preparing consolidated financial statements in accordance with IFRS 10? In addition, if possible, could you please briefly describe the rationale for that prevalent interpretation?*

(c) *On the basis of your response to Question 2, to what extent do you observe diversity in the interpretation?*

(d) *If you answered 'yes' to Question 1, is there any regulation or rule in your jurisdiction that addresses financial reporting of the combined entity or of each combining entity on or after the stapling arrangement* *(or similar contracts), in the situation in which no combining entity has 'control' as defined in IFRS 10 as a consequence of the business combination?*

67. We received responses from two regulatory bodies and eleven national standard-setters. Please note that the views expressed below are informal opinions from the regulators and national standard-setters. They do not reflect the formal views of those organisations.

Responses received from regulators

68. No respondent stated that the transactions that are similar to the transaction described in the submission are significantly widespread in its member jurisdictions.

Responses received from national standard-setters

69. The geographical breakdown for the responses received from national standard-setters is as below:

Geographical area	**Number of respondents**
Americas	3
Asia/Oceania	4
Africa	1
Europe	3
Total respondents	**11**

70. All the respondents stated that transactions similar to the transaction described in the submission are not common in their jurisdictions.

71. However, on the basis of the informal discussions with the submitter and some interested parties in the submitter's jurisdiction, we learnt that there are 37 stapling arrangements listed in the jurisdiction.

72. In addition, we were told that most stapling arrangements that occurred prior to the transition to IFRSs were carried forward into IFRS on the basis of the previous GAAP by applying the exemptions for business combinations in Appendix C of IFRS 1 *First-time Adoption of International Financial Reporting Standards*. However, stapling arrangements that occurred on or after the date of transition to IFRSs were all accounted for as business combinations in accordance with IFRS 3 and the acquirer identified under IFRS 3 has prepared consolidated financial statements of the stapled group.

Agenda criteria assessment

73. In this section, we assess the issue against the agenda criteria of the Interpretations Committee as described in paragraphs 5.14–5.21 of the *Due Process Handbook*. Please refer to **Appendix B** to this Agenda Paper for the details of the agenda criteria and the assessment of the issue against the agenda criteria.

74. The results of the outreach indicate that this issue is widespread only in the jurisdiction of the submitter. On the basis of the information from the submitter and other parties in the jurisdictions of the submitter, we learnt that there is a significant number of stapling arrangements in the jurisdiction. Thus, we think that this issue is widespread.

75. Notwithstanding the above, the results of the outreach indicate that there is no diversity in practice in the jurisdiction of the submitter. Stapling arrangements that occurred on or after the date of transition to IFRSs are all accounted for as business combinations under IFRS 3. Entities in those stapling arrangements that were identified as the acquirers prepare consolidated financial statements of the stapled group. We think that this prevalent accounting practice is consistent with our technical analysis of the requirements and guidance in IFRS 3 (2008) and IFRS 10. Consequently, we do not expect diversity in practice to emerge in the future.

76. Accordingly, we are of the view that this issue does not meet the agenda criteria of the Interpretations Committee.

Staff recommendation

77. We are of the view that in the light of the requirements and guidance in IFRS 3 (2008) and IFRS 10:

    (a) The IASB’s intention is that control, as defined in IFRS 10, over a combining entity or entities is obtained by a group of the former owners of a combining entity in all business combinations under IFRS 3 (2008).

    (b) If IFRS 10 does not clearly indicate which of the combining entity has obtained control, the additional guidance in IFRS 3 (2008) identifies an acquirer that has obtained economic control over the other combining entity.

    (c) The IASB’s statement in September 2004 regarding the interaction between IFRS 3 (2004) and IAS 27 is still valid under IFRS 3 (2008) and IFRS 10.

    (d) Accordingly, the acquirer identified under IFRS 3 (2008) is required to prepare consolidated financial statements of the combined group of entities in accordance with IFRS 10.

78. We think that this issue does not meet the agenda criteria of the Interpretations Committee because significant diversity in practice does not exist and is not expected to emerge in the future. Accordingly, we recommend that the Interpretations Committee should not add this issue to its agenda.

