

STAFF PAPER

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Project	Business Combinations under Common Control		
Paper topic	Scope of the project		
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Purpose of the paper

1. In June 2014, the International Accounting Standards Board (Board) made a tentative decision on the scope of the Business Combinations under Common Control (BCUCC) research project. In this paper, the staff consider further issues related to the scope of the project and recommend a clarification.

Staff recommendation

2. The staff recommend the Board should clarify that the scope of the BCUCC project includes transactions under common control in which the reporting entity obtains control of one or more businesses, regardless of whether IFRS 3 *Business Combinations* would identify the reporting entity as the acquirer.¹

Structure of the paper

3. The paper is structured as follows:
 - (a) Board's tentative decision on scope (paragraphs 4–8);

¹ Throughout this paper, reference is made to IFRS 3 *Business Combinations* issued in January 2008, unless specifically indicated otherwise.

- (b) further considerations on scope (paragraphs 9–28);
 - (i) business combinations under common control;
 - (ii) group restructurings;
 - (iii) staff analysis and recommended clarification;
- (c) question for the Board; and
- (d) Appendix—illustrative examples of transactions that will be included in the scope of the project according to the staff recommendation.

Board’s tentative decision on scope

- 4. In June 2014, the Board tentatively decided that the project should consider:
 - (a) business combinations under common control that are currently excluded from the scope of IFRS 3;
 - (b) group restructurings; and
 - (c) the need to clarify the description of business combinations under common control, including the meaning of ‘common control’.
- 5. In making that decision the Board considered (see Agenda Paper 14 *Scope of the research project*, June 2014):
 - (a) the fact that IFRS Standards do not generally contain scope exclusions for transactions between entities under common control, apart from the scope exclusion in IFRS 3 for business combinations under common control;
 - (b) concerns raised by security regulators about the absence of guidance in IFRS Standards on business combinations under common control and group restructurings, and consequent diversity in practice in accounting for such transactions; and
 - (c) the view expressed by members of the Accounting Standards Advisory Forum (ASAF) that the project should focus on the most pervasive application issues.

6. The Board acknowledged that there is an interaction between accounting for transactions in the scope of the project and accounting for other transactions under common control or related party transactions more broadly. The staff will consider this interaction as the project progresses.
7. The Board also tentatively decided to give priority to considering transactions that involve third parties, for example those undertaken in preparation for an initial public offering (IPO), which is an area of particular concern for securities regulators. However, the Board did not restrict the scope of the project to such transactions only. The BCUCC project will consider business combinations under common control and group restructurings irrespective of whether those transactions affect third parties or take place in connection with an IPO.
8. At that time, the Board did not discuss which *reporting entity* and which *financial statements* of that reporting entity the BCUCC project will focus on.

Further considerations on scope

9. The staff note that:
 - (a) ‘business combinations under common control’ are described in IFRS 3. However, there are application questions on whether particular transactions satisfy that description.
 - (b) ‘group restructuring’ is not a defined term and its meaning is not discussed in existing IFRS Standards.
10. Accordingly, the following sections provide further analysis of the population of transactions that should be included in the scope of the BCUCC project.
11. The following sections also discuss which *reporting entity* and which reporting entity’s *financial statements* the project will focus on.

Business combinations under common control

12. Business combinations under common control are excluded from the scope of IFRS 3. According to the Board's tentative decision, transactions that satisfy the description of a business combination under common control, as described in IFRS 3, are included in the scope of the BCUCC project.
13. Paragraph B1 of IFRS 3 describes business combinations under common control as business combinations in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.
14. The key components of this description are:
 - (a) the transaction is a 'business combination'. 'Business combination' is defined in IFRS 3 as a transaction or other event in which an acquirer obtains control of one or more businesses.
 - (b) all the combining entities or businesses are 'under common control', that is, ultimately controlled by the same party or parties both before and after the business combination. Paragraphs B2–B4 of IFRS 3 provide application guidance on how to assess common control. In particular, paragraph B3 of IFRS 3 specifies that it is not necessary for combining entities to be included as part of the same consolidated financial statements. The combining entities may be controlled by a party that does not prepare financial statements.
 - (c) the common control is 'not transitory'. IFRS 3 does not elaborate on transitory control. However, paragraph BC28 of the Basis for Conclusions on IFRS 3 *Business Combinations*, issued in March 2004, specified that the Board decided to require common control not to be transitory to avoid business combinations between parties acting at arm's length being 'structured through the use of "grooming" transactions so that, for a brief period immediately before the combination, the combining entities or businesses are under common control'.

