IFRS Accounting

Staff paper

Agenda reference: 5

IFRS® Interpretations Committee meeting

Date	**November 2023**
Project	**Merger between a Parent and Its Subsidiary in Separate Financial Statements (IAS 27)**
Topic	**Comment letters on tentative agenda decision**
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Introduction

1. In June 2023 the IFRS Interpretations Committee (Committee) published a tentative agenda decision in response to a submission about how a parent 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 analyse comments on the tentative agenda decision; and

   (b) to ask the Committee whether it agrees with our recommendation to finalise the agenda decision.

Structure

3. This paper includes:

   (a) background (paragraphs 5–8);

   (b) comment letter summary (paragraphs 9–15);

(c) staff analysis (paragraphs 16–38);

(d) staff recommendation (paragraph 39); and

(e) questions for the Committee.

4. The appendix to this paper sets out the suggested wording of the final agenda decision.

Background

5. 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*); and

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

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

(a) constitutes a business combination and consequently, whether an entity should apply the acquisition method (and related requirements) in IFRS 3[1].

(b) 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).

[1] For simplicity, we refer to the acquisition method (and related requirements) in IFRS 3 as 'the acquisition method' throughout the rest of this paper.

7. Evidence gathered through our information request and our additional research[2] indicated little, if any, diversity in accounting for the merger transaction. In accounting for the merger transaction, in their separate financial statements, parent entities generally do not apply the acquisition method.

8. Based on its findings, the Committee concluded that the matter described in the submission does not have widespread effect. Consequently, the Committee tentatively decided not to add a standard-setting project to the work plan and published a tentative agenda decision.

Comment letter summary

9. We received 14 comment letters by the comment letter deadline. All comment letters, including any late comment letters, are available on our website.[3] This agenda paper includes analysis of only the comment letters received by the comment letter deadline, which are reproduced in Agenda Paper 5A.

10. Seven respondents (Deloitte, the Institute of Indonesia Chartered Accountants (IICA), Ancoram Limited, Petrobras, CPC (Brazilian Accounting Pronouncements Committee), Saudi Organisation for Chartered and Professional Accountants (SOCPA) and Malaysian Accounting Standards Board) agree with the Committee's decision not to add the matter to its standard-setting agenda for the reasons outlined in the tentative agenda decision.

11. Some respondents say the merger transaction is prevalent. However, most of these respondents agree with the Committee's observation about entities not generally applying the acquisition method to account for the merger transaction. Two of these respondents (Group of Latin American Accounting Standard Setters (GLASS) and Organismo Italiano di Comtabilita (OIC)) nonetheless suggest updating the agenda

[2] See paragraphs 10–18 of Agenda Paper 3 to the Committee's June 2023 meeting.

[3] At the date of posting this agenda paper, there were no late comment letters.

decision to explain how an entity applies IFRS Accounting Standards when considering the matter described in the submission.

12. One respondent (Institute of Chartered Accountants of India (ICAI)) agrees with the Committee's observation of a lack of diversity but says '…there is an urgent need of guidance on accounting for such transactions and the same should be taken up as a standard-setting project…'.

13. One respondent (CA Vidhyadhar Kulkarni) disagrees with the Committee's observations and conclusions. The respondent says the merger transaction is prevalent in their jurisdiction and says an entity should apply the relevant requirements in IFRS Accounting Standards (including those in IFRS 3) when accounting for intra-group transactions in separate financial statements.

14. A number of respondents—while not disagreeing with the Committee's observations about entities generally not applying the acquisition method to account for the merger transaction—say there is diversity in how entities apply a carrying amount method. These respondents generally suggest clarifying how entities apply (or should apply) a carrying amount method and/or referring the matter to the International Accounting Standards Board (IASB). A few respondents, including those who agreed with the Committee's analysis and conclusions, suggest the IASB consider this matter as part of the IASB's *Business Combinations under Common Control (BCUCC)* project.

15. One respondent (Petrobras) suggests amending the agenda decision not to mention prevalent practice.

Staff analysis

Committee's observations and including explanatory material in the agenda decision

Feedback

16. The tentative agenda decision states:

> Evidence gathered by the Committee [to date] indicates little, if any, diversity in accounting for the merger transaction described in the request. In accounting for the merger transaction described in the request, in their separate financial statements, parent entities generally do not apply the [acquisition method].