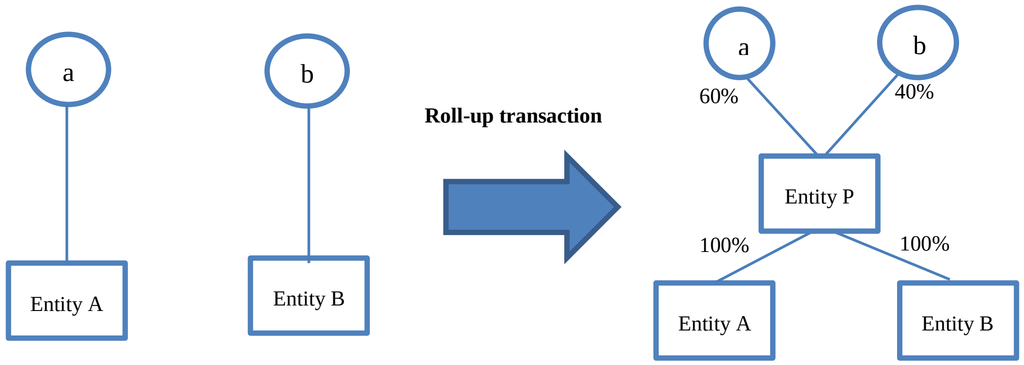
Question for the Interpretations Committee

Question 4
Does the Interpretations Committee agree with the staff recommendation that the Interpretations Committee should not add this issue to its agenda? If so, does the Interpretations Committee agree with the wording of the tentative agenda decision in Appendix E of this Agenda Paper?

Appendix A—Illustrative examples

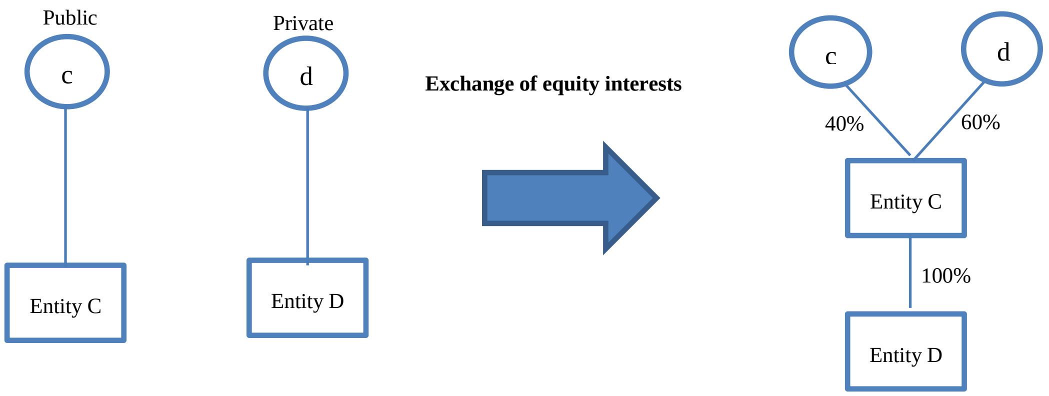
Example 1: a roll-up transaction

Entity A and Entity B entered into an agreement in which they establish a new entity (Entity P) and Entity P issues new shares to shareholders of Entity A and Entity B in exchange for the shares issued by Entity A and Entity B. As a result of the arrangement, the former shareholders group of Entity A (“a”) obtained 60 per cent voting rights of Entity P, and the former shareholders group of Entity B (“b”) obtained 40 per cent voting rights of Entity P.



Example 2: a reverse acquisition

Entity C, a public entity, and Entity D, a private entity, entered into an agreement in which Entity C acquires equity interests in Entity D in exchange for the equity interests in Entity C so that Entity D can become public entity without registering its equity shares. As a result of the arrangement, the former shareholders group of Entity C (“c”) retained 40 per cent voting rights of Entity C, which obtained 100 per cent voting rights in Entity D, and the former shareholders group of Entity D (“d”) obtained 60 per cent voting rights of Entity C.