15. The staff are aware that some interested parties have raised questions on the meaning of ‘transitory control’ and whether particular business combinations satisfy the description of ‘under common control’. In particular, such questions were raised through submissions to the IFRS Interpretation Committee. The staff plan to provide the Board with an overview of those submissions in a future Agenda Paper. The staff will also ask whether the Board would like to clarify the description of business combinations under common control, and if so, how.

Group restructurings

16. According to the Board’s tentative decision, group restructurings are included in the scope of the project. However, as noted in paragraph 9(b) of this paper, ‘group restructuring’ is not a defined term and it is understood differently by different parties, for example:

- (a) some parties use the expression ‘group restructurings’ to refer to a broad group of transactions that involve restructuring the relationships between entities or businesses within a group. These transactions can take various forms and include transactions that satisfy the description of a business combination under common control.
- (b) in contrast, other parties use the expression ‘group restructurings’ in a narrower sense to refer to transactions that involve a transfer of entities or businesses between entities under common control but does not satisfy the description of business combinations under common control (see Example 3 in the Appendix to this paper).

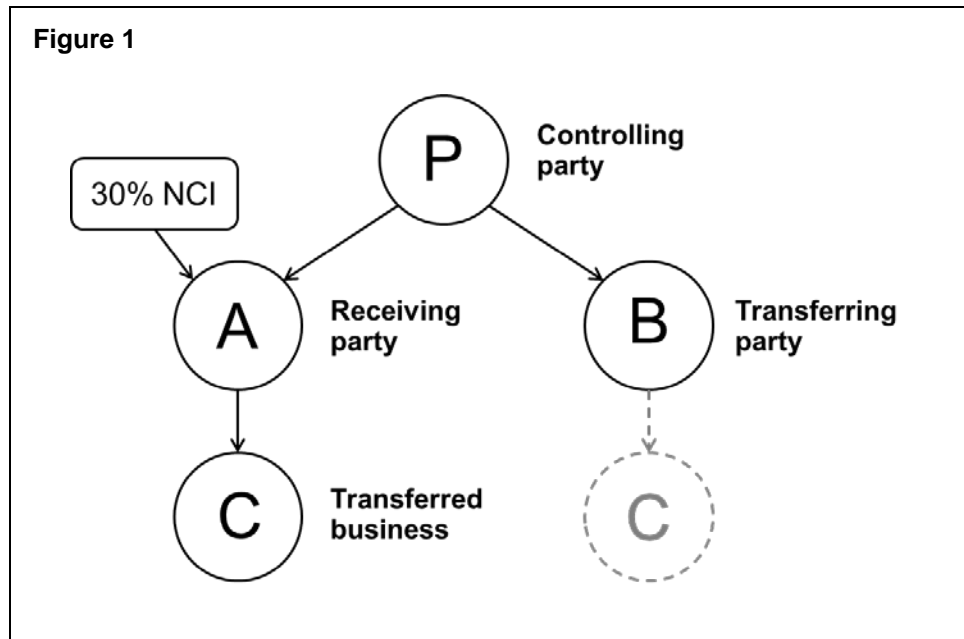
17. In both cases, the question arises as to what transactions, other than business combinations under common control, are included in the scope of the project. Accordingly, the staff think that the Board should clarify the scope of the project.

Staff analysis and recommended clarification

18. In order to identify and describe the population of transactions, other than business combinations under common control, that should be included in the scope of the project, the staff analysed the broad group of transactions that involve restructuring the relationships between entities or businesses under common control.
19. The staff note that ‘restructuring’, in common language, means organising components of the whole in a different way.² In the context of a group, restructuring would involve organising entities or businesses within the group in a different way. Such changes in the group structure would involve transferring control over entities or businesses between existing or newly created entities under common control. Some of those transfers would satisfy the description of business combinations under common control whereas others would not.
20. However, regardless of whether a transfer satisfies the description of a business combination under common control, any such transfer would involve the following parties:³
- (a) the controlling party or parent;
 - (b) the transferring party or transferor;
 - (c) the transferred party (entity or business); and
 - (d) the receiving party.
21. The following figure (**Figure 1**) illustrates the parties involved in a transfer of business between entities under common control where Entity A gains control over Entity C (assume that Entity C meets the definition of ‘business’ in IFRS 3).

