IFRS

STAFF PAPER

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IASB® meeting

Project	**Business Combinations under Common Control**
Paper topic	Project objective and scope

CONTACT(S) ChunHo Lee clee@ifrs.org
Paolo Dragone pdragone@ifrs.org

Purpose and structure

1. The purpose of this paper is to:
   - (a) provide the International Accounting Standards Board (IASB) with our analysis of feedback on the objective and suggestions to expand the scope of the project on business combinations under common control (BCUCCs); and
   - (b) ask the IASB whether it agrees with our recommendations to:
     - (i) update the project objective to reflect the stage of the project and to emphasise that the project considers users of the receiving entity (that is, the reporting entity)'s financial statements; and
     - (ii) not expand the project scope to address:
       1. reporting by entities involved in a BCUCC other than the receiving entity;
       2. reporting of an investment in a subsidiary received under common control in separate financial statements; or
       3. reporting of common control transactions other than BCUCCs.

2. The paper is structured as follows:

   (a) project objective (paragraphs 3–11); and

   (b) project scope (paragraphs 12–41).

Project objective

Background and feedback

3. Paragraph 2(c) of IFRS 3 *Business Combinations* excludes 'a combination of entities or businesses under common control' from IFRS 3's scope (BCUCC scope exception). As paragraphs 1.6–1.8 of the Discussion Paper *Business Combinations under Common Control* (Discussion Paper) note, feedback indicated that BCUCCs occur in many jurisdictions. Feedback also highlighted that the lack of a specifically applicable IFRS Accounting Standard has resulted in diversity in receiving entities' reporting for BCUCCs. Stakeholders, notably regulators of capital markets, expressed concerns about this diversity when responding to the IASB's 2011 and 2015 agenda consultations. The diversity can make it difficult for users of financial statements (users) to understand how a BCUCC affects the receiving entity and to compare entities that undertake similar transactions. Consequently, the IASB began a research project on BCUCCs.

4. Paragraph 1.9 of the Discussion Paper states:

> …The objective of the project is to explore possible reporting requirements for a receiving company that would reduce diversity in practice and improve the transparency of reporting these combinations. More specifically, the [IASB] aims to provide users of financial statements with better information that is both:
>
> (a) more relevant—by setting up reporting requirements based on user information needs; and
>
> (b) more comparable—by requiring similar transactions to be reported in a similar way.

5. The Discussion Paper did not specifically ask whether respondents agreed with the project objective. However, a few respondents commented on it and agreed that the project should aim to:

   (a) provide users relevant and comparable information about BCUCCs;

   (b) reduce diversity in reporting BCUCCs;

   (c) improve transparency of reporting BCUCCs; and

   (d) fill the gap in IFRS Accounting Standards created by the BCUCC scope exception.

6. Although the Request for Information *Third Agenda Consultation* (Third Agenda Consultation) published in March 2021 did not specifically ask for comments about projects on the current work plan, a few respondents expressed views in favour of continuing the BCUCC project. They said there are many issues relating to this topic in practice and much diversity exists because there are no requirements in IFRS Accounting Standards on BCUCCs.[1]

Staff analysis

7. We see no reason to substantially change the project objective. The objective as described in the Discussion Paper (see paragraph 4) remains relevant.

8. However, we think the IASB should:

   (a) update the objective to reflect the stage of the project (that is, change the objective from being 'to explore possible reporting requirements' to 'to develop reporting requirements');

[1] See paragraph 8 of Agenda Paper 24A to the IASB's December 2021 meeting.

(b) to avoid possible misunderstanding, emphasise as part of the objective that the project considers users of the receiving entity[2,] (that is, the reporting entity)'s financial statements;[3] and

(c) make minor editorial changes.

9. Consequently, we think the project objective should be (new text is underlined and deleted text is struck through):

> The objective of the project is to ~~explore possible~~ develop reporting requirements for a receiving ~~company~~ entity that would reduce diversity in practice and improve the transparency of reporting ~~these combinations~~ business combinations under common control. More specifically, the ~~Board~~ IASB aims to provide users of a receiving entity's financial statements with better information that is both:
>
> (a) more relevant—by setting up reporting requirements based on user information needs; and
>
> (b) more comparable—by requiring similar transactions to be reported in a similar way.