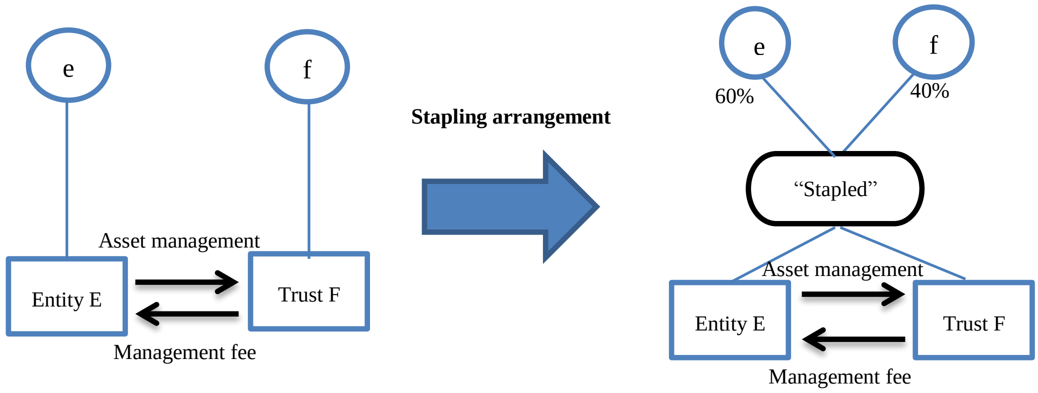
Example 3: stapling arrangements

Entity E and Trust F entered into a stapling arrangement in which Entity E issues new shares, which is combined with (stapled to) shares issued by Trust F, to shareholders of each entity in exchange for shares issued by each entity. The combined (stapled) security represents legally separate shares in Entity E and Trust F. However, those cannot be traded separately. As a result of the stapling arrangement, the former shareholders group of Entity E ("e") obtained 60 per cent voting rights of Entity E and Trust F, and the former unit holders group of Trust F ("f") obtained 40 per cent voting rights of each of Entity E and Trust F.

The stapling arrangement can be terminated only if the stapling arrangement becomes unlawful or if a special resolution (super majority vote) of the stapled securities' holders determines to do so.

As a result of the stapling arrangement, in accordance with the relevant regulation, Entity E is identified as the 'responsible entity' and so is responsible for the management of assets held by Trust F (eg shopping malls, toll roads, hotels). Entity E receives a management fee from Trust F, which is variable on the performance of Trust F.

There is no involvement of Entity E with Trust F except for the asset management before and after the stapling arrangement.



Appendix B—Agenda criteria of the Interpretations Committee and assessment against the criteria

B1. In the table below, we have assessed the issue against the agenda criteria of the Interpretations Committee as described in paragraphs 5.14–5.22 of the *Due Process Handbook*.

Agenda criteria of the Interpretations Committee	
We should address issues (see paragraph 5.16):	
that have widespread effect and have, or are expected to have, a material effect on those affected;	**Met** The results of the outreach indicate that this issue is widespread only in the jurisdiction of the submitter. From the informal discussions with the submitter and other parties in the jurisdiction of the submitter, we learnt that there are 37 stapling arrangements listed in the jurisdiction of the submitter. Thus, we think that this issue is widespread.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	**Not met** The results of the outreach indicate that there is no diversity in practice in the jurisdiction of the submitter. Stapling arrangements are all accounted for as business combinations under IFRS 3. An acquirer identified under IFRS 3 prepares consolidated financial statements of the stapled group. This accounting practice is consistent with our technical analysis of the requirements in IFRS 3 and IFRS 10. Consequently, we do not expect diversity in practice to emerge in the future.
that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.	**Met** This issue arose from the interpretations of the existing requirements and guidance in IFRS 3 and IFRS 10. We think that developing a new principle or change an existing principle in IFRSs and Conceptual Framework is

	unnecessary to solve this issue.
In addition:	
Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRSs (see paragraph 5.17)?	**Met** This issue concerns about business combinations achieved by contract alone that paragraph 43(c) of IFRS 3 addresses. Thus, we think that this issue is sufficiently narrow in scope that the Interpretations Committee can address in an efficient manner.
Will the solution developed by the Interpretations Committee be effective for a reasonable time period (see paragraph 5.21)? (The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified).	**Met** We are not aware of any existing or forthcoming project of the IASB that would affect the issue discussed in this Agenda Paper.

Appendix C—Excerpt from the *IASB Update* for September 2004 and IFRS 3 as issued in 2008

C1. The excerpt from the IASB Update for September 2004 is as following:

Business combinations (phase I)

The Board considered at this meeting the comment letters received on the Exposure Draft of *Proposed Amendments to IFRS 3 Business Combinations by Contract Alone or Involving Mutual Entities.*

…

Other issues raised by respondents

Combinations by contract alone without the obtaining of an ownership interest

Some respondents were not sure which transactions included in the descriptor 'by contract alone without the obtaining of an ownership interest'. For example, respondents questioned whether the following features would imply that a combination was not by contract alone without the obtaining of an ownership interest:

- *'Stapling' transactions*[1] By legal form these are not 'by contract alone without the obtaining of an ownership interest', because the *shareholders* of each of the combining entities receive, at a notional amount, equity instruments (ie ownership interests) in the other combining entity that are then 'stapled' to their existing shareholdings. However, in economic substance such transactions can be regarded as no different from a dual listing.
- *Cash or other payments* The contractual arrangements underpinning a dual listing or a security stapling often involve transactions in anticipation of the combination, such as one of the combining entities paying 'special dividends' or issuing bonus shares to its existing shareholders immediately before the combination is effected. The purpose of such transactions is to 'equalise' the value of the combining entities' equity instruments immediately before the combination is effected. Are such payments pre-combination in nature or should they be regarded as consideration paid in the business combination?
- *Direct investment in the other combining entity* It is not clear whether a combination could be regarded as 'by contract alone without the obtaining of an ownership interest' when one of the combining entities has a pre-existing ownership interest in the other combining entity, or the combination is *predominantly* by contract while at the same time involving *some* consideration being given by the acquirer for an ownership interest in the acquiree. For example, the formation of a dual listed corporation may, as part of the contractual arrangement, involve the acquirer obtaining a small parcel of shares in the acquiree, but that ownership interest on its own (ie excluding the other terms of the contract) does not give the acquirer control of the acquiree.

The Board observed that 'by contract alone without the obtaining of an ownership interest' was intended to capture (and exclude from IFRS 3) any business combination in which the obtaining of control by one of the combining entities was effected solely as a result of contractual arrangements, without the combination itself (ie the bringing together of the separate entities into one reporting entity)

[1] 'Stapled securities' refers to a situation in which a listed legal entity (typically a company) has issued equity instruments that are combined with ('stapled' to) the equity instruments issued by another legal entity (typically a trust). The stapled securities cannot be traded independently and are quoted at a single price. The stapling results in the two (or more) legal entities having equity holders in common. Such transactions are generally tax-driven. They meet the IFRS 3 definition of a business combination because they in substance involve 'the bringing together of separate entities or business into one reporting entity' (a reporting entity is defined in IFRS 3 as one 'for which there are users who rely on the entity's general purpose financial statements for information that will be useful to them for making decisions about the allocation of resources. A reporting entity can be a single entity or a group …').

involving any of the combining entities (as opposed to their shareholders) obtaining an ownership interest in the other combining entity (or entities). The reasons for the proposed exclusion were:

- although identification of the acquirer rests on the notion of control, the purchase method in IFRS 3 is a 'cost allocation' model, with 'cost' being the fair value *given by the acquirer* in exchange for control of the acquiree (plus any costs incurred by the acquirer that are directly attributable to the combination).
- complications arise in applying IFRS 3's version of the purchase method when there is no 'cost' in the traditional sense *given by the acquirer* in exchange for that control[2].
- a distinction needs to be drawn between reverse acquisitions (for which the Board has developed guidance on applying the purchase method), and other combinations intended to be excluded from IFRS 3 for which there is no 'cost' given by the acquirer in exchange for control. The distinction is that a reverse acquisition involves one of the combining entities, though not the accounting acquirer, obtaining an ownership interest in the other combining entity.

It follows that:

- the stapling transactions referred to by respondents *are* intended to be captured within the term 'by contract alone without the obtaining of an ownership interest'. This is because such combinations are effected by contract without one of the *combining entities* obtaining an ownership interest in the other combining entity.
- the cash or other payments referred to by respondents that are made in anticipation of a dual listing or security stapling are pre-combination in nature—they are not a 'cost' given by the acquirer in exchange for control of the acquiree nor do they result in one of the combining entities obtaining an ownership interest in the other combining entity.
- if a combination is predominantly by contract while at the same time involving some consideration being given by the acquirer for an ownership interest in the acquiree, it is not a combination by contract alone without the obtaining of an ownership interest. This would include, for example, the formation of a dual listed corporation that also involves the acquirer obtaining an ownership interest in the acquiree, but that ownership interest on its own (ie excluding the other terms of the contract) does not give the acquirer control of the acquiree. Consequently, such combinations would be required to be accounted for by applying the purchase method principles in IFRS 3. This means that goodwill would be recognised by the acquirer, but only to the extent that it is attributable to the ownership interest held by the acquirer in the acquiree.

Identifying an acquirer and the interaction between IFRS 3 and IAS 27

A business combination is defined in IFRS 3 as 'the bringing together of separate entities or businesses into one reporting entity'. The Board's view is that as with any 'traditional' business combination, when separate mutual entities are brought together into one reporting entity or when separate entities are brought together solely as a result of contractual arrangements without the obtaining of an ownership interest, the result generally is that one of the combining entities ends up with the ability to direct the financial and operating policies of the other combining entity so as to obtain benefits from its activities. Nevertheless, the Basis for Conclusions on IFRS 3 leaves open the possibility that a business combination (however rarely) might not involve one of the combining entities obtaining control of the other combining entity (or entities).