² Restructure: ‘to organize (a system, business, society, etc) in a different way’ (Collins English Dictionary); ‘organise differently’ (Oxford Living Dictionary); ‘to organize a company, business, or system in a new way to make it operate more effectively’ (Cambridge English Dictionary).

³ For simplicity, this paper refers to a single party. All references to a party should also be understood as referring to more than one party.

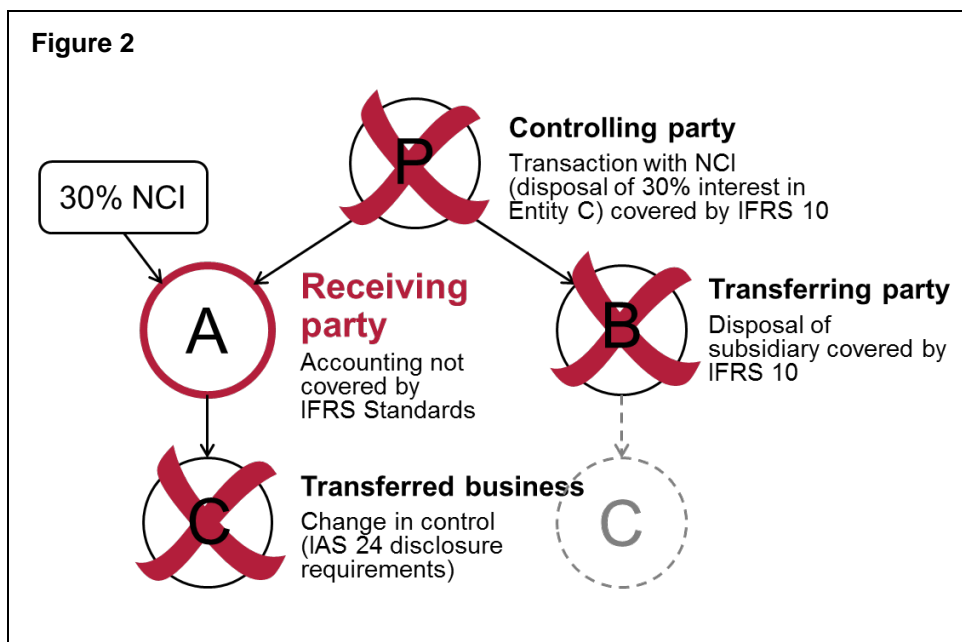


22. The consequences of such a transfer can be analysed from the point of view of the parties involved in such transaction as discussed below (our analysis assumes that the parties involved in the transaction are reporting entities):

- (a) **the controlling party or parent (P):** from the perspective of the controlling party, the transaction does not change the entities or businesses that party controls. If there is no non-controlling interest (NCI) affected by the transfer, the accounting consequences of such a transfer are generally eliminated in full from the parent’s consolidated financial statements according to IFRS 10 *Consolidated Financial Statements* (see paragraph B86 of IFRS 10). If there is NCI affected by the transaction, the transfer would involve a transaction with NCI and the parent may need to recognise a change in its ownership interest in the transferred business. Accounting for such a change in ownership interest is also covered by IFRS 10 (see paragraphs 22–24 of IFRS 10).
- (b) **the transferring party or transferor (B):** from the perspective of the transferring party, the transaction results in a disposal of an entity or business. The transferor loses control over the transferred entity or business and accounts for the transaction according to paragraphs 25–26 of IFRS 10.

- (c) **the transferred party (entity or business) (C):** from the perspective of the transferred party, the transaction results in a change in its immediate parent. IAS 24 *Related Party Disclosures* requires an entity to disclose the name of its parent and, if different, the ultimate controlling party (see paragraph 13 of IAS 24).
- (d) **the receiving party (A):** from the perspective of the receiving party, the transaction results in a change in entities or businesses that the receiving party controls and needs to report on. After the transaction, its financial statements will also need to include financial information about the transferred entity or business. **The accounting for such transactions under common control is not covered by existing IFRS Standards.**

23. The following figure (**Figure 2**) summarises the discussion in paragraph 22 (a)–(d) using as an illustration the transfer of a business between entities under common control presented in Figure 1 where Entity A gains control over Entity C (Entity C meets the definition of ‘business’ in IFRS 3).