10. Although paragraph 9 illustrates what we think the wording of the project objective should be, we are not asking for drafting suggestions at this meeting.

Staff recommendation on project objective

11. Based on our analysis, we recommend updating the project objective to reflect the stage of the project and to emphasise that the project considers users of the receiving entity (that is, the reporting entity)'s financial statements.

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[2] As explained in Appendix A of the Discussion Paper, a receiving entity is the entity to which control of a business is transferred in a BCUCC. The term 'receiving entity' refers not only to the immediate receiving entity in the combination. It also refers to those parent entities (if any) of that immediate receiving entity that did not control the transferred entity before the combination.

[3] Paragraphs 19–26 of this paper analyse respondents' suggestions to address reporting by other entities involved in a BCUCC.

Question 1 for the IASB
Does the IASB agree with our recommendation in paragraph 11?

Project scope

12. This section analyses respondents' suggestions to expand the scope of the project beyond that covered by the Discussion Paper. We are asking for the IASB's tentative decisions on these matters first because these decisions could significantly affect the deliberation plan and timelines. Although respondents provided feedback on other aspects of project scope, we will bring our analysis of feedback on those matters to a future meeting. This includes our analysis of feedback on:

    (a) transitory control—see paragraphs 13–17 of Agenda Paper 23A to the IASB's December 2021 meeting (December Agenda Paper);

    (b) group restructurings—see paragraphs 18–21 of the December Agenda Paper; and

    (c) specific clarification requests—see Appendix A of the December Agenda Paper.

Background

13. The IASB's preliminary view is that it should develop proposals that cover a receiving entity's reporting for all transfers of a business under common control, even if the transfer is:

    (a) preceded by an acquisition from an external party or followed by a sale of one or more of the combining entities to an external party (that is, a party outside the group); or

    (b) conditional on a sale of the combining entities to an external party, such as in an initial public offering.

14. The IASB's preliminary view means the project would:

(a) consider all transfers of businesses (including unincorporated businesses) under common control, but not other types of common control transactions, for example, transfers of assets under common control;

(b) consider group restructurings—transactions that involve a transfer of a business under common control but do not meet the definition of a *business combination* in Appendix A of IFRS 3;

(c) consider reporting requirements for only a receiving entity and not other entities involved in a BCUCC, for example, the controlling entity or the transferring entity;

(d) consider how a receiving entity reports BCUCCs generally in its consolidated financial statements—however, if the transaction involves the transfer of an unincorporated business, the reporting requirements developed in this project would also apply in other types of financial statements prepared by the receiving entity such as separate financial statements; and

(e) not consider a receiving entity's reporting of an investment in a subsidiary received under common control in separate financial statements.

15. As reported in the December Agenda Paper, almost all respondents agree the project should cover the receiving entity's reporting for the types of transactions which would be covered in the project applying the preliminary view—that is, they do not say any transaction should be removed from the project's scope or disagree with covering the receiving entity's reporting.

16. Respondents suggest expanding the project scope to also cover:

(a) the reporting by other entities involved in a BCUCC—most commonly the transferring entity (some);

(b) reporting of an investment in a subsidiary received under common control in separate financial statements (some); and/or

(c) reporting of other common control transactions, such as transfers of investments in associates under common control (some).

17. Some respondents suggest covering these matters by expanding the scope of the BCUCC project whereas others suggest covering these matters in a separate project(s) to avoid delaying the BCUCC project.

Staff analysis

18. This section includes our analysis of feedback on:

    (a) reporting by other entities involved in a BCUCC (paragraphs 19–26);

    (b) reporting of an investment in a subsidiary received under common control in separate financial statements (paragraphs 27–32); and

    (c) reporting of other common control transactions (paragraphs 33–40).