17. As paragraph 11 of this paper notes, two respondents (GLASS and OIC)—while not disagreeing with the Committee's observations about a lack of diversity—suggest updating the agenda decision to explain how an entity applies IFRS Accounting Standards when considering the matter described in the submission. Both respondents say, in their view, applying IFRS Accounting Standards an entity should apply the carrying amount method and request the Committee confirm this in the agenda decision. One respondent (CA Vidhyadhar Kulkarni) says the agenda decision should refer to the exclusion of business combinations under common control from the scope of IFRS 3.

18. The OIC says:

> …In our view, the [tentative agenda decision] may accidently create divergence in practice, because it could lead to believe that both methods (ie acquisition method and [carrying amount method]) may be applied in accordance with IFRS [Accounting] Standards…

19. One respondent (CA Vidhyadhar Kulkarni) disagrees with the Committee's observations that:

    (a) the matter is not widespread—the respondent says the transaction is common in India.

    (b) entities do not generally apply the acquisition method to account for the merger transaction. The respondent says entities in India are required to apply all relevant Ind AS standards (including the Ind AS equivalent of IFRS 3) to account for intra-group transactions in separate financial statements and provides examples of other intra-group transactions.

Analysis

20. Assessing whether a matter has widespread effect requires considering not only whether the fact pattern or transaction described in the submission is prevalent, but also whether the existence of different views, and consequently, diversity in accounting for that fact pattern or transaction is widespread.

21. Feedback on the tentative agenda decision supports the Committee's tentative conclusion that the matter does not have widespread effect. Respondents either confirmed the Committee's observation about entities not generally applying the acquisition method when accounting for the merger transaction or did not provide any contrary evidence.

22. The Committee's observation of parent entities' not applying the acquisition method were limited to only the observed practice in accounting for the merger transaction and not to other intra-group transactions.

23. Regarding whether the agenda decision should explain the required accounting, paragraph 8.3 of the *Due Process Handbook* states:

    > … An agenda decision typically includes explanatory material when the reason for not adding a standard-setting project to the work plan is the Interpretations Committee's conclusion that the

> principles and requirements in the Standards provide an adequate basis for an entity to determine the required accounting. …

24. In this case, the Committee's reason for not adding a standard-setting project to the work plan is a different one—it is that the matter does not meet the 'widespread and material' criterion set out in paragraph 5.16(a) of the *Due Process Handbook*.

25. As noted in paragraph 27 of [Agenda Paper 4] of the Committee's September 2023 meeting which discussed similar comments on another matter in which the Committee concluded that the matter did not meet the 'widespread and material' criterion:

> … the Committee's role is not to undertake technical analysis and provide explanatory material in agenda decisions when the Committee has obtained insufficient evidence that the matter has widespread effect and has, or is expected to have, a material effect on those affected. We think doing so could risk setting a precedent that the Committee will provide technical analysis on all matters submitted to it, even when the evidence obtained indicates that the matter is not widespread (including when evidence suggests there is little diversity in the accounting treatment entities apply).

26. Consistent with the Committee's decisions on previous issues that did not meet the 'widespread and material' criterion[4], we think the Committee should not include explanatory material in this agenda decision.

Conclusion

27. Based on our analysis, we:

    (a) continue to agree with the Committee's conclusion that the matter described in the submission does not have widespread effect; and

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[4] See for example, Agenda Decision *Homes and Home Loans Provided to Employees* published in September 2023 and Agenda Decision *Non-refundable Value Added Tax on Lease Payments (IFRS 16 Leases)* published in October 2021.

(b) recommend not adding explanatory material to the agenda decision.

Application of the carrying amount method

Feedback

28. As paragraph 14 of this paper notes, a number of respondents say there is diversity in how entities apply the carrying amount method. These respondents say there is diversity in, for example:

    (a) how entities determine the carrying amounts of assets and liabilities transferred;

    (b) how entities account for any difference between the carrying amount of the investment in the subsidiary in the separate financial statements of the parent before the merger transaction and the carrying amount of the assets and liabilities transferred; and

    (c) whether entities restate comparative information.

29. These respondents suggest clarifying how entities apply (or should apply) a carrying amount method and/or referring the matter to the IASB. A few respondents suggest the IASB consider this matter as part of the IASB's BCUCC project.

Analysis

30. The submission asked whether an entity applies the acquisition method to the merger transaction. The Committee observed no diversity in respect of the question asked and the tentative agenda decision reflects this observation. Addressing how entities should apply the carrying amount method to the merger transaction would go beyond the question asked.