Some constituents suggested that if a business combination did not involve one of the combining entities obtaining control of the other combining entity (or entities), the entity identified as the acquirer for purposes of applying IFRS 3 would not meet the definition in IAS 27 *Consolidated and Separate Financial Statements* of a 'parent' (ie an entity that has one or more subsidiaries). Therefore, the acquirer would not be required to prepare consolidated financial statements.

The Board was concerned by this suggestion and noted that:

[2] This includes reverse acquisitions because there is no 'cost' in the traditional sense *given by the acquirer* in exchange for control—it is the 'legal acquirer' (ie the acquiree for accounting purposes) that purchases an ownership interest in the 'legal acquiree' (ie the acquirer for accounting purposes).

- IFRS 3 defines the acquirer in a business combination as ‘the combining entity that obtains control of the other combining entities or businesses’.
- ‘control’ has the same definition in IFRS 3 as in IAS 27 (ie the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities).
- the intended interaction between IFRS 3 and IAS 27 is that an entity that is identified as the ‘acquirer’ of another entity in accordance with IFRS 3, is a ‘parent’ for the purposes of IAS 27. Therefore, it is required to prepare consolidated financial statements that include on a line-by-line basis the assets, liabilities, income and expenses of the subsidiary. In other words, the requirement in IAS 27 for a parent to prepare consolidated financial statements applies to all entities that are, in accordance with IFRS 3, identified as an acquirer of another entity.

Communication with respondents

…

C2. The excerpt from the relevant requirements in IFRS (2008) is as following:

Appendix B
Application guidance

This appendix is an integral part of the IFRS.

Identifying a business combination (application of paragraph 3)

B5 This IFRS defines a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses. An acquirer might obtain control of an acquiree in a variety of ways, for example:

(a) by transferring cash, cash equivalents or other assets (including net assets that constitute a business);

(b) by incurring liabilities;

(c) by issuing equity interests;

(d) by providing more than one type of consideration; or

(e) without transferring consideration, including by contract alone (see paragraph 43).

B6 A business combination may be structured in a variety of ways for legal, taxation or other reasons, which include but are not limited to:

(a) one or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer;

(b) one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners;

(c) all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity (sometimes referred to as a roll-up or put-together transaction); or

(d) a group of former owners of one of the combining entities obtains control of the combined entity.

Identifying the acquirer (application of paragraphs 6 and 7)

B13 The guidance in IFRS 10 *Consolidated Financial Statements* shall be used to identify the acquirer—the entity that obtains control of the acquiree. If a business combination has occurred but applying the guidance in IFRS 10 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–B18 shall be considered in making that determination.

B14 In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

B15 In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called 'reverse acquisitions', the issuing entity is the acquiree. Paragraphs B19–B27 provide guidance on accounting for reverse acquisitions. Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:

(a) *the relative voting rights in the combined entity after the business combination*—The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. In determining which group of owners retains or receives the largest portion of the voting rights, an entity shall consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities.

(b) *the existence of a large minority voting interest in the combined entity if no other owner or organised group of owners has a significant voting interest*—The acquirer is usually the combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity.

(c) *the composition of the governing body of the combined entity*—The acquirer is usually the combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity.

(d) *the composition of the senior management of the combined entity*—The acquirer is usually the combining entity whose (former) management dominates the management of the combined entity.

(e) *the terms of the exchange of equity interests*—The acquirer is usually the combining entity that pays a premium over the pre-combination fair value of the equity interests of the other combining entity or entities.

B16 The acquirer is usually the combining entity whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities.

B17 In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities.

B18 A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer by applying the guidance in paragraphs B13–B17. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

Reverse acquisitions

B19 A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes on the basis of the guidance in paragraphs B13–B18. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. In this example, the public entity is the **legal acquirer** because it issued its equity interests, and the private entity is the **legal acquiree** because its equity interests were acquired. However, application of the guidance in paragraphs B13–B18 results in identifying:

(a) the public entity as the **acquiree** for accounting purposes (the accounting acquiree); and

(b) the private entity as the **acquirer** for accounting purposes (the accounting acquirer).

The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles in this IFRS, including the requirement to recognise goodwill, apply.

Measuring the consideration transferred

B20 In a reverse acquisition, the accounting acquirer usually issues no consideration for the acquiree. Instead, the accounting acquiree usually issues its equity shares to the owners of the accounting acquirer. Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree is based on the number of equity interests the legal subsidiary would have had to issue to give the owners of the legal parent the same percentage equity interest in the combined entity that results from the reverse acquisition. The fair value of the number of equity interests calculated in that way can be used as the fair value of consideration transferred in exchange for the acquiree.

