IFRS® Interpretations Committee meeting

Date	**June 2023**
Project	**Merger between a Parent and Its Subsidiary in Separate Financial Statements (IAS 27)**
Topic	**Initial consideration**
Contact	Rashida Abdryashitova (rabdryashitova@ifrs.org)

Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about how an entity that prepares separate financial statements applying IAS 27 *Separate Financial Statements* accounts for a merger with its subsidiary in its separate financial statements.

2. The objective of this paper is:

   (a) to provide the Committee with a summary of the matter;

   (b) to present our research and analysis; and

   (c) to ask the Committee whether it agrees with our recommendation not to add a standard-setting project to the work plan.

Structure

3. This paper includes:

   (a) background and summary of submission (paragraphs 5–9);

   (b) findings from information request (paragraphs 10–16);

(c) additional research (paragraphs 17–18);

(d) staff analysis (paragraphs 19–29); and

(e) staff recommendation (paragraphs 30–31).

4. There are two appendices to this paper:

(a) Appendix A—suggested wording for the tentative agenda decision; and

(b) Appendix B—submission.

Background and summary of submission

5. Paragraphs 9–10 of IAS 27 state:

> 9. Separate financial statements shall be prepared in accordance with all applicable IFRSs, except as provided in paragraph 10.
>
> 10. When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either:
>
> (a) at cost;
>
> (b) in accordance with IFRS 9; or
>
> (c) using the equity method as described in IAS 28.
>
> …

6. In the fact pattern described in the submission (reproduced in Appendix B):

(a) a parent entity prepares separate financial statements applying IAS 27 and recognises an investment in a subsidiary applying paragraph 10 of IAS 27;

(b) the subsidiary contains a business (as defined by IFRS 3 *Business Combinations*)[1];

[1] Appendix A of IFRS 3 defines a business as 'an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities'.

(c) the parent entity merges with the subsidiary resulting in the subsidiary's business becoming part of the parent entity.

7. The submission asks how the parent entity accounts for the merger with its subsidiary in its separate financial statements. In particular, it asks whether, in the context of the parent entity's separate financial statements, the merger is a business combination as defined by IFRS 3 and consequently, whether the parent should apply the business combination accounting requirements in IFRS 3[2].

8. The submitter identifies the following views:

(a) *View 1*—the merger should be accounted for as a business combination applying IFRS 3. Proponents of this view say from the perspective of a parent entity's separate financial statements, the subsidiary's business is deemed to be independent of the parent entity. Consequently, the existing parent-subsidiary relationship should be ignored, and the parent entity does not control the subsidiary's business until the parent entity and its subsidiary are legally merged.

(b) *View 2*—the merger should not be accounted for as a business combination. Proponents of this view say the parent obtained control of the subsidiary before the merger, and the existing parent-subsidiary relationship continues to hold even in the context of separate financial statements. Therefore, the merger does not meet the definition of a 'business combination' in IFRS 3. Applying this view, a parent entity—in its separate financial statements—recognises the assets and liabilities of the subsidiary at their previously recognised carrying amounts (carrying amount method).

(b) *View 3*—accounting policy choice between View 1 and View 2. Proponents of this view say there is no IFRS Accounting Standard that specifically applies to

[2] Appendix A of IFRS 3 defines a business combination as 'a transaction or other event in which an acquirer obtains control of one or more businesses'.

this fact pattern and therefore, management should apply the requirements in paragraphs 10–12 of IAS 8 to develop an accounting policy.

9. The submission—reproduced in Appendix B—includes further information about the three views and an example illustrating the difference in outcome resulting from applying View 1 and View 2.

Findings from information request

10. We sent an information request to members of the International Forum of Accounting Standard-Setters, securities regulators and large accounting firms. We also made the submission available on our website.