Other entities involved in a BCUCC

Background and feedback

19. As paragraphs 1.17–1.19 of the Discussion Paper explain, the project considers reporting requirements for a receiving entity—that is, the receiving entity is the reporting entity. The project does not consider reporting requirements for other entities involved in a BCUCC. The Discussion Paper notes IFRS Accounting Standards already contain requirements for those other entities:

    (a) the controlling party—IFRS 10 *Consolidated Financial Statements* covers any effects on the controlling party;

    (b) the transferred entity—disclosure of information about its new parent is covered by IAS 24 *Related Party Disclosures*; and

    (c) the transferring entity—the loss of control of its subsidiary is covered by IFRS 10.

20. Paragraphs 28–32 of the December Agenda Paper summarise respondents' comments on this matter.

21. Some respondents suggested also addressing a *transferring entity*'s reporting of a BCUCC:

(a) a few acknowledged IFRS 10 includes requirements for the transferring entity's reporting but said those requirements could result in not faithfully representing the economic substance of the transaction. They said applying IFRS 10, the transferring entity would typically recognise any difference between the consideration received and the net assets transferred as a gain or loss in profit or loss. They said this:

  (i) would be inconsistent with the receiving entity recognising that same difference as either goodwill or in equity when it applies the preliminary views in the Discussion Paper;

  (ii) would not reflect the economic substance of the transaction—that is, a transaction directed by the controlling party in their capacity as owners; and

  (iii) could create opportunities for accounting arbitrage because the BCUCC could be structured to inflate earnings of the transferring entity; and

(b) a few others said IFRS Accounting Standards (such as IFRS 10, IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, IAS 27 *Separate Financial Statements* and IFRIC 17 *Distributions of Non-cash Assets to Owners*) do not provide sufficient guidance for the transferring entity's reporting.

22. These respondents suggested developing requirements for the transferring entity that:

(a) would be symmetrical with the receiving entity's reporting (most of these respondents);

(b) would align a transferring entity's reporting in separate financial statements for an investment in a subsidiary transferred in a BCUCC with the reporting in its consolidated financial statements (a few); and

(c) would be consistent with US GAAP (a few).

23. A few respondents suggested exploring the effects of, and providing guidance on, the reporting of a BCUCC in separate and/or consolidated financial statements of the *controlling party*.

24. Although the Third Agenda Consultation did not specifically ask for comments about projects on the current work plan, one respondent suggested the project on BCUCC should also cover accounting requirements for the transferring entity's separate financial statements.[4]

Staff analysis

25. We think the IASB should not expand the project scope to address reporting by other entities because:

    (a) as discussed in paragraph 5(d), the project aims to fill the gap in IFRS Accounting Standards created by the BCUCC scope exception. IFRS 3 includes reporting requirements for an acquirer—the entity that obtains control of a business or businesses—and not for other entities involved in a business combination. As discussed in paragraph 19, IFRS Accounting Standards already contain requirements for other entities involved in BCUCC. Accordingly, we think it is unnecessary to address the reporting by those other entities as part of this project. We also think reconsidering whether those requirements—which apply beyond just BCUCCs—are sufficient and/or result in reflecting a transaction's economic substance could have wider implications or unintended consequences.[5]

    (b) although we agree the reporting between a receiving entity and a transferring entity might not always be symmetrical (this would depend on the IASB's decisions on which method of accounting to apply to BCUCCs and how to apply the selected method(s)), we see no reason for the accounting by the transferring and receiving entity to be symmetrical. It is not uncommon for the reporting of the same transaction by different parties to that transaction to be asymmetrical. For example, in a business combination in the scope of IFRS 3, the acquirer typically recognises any excess of the fair value of assets and liabilities acquired over consideration

[4] See paragraph 9 of Agenda Paper 24A to the IASB's December 2021 meeting.

[5] Further information about how the IFRS Foundation and the IASB help support consistent application of IFRS Accounting Standards can be found here.

paid as goodwill; however, the entity losing control typically recognises a gain or loss on disposal.

(c) as highlighted by some respondents, addressing the reporting by other entities would require significant additional time and effort and could significantly delay the project.