24. The transaction discussed above may or may not satisfy the description of a business combination under common control depending on whether IFRS 3 would identify one of the combining parties (ie the receiving party or (one of) the transferred party (ies)) as the acquirer:
- (a) if the acquirer can be identified, the transaction satisfies the description of a business combination under common control (see Example 1 and Example 2 in the Appendix to this paper). Such a transaction is not covered by existing IFRS Standards and is included in the scope of the project in accordance with the Board’s tentative decision; but
 - (b) if none of the combining parties can be identified as the acquirer according to IFRS 3 (for example, because the receiving party is a newly formed entity that issues shares to acquire one business—see Example 3 in the Appendix to this paper), the transaction does not satisfy the description of business combination under common control because it does not meet the definition of business combination. However, such a transaction changes the structure of the group, involves the transfer of a business and is not covered by existing IFRS Standards. The staff think it should also be included in the scope of the project.
25. Accordingly, the staff recommend that the Board should clarify that the scope of the BCUCC project includes transactions under common control in which the reporting entity obtains control of one or more businesses, regardless of whether IFRS 3 would identify the reporting entity as the acquirer.
26. The staff recommendation focuses on the *transaction* that needs to be accounted for by the reporting entity. It does not specify to which financial statements of that reporting entity—consolidated, separate or individual—any accounting requirements developed in this project will apply. This is consistent with how the scope is set out in IFRS 3—that Standard also specifies which transactions it applies to but does not specify which reporting entity’s financial statements it applies to.

27. This is because the financial statements affected by any accounting requirements developed in this project will depend on specifics of the transaction:
- (a) for example, if a reporting entity obtains control of a business that continues as a separate entity after the transaction, any requirements developed in this project will apply only in the reporting entity's consolidated financial statements. In its separate financial statements, the reporting entity will account for the investment applying the requirements in IAS 27 *Separate Financial Statements* (which does not include any scope exclusions related to transactions under common control).
 - (b) conversely, if the acquired business is not or does not continue as a separate entity after the transaction, any requirements developed in this project will apply in all financial statements prepared by the reporting entity (consolidated, separate, individual).
28. The Appendix provides illustrative examples of transactions that will be included in the scope of the project according to the staff recommendation. Some of these illustrative examples were derived from submissions received by the IFRS Interpretation Committee.

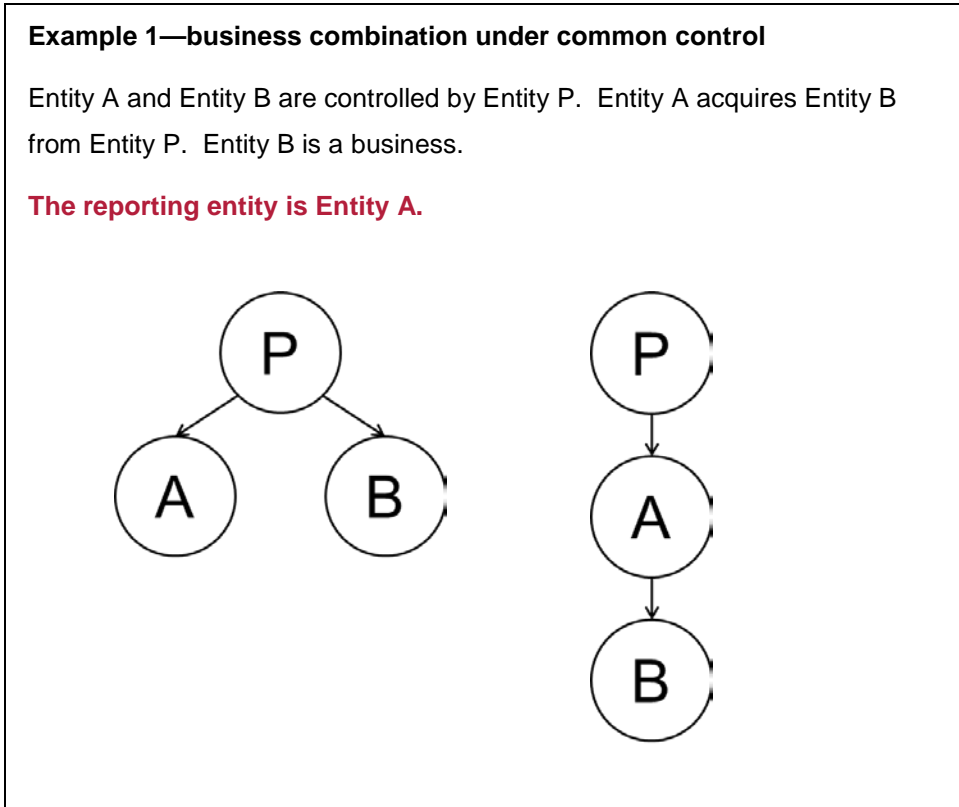
Question for the Board

Question 1—scope of the BCUCC project

Does the Board agree with the staff recommendation to clarify that the scope of the BCUCC project includes transactions under common control in which the reporting entity obtains control of one or more businesses, regardless of whether IFRS 3 would identify the reporting entity as the acquirer?