11. The request asked whether the fact pattern described in the submission is common—that is, situations in which a parent entity—that prepares separate financial statements applying IAS 27—merges with its subsidiary resulting in the subsidiary's business becoming part of the parent entity; and, if so

    (a) in which jurisdiction(s) this fact pattern is common; and

    (b) how the parent entity accounts for the merger in its separate financial statements—if the respondents observe diversity in accounting for the fact pattern described in the submission across all or particular jurisdictions, we asked which accounting method was more prevalent in particular jurisdictions.

12. We received 16 responses—seven from national standard-setters, six from accounting firms, two from organisations representing a group of securities regulators and one from a preparer. The responses represent informal opinions and do not necessarily reflect the official views of those respondents or their organisations.

Is the fact pattern common?

13. Many respondents say the fact pattern is common. Four standard-setters and one accounting firm say the fact pattern is not common because:

(a) entities do not prepare separate financial statements;

(b) entities do not apply IFRS Accounting Standards when preparing separate financial statements; and/or

(c) merger transactions as described in the fact pattern occur only occasionally.

If the fact pattern is common

In which jurisdiction(s) is the fact pattern common?

14. Respondents say the fact pattern is common in some countries across Latin America, Africa, Europe and Asia.

How does the parent entity account for the merger and, if there is diversity, which accounting method is more prevalent?

15. All respondents who say that the fact pattern is common say the carrying amount method (that is, the outcome of applying View 2) is the predominant method of accounting for the merger in a parent entity's separate financial statements. They say the parent entity controlled the subsidiary before the merger and, consequently, the merger is not a business combination.

16. Two accounting firms said there might be diversity; however, they have not observed any entity applying View 1.

Additional research

17. We reviewed annual financial statements to identify the accounting policies applied with respect to the fact pattern described in the submission. We conducted our search using the market intelligence tool AlphaSense, which searches against a database containing company documents from approximately 37,000 public entities around the world. We searched annual financial statements filed in the period from 1 January

2020 to 21 April 2023. Our search was limited to financial statements published in English.

18. We reviewed the results and identified few entities which had merger transactions similar to the fact pattern described in the submission. The carrying amount method was applied to all of those merger transactions.

Staff analysis

Diversity in accounting

19. The responses to our information request indicate that few, if any, entities apply View 1 to account for the fact pattern described in the submission. Our additional research also did not provide any example of an entity applying View 1.

20. Accordingly, we have no evidence of diversity in accounting for the fact pattern described in the submission.

Should the Committee add this matter to its standard-setting agenda?

Does the matter have widespread effect and have, or is expected to have, a material effect on those affected?[3]

21. The submission discusses the existence of different views on accounting for the fact pattern, therefore the matter that the submission effectively raises is the challenge of possible diversity in accounting—for example, the challenge users of the financial statements might face when comparing financial statements of different entities that apply different accounting to the fact pattern.

[3] Paragraph 5.16(a) of the [*Due Process Handbook.*]

22. While findings from our information request indicate that the fact pattern described in the submission could be common, those findings and our additional research show no evidence of diversity in accounting for the fact pattern.

23. Therefore, we have not obtained evidence that the matter has widespread effect. In particular, the existence of the different views described in the submission is not widespread.

24. Consequently, we recommend that the Committee does not add a standard-setting project to the work plan and instead publish a tentative agenda decision that explains its reasons for not adding a standard-setting project.

25. Our recommendation is:

 (a) consistent with the approach the Committee has taken on other matters in which the fact pattern described in the submission could be common but for which the Committee has obtained little, if any, evidence of diversity in accounting (see for example, the agenda decision *Presenting Comparative Amounts when a Foreign Operation First Becomes Hyperinflationary—IAS 21 and IAS 29*).

 (b) based on the evidence we obtained to date from our information request and additional research. Should there be additional evidence which could lead to a different conclusion on whether the matter is widespread, stakeholders will have the opportunity to share this with the Committee by providing feedback to the tentative agenda decision.