Preparation and presentation of consolidated financial statements

B21 Consolidated financial statements prepared following a reverse acquisition are issued under the name of the legal parent (accounting acquiree) but described in the notes as a continuation of the financial statements of the legal subsidiary (accounting acquirer), with one adjustment, which is to adjust retroactively the accounting acquirer's legal capital to reflect the legal capital of the accounting acquiree. That adjustment is required to reflect the capital of the legal parent (the accounting acquiree). Comparative information presented in those consolidated financial statements also is retroactively adjusted to reflect the legal capital of the legal parent (accounting acquiree).

B22 Because the consolidated financial statements represent the continuation of the financial statements of the legal subsidiary except for its capital structure, the consolidated financial statements reflect:

(a) the assets and liabilities of the legal subsidiary (the accounting acquirer) recognised and measured at their pre-combination carrying amounts.

(b) the assets and liabilities of the legal parent (the accounting acquiree) recognised and measured in accordance with this IFRS.

(c) the retained earnings and other equity balances of the legal subsidiary (accounting acquirer) **before** the business combination.

(d) the amount recognised as issued equity interests in the consolidated financial statements determined by adding the issued equity interest of the legal subsidiary (the accounting acquirer) outstanding immediately before the business combination to the fair value of the legal parent (accounting acquiree). However, the equity structure (ie the number and type of equity interests issued) reflects the equity structure of the legal parent (the accounting acquiree), including the equity interests the legal parent issued to effect the combination. Accordingly, the equity structure of the legal subsidiary (the accounting acquirer) is restated using the exchange ratio established in the acquisition agreement to reflect the number of shares of the legal parent (the accounting acquiree) issued in the reverse acquisition.

(e) the non-controlling interest's proportionate share of the legal subsidiary's (accounting acquirer's) pre-combination carrying amounts of retained earnings and other equity interests as discussed in paragraphs B23 and B24.

Non-controlling interest

B23 In a reverse acquisition, some of the owners of the legal acquiree (the accounting acquirer) might not exchange their equity interests for equity interests of the legal parent (the accounting acquiree). Those owners are treated as a non-controlling interest in the consolidated financial statements after the reverse acquisition. That is because the owners of the legal acquiree that do not exchange their equity interests for equity interests of the legal acquirer have an interest in only the results and net assets of the legal acquiree—not in the results and net assets of the combined entity. Conversely, even though the legal acquirer is the acquiree for accounting purposes, the owners of the legal acquirer have an interest in the results and net assets of the combined entity.

B24 The assets and liabilities of the legal acquiree are measured and recognised in the consolidated financial statements at their pre-combination carrying amounts (see paragraph B22(a)). Therefore, in a reverse acquisition the non-controlling interest reflects the non-controlling shareholders' proportionate interest in the pre-combination carrying amounts of the legal acquiree's net assets even if the non-controlling interests in other acquisitions are measured at their fair value at the acquisition date.

Earnings per share

B25 As noted in paragraph B22(d), the equity structure in the consolidated financial statements following a reverse acquisition reflects the equity structure of the legal acquirer (the accounting acquiree), including the equity interests issued by the legal acquirer to effect the business combination.

B26 In calculating the weighted average number of ordinary shares outstanding (the denominator of the earnings per share calculation) during the period in which the reverse acquisition occurs:

(a) the number of ordinary shares outstanding from the beginning of that period to the acquisition date shall be computed on the basis of the weighted average number of ordinary shares of the legal acquiree (accounting acquirer) outstanding during the period multiplied by the exchange ratio established in the merger agreement; and

(b) the number of ordinary shares outstanding from the acquisition date to the end of that period shall be the actual number of ordinary shares of the legal acquirer (the accounting acquiree) outstanding during that period.

B27 The basic earnings per share for each comparative period before the acquisition date presented in the consolidated financial statements following a reverse acquisition shall be calculated by dividing:

(a) the profit or loss of the legal acquiree attributable to ordinary shareholders in each of those periods by

(b) the legal acquiree's historical weighted average number of ordinary shares outstanding multiplied by the exchange ratio established in the acquisition agreement.

Appendix D—Submission

Australian Government

Australian Accounting Standards Board

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11 September 2013

Mr Wayne Upton

Chairman

IFRS Interpretations Committee

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UNITED KINGDOM

Dear Wayne

Clarification of accounting for a business combination achieved by contract alone

We are writing to seek clarification of the IFRS Interpretation Committee's position on the interaction of the IFRS 3 *Business Combinations* requirement for entities to identify an acquirer, with the requirement in IFRS 10 *Consolidated Financial Statements* for entities to prepare consolidated financial statements when control exists.