Appendix—illustrative examples of transactions that will be in the scope of the project according to the staff recommendation

A1. The following examples illustrate broad types of transactions that will be included in the scope of the BCUCC project according to the staff recommendation.



A2. **Example 1** represents a business combination under common control where the combining entities, or businesses—Entity A and Entity B—are both controlled by Entity P before and after the transaction.

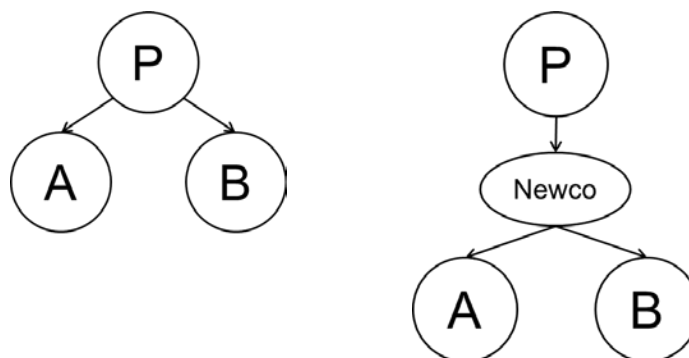
A3. According to the staff recommendation, this transaction **will be included** in the scope of the project. That would be the case regardless of whether the combining entities:

- a. are fully owned by Entity P or there is NCI in the combining entities;
- b. are listed or privately held; or
- c. are preparing for an IPO.

Example 2—formation of a Newco to acquire more than one business

Entity A and Entity B are fully controlled by Entity P. Entity P forms a new entity (Newco) and transfers Entity A and Entity B to that Newco. Both Entity A and Entity B are businesses. Newco is not a business.

The reporting entity is Newco.

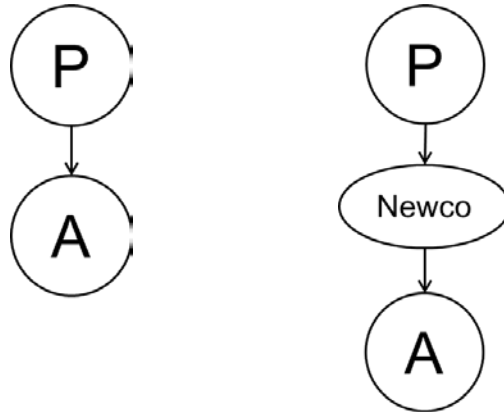


- A4. **Example 2** represents a transaction under common control where Newco becomes a new intermediate holding of Entity A and Entity B. Newco, however, may not meet the definition of ‘acquirer’ set out in IFRS 3.
- A5. IFRS 3 specifies that a new entity formed to effect a business combination is not necessarily the acquirer. When a new entity transfers cash or other assets or incurs liabilities as consideration, it may be identified as the acquirer. However, when the new entity issues equity interests to effect a combination, one of the combining entities that existed before the transaction shall be identified as the acquirer (paragraph B18 of IFRS 3).
- A6. In this example, if Newco cannot be identified as the acquirer, one of the combining entities—Entity A or Entity B—will. Consequently, this transaction satisfies the description of a business combination under common control and, according to the staff recommendation, **will be included** in the scope of the project.

Example 3—formation of a Newco to acquire one business

Entity A is fully controlled by Entity P. Entity P forms a new entity (Newco) and transfers Entity A to that Newco. Entity A is a business. Newco is not a business.

The reporting entity is Newco.



- A7. **Example 3** represents a transaction under common control where Newco becomes a new intermediate holding of Entity A. As observed in Example 2, Newco may not meet the definition of ‘acquirer’ set out in IFRS 3.
- A8. In this example, if Newco is not identified as the acquirer, the transaction will not meet the definition of ‘business combination’. This is because Newco is not a business, therefore Entity A cannot be identified as the acquirer either.
- A9. According to the staff recommendation, regardless of whether Newco would be identified as the ‘acquirer’ in accordance with IFRS 3, the transaction **will be included** in the scope of the project.