Interaction with IASB's BCUCC project

26. A few respondents to our information request suggested that the IASB consider this transaction as part of its project on Business Combinations under Common Control (BCUCC project).

27. The BCUCC project aims to develop reporting requirements for business combinations under common control and not to define what is a business combination under common control. Consequently, the project, as currently scoped, would not directly address the question raised in the submission (that is, whether the merger transaction described in the submission is a business combination).

28. The Discussion Paper *Business Combinations under Common Control* also included within the scope of the project transactions referred to as group restructurings.[4] As paragraph 20 of Agenda Paper 23A to the IASB's December 2021 meeting notes, a few respondents to the Discussion Paper suggested clarifying whether a 'hive-up' transaction (which is the transaction described in the submission) would be a group restructuring and therefore within the scope of the project.

29. The IASB is currently considering project direction[5] and has not yet discussed whether group restructurings will continue to be a part of the BCUCC project. We will report this matter to the IASB—the IASB can consider this matter if and when the IASB deliberates whether to continue to include group restructurings as part of its BCUCC project.

Staff recommendation

30. Based on our assessment of the work plan criteria in paragraph 5.16 of the *Due Process Handbook* (as discussed in paragraphs 21–25), we recommend that the Committee does not add a standard-setting project to the work plan and instead publish a tentative agenda decision that explains its reasons for not adding a standard-setting project.

[4] Paragraph 1.15 of the Discussion Paper describes group restructurings as transactions that 'involve a transfer of a business under common control but do not meet the definition of a business combination in IFRS 3'.

[5] See Agenda Paper 6 for this meeting and the IASB's April 2023 meeting page for further details.

31. Appendix A—suggested wording for the tentative agenda decision to this paper suggests wording for the tentative agenda decision.

Questions for the Committee
1. Does the Committee agree with our recommendation not to add a standard-setting project to the work plan? 2. Does the Committee have any comments on the wording of the tentative agenda decision suggested in Appendix A to this paper?

Appendix A—suggested wording for the tentative agenda decision

Merger between a Parent and Its Subsidiary in Separate Financial Statements (IAS 27 *Separate Financial Statements*)

The Committee received a request about how a parent entity that prepares separate financial statements applying IAS 27 accounts for a merger with its subsidiary in its separate financial statements.

Fact pattern:

In the fact pattern described in the submission:

(a) a parent entity prepares separate financial statements applying IAS 27 and recognises an investment in a subsidiary applying paragraph 10 of IAS 27;

(b) the subsidiary contains a business (as defined by IFRS 3 *Business Combinations*);

(c) the parent entity merges with the subsidiary resulting in the subsidiary's business becoming part of the parent entity (merger transaction).

The request asked how the parent entity should account for the merger transaction in its separate financial statements. In particular, the request asked whether, in the context of the parent entity's financial statements the merger transaction:

(a) constitutes a business combination as defined in IFRS 3 *Business Combinations* and consequently, whether an entity should apply the requirements in IFRS 3 that apply to the accounting for a business combination; or

(b) the merger should not be accounted for as a business combination. Applying this view, the parent entity—in its separate financial statements—recognises the subsidiary's assets and liabilities at their previous carrying amounts (carrying amount method).

Findings

Evidence gathered by the Committee [to date] indicates little, if any, diversity in accounting for the merger transaction—entities generally apply the carrying amount method in accounting for the merger transaction.

Conclusion

Based on its findings, the Committee concluded that the matter described in the request does not have widespread effect. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Appendix B—submission

B1. We have reproduced the submission below, and in doing so deleted details that would identify the submitter of the request.

Suggested topic for Committee agenda:

Merger between a parent and its subsidiary in separate financial statements

…

B2. We often received technical enquiries on how to account for the merger between a parent and its subsidiary in the separate financial statements of the parent. However, conflicting answers exist since IAS 27 does not provide guidance on how to account for the merger. Therefore, there is diversity in practice in our jurisdiction. We are aware that a number of jurisdictions that apply IAS 27 to prepare separate financial statements face similar challenges in applying IAS 27 to such a merger.