31. The IASB considered how an entity applies the carrying amount method as part of its BCUCC project. As paragraph 4.3 of the IASB's Discussion Paper *Business Combinations under Common Control* notes 'IFRS [Accounting] Standards do not

refer to any [carrying amount] methods and do not specify how such a method should be applied…'. At its November 2023 meeting, the IASB decided to discontinue the BCUCC project. Consequently, we think the Committee would not be able to address this matter efficiently within the confines of existing IFRS Accounting Standards and the *Conceptual Framework*.[5]

32. We acknowledge the wording '…little, if any, diversity in accounting for the merger transaction described in the request' in the tentative agenda decision could incorrectly imply the Committee also observed no diversity in how entities apply a carrying amount method. The Committee's observations were limited to whether entities apply the acquisition method. The appendix to this paper includes some suggested wording changes to the agenda decision to avoid such a misinterpretation.

Conclusion

33. Based on our analysis, we recommend:

    (a) not addressing how an entity should apply a carrying amount method; and

    (b) updating the wording in the agenda decision to avoid implying that the Committee observed no diversity in how entities apply a carrying amount method.

Reference to prevalent practice

Feedback

34. Petrobras suggest amending the agenda decision not to mention the prevalent practice. The respondent:

    (a) says the reference to prevalent practice could be seen as explanatory material that has the potential for confusion; and

[5] Paragraph 5.16(c) of the *Due Process Handbook*.

(b) refers to a previous Agenda Decision [*Preparation of Financial Statements when an Entity is No Longer a Going Concern* (IAS 10 *Events after the Reporting Period*)] published in June 2021, in which the Committee did not include prevalent practice.

Analysis

35. The statement about prevalent practice simply reflects the Committee's observations and is not explanatory material—the statement does not explain how an entity should apply IFRS Accounting Standards to the merger transaction. The statement supports the Committee's conclusions about the matter not having widespread effect and is, in our view, useful because it allows a reader to understand how the Committee arrived at its decision not to address the matter.

36. Whilst we acknowledge the Agenda Decision *Preparation of Financial Statements when an Entity is No Longer a Going Concern* (IAS 10 *Events after the Reporting Period*) did not refer to prevalent practice, the Committee has in the past referred to prevalent practice for other issues for which it concluded the matter did not have widespread effect due to a lack of observed diversity including, for example, in the Agenda Decision [*Presenting Comparative Amounts when a Foreign Operation first becomes Hyperinflationary* (IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies*)] published in March 2020.

Conclusion

37. We recommend the Committee not delete the statement in the agenda decision about prevalent practice.

Other

38. We were made aware that the statement in the tentative agenda decision 'the requirements in IFRS 3 that apply to the accounting for a business combination' could

be confusing. In particular, it might not be clear as to whether the statement refers to only the acquisition method (and related requirements) in IFRS 3 or also to other requirements in IFRS 3 (for example, paragraphs in IFRS 3 that set out the scope of IFRS 3). The appendix to this paper includes some wording suggestions to improve the clarity of the agenda decision.

Staff recommendation

39. Based on our analysis in paragraphs 16–38, we recommend finalising the agenda decision, with changes to the wording of the tentative agenda decision as marked in the appendix to this paper. If the Committee agrees with our recommendation, we will ask the IASB whether it objects to the agenda decision at the first IASB meeting at which it is practicable to present the agenda decision.

Questions for the Committee
1. Does the Committee agree with our recommendation to finalise the agenda decision as explained in paragraph 39 of this paper? 2. Do Committee members have any comments on the wording of the agenda decision in the appendix to this paper?

Appendix—suggested wording for the agenda decision

A1. We propose the following wording for the final agenda decision (new text is underlined and deleted text is struck through).

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 request:

(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*); and

(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 separate financial statements, the merger transaction:

(a) constitutes a business combination as defined in IFRS 3 and consequently, whether an entity should apply ~~all~~ the <u>acquisition method (and related requirements)</u> 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 previous carrying amounts.

Findings

Evidence gathered by the Committee ~~[to date]~~ indicates little, if any, diversity in ~~accounting~~ determining whether to apply the acquisition method (and related requirements) in IFRS 3 ~~for~~ to the merger transaction described in the request. In accounting for the merger transaction described in the request in their separate financial statements, parent entities generally do not apply the acquisition method (and related requirements) in IFRS 3~~ that apply to the accounting for a business combination~~.

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.