Specifically, we are seeking clarification as to whether, in circumstances where an acquirer has been identified for a business combination achieved by contract alone, such as in a stapling arrangement, with no entity/party to the business combination having 'control' over the other entities, the 'acquirer' is the parent for the purposes of preparing consolidated financial statements under IFRS 10.

Consistent with the Committee's process for considering issues, we have provided a more detailed explanation of the issue, possible alternative accounting treatments and reasons for the Committee to address this issue as a potential agenda request in Appendix A to this letter.

We seek your clarification on this issue urgently to help avoid diversity in practice arising on this issue in financial statements for the period ending 31 December 2013.

If you require further information on the matters raised above or in Appendix A, please contact me or Kala Kandiah (kkandiah@aasb.gov.au).

Yours sincerely

K.M. Stevenson

Kevin M. Stevenson

Chairman and CEO

Appendix A: Potential agenda item request

When two or more entities and their businesses are brought together by contract alone, with no transfer of consideration or exchange of equity interests, the combination is accounted for as a business combination, where an acquirer is identified and the acquisition method of accounting is applied, even in circumstances where no entity/party to the business combination has 'control' over the other entity/entities. . This approach is based on the following guidance in IFRS 3:

- paragraph 43 "An acquirer sometimes obtains control of an acquiree without transferring consideration. The acquisition method of accounting for a business combination applies to those combinations. Such circumstances include*:*

  ...

  (c) The acquirer and acquiree agree to combine their businesses by contract alone.

  > The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously. Examples of business combinations achieved by contract alone include bringing two businesses together in a stapling arrangement or forming a dual listed corporation";

- the definition of business combination in Appendix A "….Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in this Standard"; and

- paragraph 6 "For each business combination, one of the combining entities shall be identified as the acquirer. … If a business combination has occurred but applying the guidance in IFRS 10 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14-B18 shall be considered in making that determination."

As mentioned in paragraph 43(c) of IFRS 3, a stapling arrangement is an example of a business combination achieved by contract alone. A stapling arrangement is a contractual arrangement between two or more entities or their shareholders, typically without the transfer of consideration, where the equity securities of the entities in a stapling arrangement are stapled together and the entities each have the same owners. The stapled securities are quoted as a single security and cannot be traded or transferred independently. Generally a stapling transaction is entered into for tax reasons and in many of these arrangements, no entity/party to the stapling arrangement has 'control' over the other entities.

Question

Where an acquirer has been identified for a business combination achieved by contract alone, such as in a stapling arrangement, with no entity/party to the business combination having 'control' over the other entities, is the 'acquirer' the parent for the purposes of preparing consolidated financial statements under IFRS 10?

We are aware of two views on the issue:

View 1

If a business combination has been achieved by contract alone between two or more entities, with no entity having control, IFRS 3 paragraph 6 requires one of the entities to be identified as the acquirer for the purposes of acquisition accounting. That same entity would be identified as the parent for the purposes of preparing consolidated financial statements under IFRS 10.

In other words, there is no need to go through the criteria in paragraph 7 of IFRS 10 to determine the parent entity for a business combination achieved by contract alone where in substance there is no control by one entity over the others. In such circumstances, the acquirer identified in accordance with the guidance in paragraph B14–B18 of IFRS 3 would be the parent for the purposes of preparing consolidated financial statements in accordance with IFRS 10.

View 2

IFRS 10 requires an entity that is a parent to present consolidated financial statements. IFRS 10 defines a parent as an entity that controls one or more other entities. For the purposes of IFRS 10, an investor controls an investee if and only if the investor has all of the following: (a) power over the investee;

(b) exposure, or rights, to variable returns from its involvement with the investee; and

(c) the ability to use its power over the investee to affect the amount of the investor's returns.

In a business combination achieved by contract alone where there is no controlling entity, the acquirer identified under IFRS 3 would not necessarily be the parent under IFRS 10. 'Control' and 'parent' would need to be identified based on the guidance in IFRS 10 and if there is no control, there would be no parent entity identified under IFRS 10 and consolidated financial statements cannot be presented.