…

Subject

B3. Interpretation of paragraph 9 of IAS 27 *Separate Financial Statements*, and clarification on how to account for the merger between a parent and its subsidiary in the separate financial statements of the parent.

Background information

B4. An entity is required to apply IFRS [Accounting Standards] to prepare consolidated financial statements in our jurisdiction. The entity is also required to prepare its separate financial statements by applying IAS 27. Preparers often find difficulties in applying IAS 27, but application of paragraph 9 of IAS 27 for transactions between a parent and its subsidiary is the most controversial. In particular, it is not clear how the merger between a parent and its subsidiary should be accounted for in the parent's separate financial statements, because there are conflicting views:

(a) the merger is a business combination; and

(b) the merger is not a business combination.

B5. In our jurisdiction, a parent company merges with a subsidiary for various reasons such as enhancing business efficiency, strengthening competitive power, achieving economies of scale, risk hedging through business diversification, lowering the cost of financing, increasing corporate value through reallocation of resources by group restructuring and enhancing transparency of managing company.

…

Issue and opposing views

Issue

B6. Paragraph 9 of IAS 27 is difficult to apply for a merger between a parent and its subsidiary.

B7. IFRS 3 will be generally applicable for a merger between different companies that are not in a parent-subsidiary relationship, which is a business combination. However, there is a dispute whether IFRS 3 will be also applicable for a merger between companies that are already in a parent-subsidiary relationship because it is not clearly stated in IAS 27 whether this merger constitutes a business combination. A parent-subsidiary relationship assumes a business combination which was conducted when the parent obtained control of the subsidiary.

Opposing views

(View 1) The merger is a business combination in separate financial statements

B8. This view is based on the following reasons:

(a) The existing parent-subsidiary relationship, i.e., the parent's control over its subsidiary should be ignored. Given this, the merger meets the definition of 'business combination' in IFRS 3 because IFRS 3 defines 'business combination' as a transaction or other events in which an acquirer obtains control of one or more businesses.

(b) From the perspective of separate financial statements, a subsidiary's business is deemed to be independent of its parent's business until the two are legally merged.

(View 2) The merger is not a business combination in separate financial statements

B9. This view is based on the following reasons:

(a) The parent has already obtained control of the subsidiary before the merger, and the resulting parent-subsidiary relationship should continue to hold even in the context of separate financial statements. Therefore, the merger does not meet the definition of 'business combination' in IFRS 3.

(b) From the perspective of separate financial statements, a subsidiary's business is deemed to be compressed into its parent's investment in the subsidiary. So, a subsidiary's business should not be viewed as independent of its parent's business.

(View 3) The merger may be treated either as a business combination or as another transaction

B10. This view is based on the following reason: since an IFRS [Accounting Standard] that specifically applies to the merger is absent, management should use its judgement to develop accounting policy that will result in more relevant and reliable information, as stated in paragraph 10 of IAS 8 [*Accounting Policies, Changes in Accounting Estimates and Errors*].

Illustrative example

Fact pattern

B11. A parent (P) acquires 100% of the shares of subsidiary 1 (S1) and subsidiary 2 (S2), and pays 500 CU, which is equal to the fair market value of the total acquired shares, for each acquisition. S1 and S2 meet the definition of a business in IFRS 3 Business Combinations. P obtains control of S1 and S2.

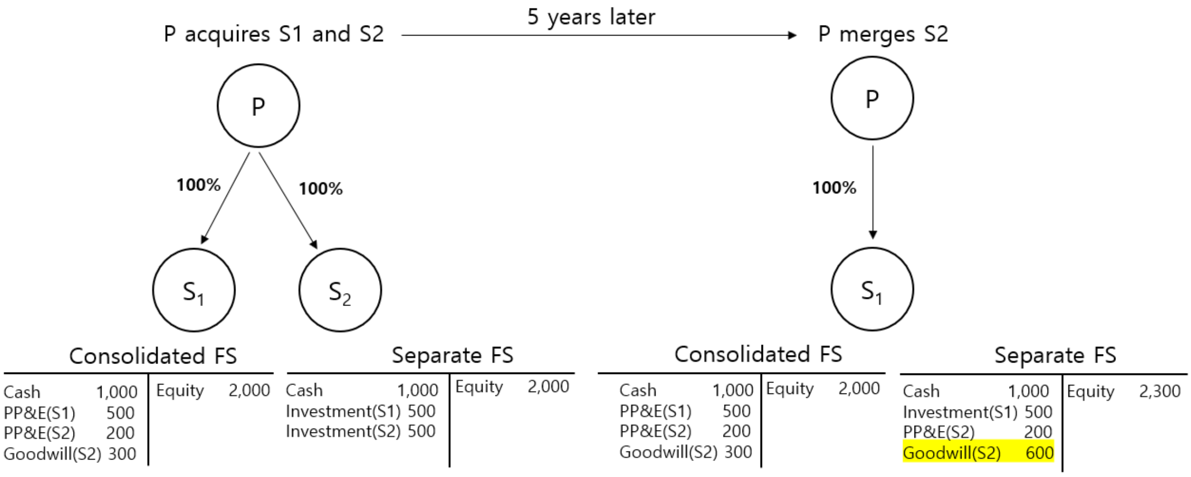
(a) The net asset values of S1 and S2 at the acquisition dates are 500 CU and 200 CU, respectively.

(b) Assets of S1 and S2 consist of PP&E, and there are no liabilities in both S1 and S2.

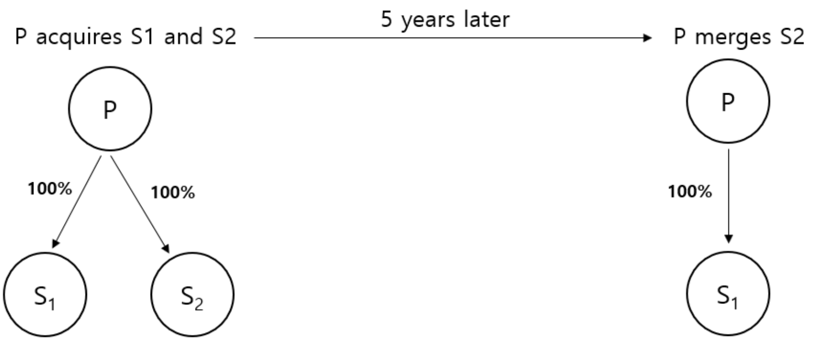
B12. After the acquisitions, P still has 1000 CU in cash for future investment. After 5 years, P merges with S2 when the fair market value of the total shares of S2 have grown from 500 CU to 800 CU.

Consequences of the merger

B13. According to View 1, goodwill is remeasured at the date of the merger. Amounts of goodwill in consolidated financial statements and in separate financial statements are different.



B14. According to View 2, goodwill is not remeasured at the date of the merger. Amounts of goodwill in consolidated financial statements and in separate financial statements are the same.



Consolidated FS (P acquires S1 and S2)

Cash	1,000	Equity	2,000
PP&E(S1)	500		
PP&E(S2)	200		
Goodwill(S2)	300		

Separate FS (P acquires S1 and S2)

Cash	1,000	Equity	2,000
Investment(S1)	500		
Investment(S2)	500		

Consolidated FS (P merges S2)

Cash	1,000	Equity	2,000
PP&E(S1)	500		
PP&E(S2)	200		
Goodwill(S2)	300		

Separate FS (P merges S2)

Cash	1,000	Equity	2,000
Investment(S1)	500		
PP&E(S2)	200		
Goodwill(S2)	300		