Reasons for IFRS IC to address the issue

Criteria	**Assessment**

The issue is widespread and has practical relevance.	Yes – Business combinations achieved by contract alone are relatively common in many parts of the world. Examples of such business combinations are stapling arrangements (prevalent in Australia and Canada) and forming dual listed entities (such entities exist in Europe and Australia). In most such business combinations, there is no controlling entity/party.
The issue indicates that there are significantly emerging divergent interpretations in practice.	Yes – IFRS 10 is applicable from 1 January 2013 and we are currently aware of divergent views on the issue as
Financial reporting would be improved through the elimination of the diversity.	Yes – reducing diversity on this issue would help comparability of financial statements, particularly as the diverse views on this issue would result in completely different sets of financial statements.
The issue is a narrow implementation or application issue that can be resolved efficiently within the confines of existing 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 – it requires a clarification of whether the acquirer identified in accordance with IFRS 3 for business combinations achieved by contract alone (with no controlling entity/party) would be the parent entity for the purposes of preparing consolidated financial statements under IFRS 10.
If the issue relates to a current or planned IASB project, there is a pressing need to provide guidance on a more timely basis than would be expected from that project.	There is no current relevant IASB project (on the active or research work plans).

Appendix E—Proposed wording for the tentative agenda decision

IFRS 3 *Business Combinations*—Identification of the acquirer in accordance with IFRS 3 and the parent in accordance with IFRS 10 in a stapling arrangement

The Interpretations Committee received a request to clarify the interaction of the requirements in IFRS 3 *Business Combinations* (as revised in 2008) for identifying an acquirer with the requirements in IFRS 10 *Consolidated Financial Statements* for deciding whether control exists. More specifically, the submitter is seeking clarification on whether an acquirer identified for the purpose of IFRS 3 (as revised in 2008) is a parent for the purpose of IFRS 10 in circumstances in which a business combination is achieved by contract alone, such as a stapling arrangement, with no combining entity obtaining control of the other combining entities.

IFRS 3 (as revised in 2008) defines a business combination as "a transaction or other event in which an acquirer obtains control of one or more businesses". In addition, IFRS 3 (as revised in 2008) refers to IFRS 10 for the meaning of the term 'control'. IFRS 10 states that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Hence, the Interpretations Committee observed that an investment is not needed in order for an entity to control another entity.

Analysing transactions within the scope of IFRS 3 (as revised in 2008), the Interpretations Committee noted that a group of former owners of one of the combining entities obtains control of the combined entity (or a group of combined entities) as a result of the unification of ownership and voting interests in the combining entities as described in paragraph B6 of IFRS 3 (as revised in 2008). Consequently, the Interpretations Committee noted that a stapling arrangement that unifies ownership and voting interests in the combining entities is a business combination as defined by IFRS 3 (as revised in 2008).

The Interpretations Committee noted that paragraph 6 of IFRS 3 (as revised in 2008) requires that one of the combining entities in a business combination be identified as the acquirer. IFRS 3 (as revised in 2008) provides additional guidance in paragraphs B14-B18 for identifying the acquirer that has obtained control of other combining entities if the guidance in IFRS 10 does not clearly indicate which combining entity is the acquirer. The Interpretations Committee noted that IFRS 3 (as revised in 2008) requires that the acquirer is identified as the entity that obtains economic control and that this entity may not obtain legal control.

The Interpretations Committee noted that the IASB stated in September 2004 that the intended interaction between IFRS 3 (issued in 2004) and IAS 27 *Consolidated and Separate Financial Statements* is that an entity that is identified as the 'acquirer' of another entity in accordance with IFRS 3 (issued in 2004) is a 'parent' for the purposes of IAS 27. The Interpretations Committee noted that the meaning of the term 'acquirer' has not changed since 2004 and that the term 'control' is used consistently between IFRS 3 (as revised in 2008) and IFRS 10. It also noted that the acquirer identified obtains control over other combining entities in all business combinations consistently with the definition of a business combination in IFRS 3 (as revised in 2008). Accordingly, the Interpretations Committee observed that the IASB's statement on the interaction between IFRS 3 (issued in 2004) and IAS 27 remains valid in respect of the interaction between IFRS 3 (as revised in 2008) and IFRS 10. Consequently, an acquirer identified for the purpose of IFRS 3 (as revised in 2008) should prepare consolidated financial statements of the combined group of entities in accordance with IFRS 10.

The Interpretations Committee noted that there is no diversity in practice for the accounting for business combinations achieved by contract alone. It further noted that it does not expect diversity to emerge in the future on the basis of the analysis on the requirements and guidance in IFRS 3 (as revised in 2008) and IFRS 10.

Accordingly, the Interpretations Committee [decided] not to add this issue to its agenda.