Staff recommendation

26. Based on our analysis, we recommend not expanding the scope of the project to address the reporting by entities involved in a BCUCC other than the receiving entity.

Investment in a subsidiary in separate financial statements

Background and feedback

27. Paragraph 1.23 of the Discussion Paper explains that the project does not address how a receiving entity should report an investment in a subsidiary received under common control in its separate financial statements. That topic is addressed by IAS 27.

28. As explained in paragraphs 23–26 of the December Agenda Paper, some respondents to the Discussion Paper suggested addressing the reporting for an investment in a subsidiary received in a common control transaction in the receiving entity's separate financial statements. Of these respondents:

(a) many acknowledge IFRS Accounting Standards (for example, IAS 27) include requirements for reporting an investment in a subsidiary received in a common control transaction but say those requirements could result in not faithfully representing the economic substance of the transaction. They say:

(i) in their jurisdiction, statutory financial statements are used for purposes such as tax, dividends and capital requirements and BCUCCs can have a material effect on separate financial statements;

(ii) the preliminary views could result in entities reporting the profitability of subsidiaries differently in consolidated and separate financial statements; and

(iii) the preliminary view could result in different accounting treatments in separate financial statements depending on whether the transferred business is incorporated.

(b) many say IAS 27 does not provide sufficient guidance on reporting an investment in a subsidiary received in a common control transaction. They say:

(i) IAS 27 does not explain how a receiving entity measures the initial cost of the investment in a subsidiary received in a common control transaction;[6]

(ii) IAS 27 does not explain whether any difference between that initial cost and consideration paid should be recognised in profit or loss, or as a contribution to or distribution from equity; and

(iii) the lack of clear guidance results in diversity.

29. A few of these respondents say a BCUCC should be measured consistently at fair value or book value in a receiving entity's separate and consolidated financial statements.

Staff analysis

30. We think the IASB should not expand the scope of the project to address a receiving entity's reporting for an investment in a subsidiary received under common control in its separate financial statements because:

(a) as discussed in paragraph 5(d), the project aims to fill the gap in IFRS Accounting Standards created by the BCUCC scope exception. IAS 27 already includes requirements that address the accounting for an investment in a subsidiary in separate financial statements. Accordingly, we think it is unnecessary to address the matter as part of this project. We also think reconsidering whether IAS 27—which applies beyond just BCUCCs—is

[6] In the past, some stakeholders raised questions about the meaning of 'cost' in IAS 27 (not specifically for common control transactions)—see, for example, the IFRS Interpretations Committee's agenda decision in January 2019 *Investment in a Subsidiary Accounted for at Cost: Step acquisition (IAS 27)*.

sufficient and/or results in reflecting a transaction's economic substance could have wider implications or unintended consequences.[7]

(b) the requirements in IAS 27 and other IFRS Accounting Standards applying to the reporting of an investment in a subsidiary in separate financial statements differ from those applying to the reporting of a subsidiary in consolidated financial statements. The application of these requirements already results in:

(i) different accounting treatments in separate financial statements depending on whether a business is incorporated; and

(ii) entities reporting the profitability of subsidiaries differently in consolidated and separate financial statements.[8]

(c) addressing this matter would require significant additional time and effort and could significantly delay the project.

(d) as discussed in Table 1 in Agenda Paper 24C to this IASB meeting, in general, feedback from the Third Agenda Consultation on a potential project on separate financial statements indicates that matters relating to separate financial statements are not pervasive or acute. The matters raised by some respondents are likely to affect those entities that operate in a jurisdiction with a legal requirement to prepare separate financial statements. In addition, most users who commented on a potential project on separate financial statements in the Third Agenda Consultation rated the project as medium or low priority.

31. We acknowledge there may be interactions between the accounting requirements that apply to an investment in a subsidiary in separate financial statements and to a subsidiary in consolidated financial statements, for example, if an entity applies the equity method to account for its investment in a subsidiary.[9] As the IASB makes decisions on whether and how to apply a particular method of reporting to a BCUCC,

[7] Further information about how the IFRS Foundation and the IASB help support consistent application of IFRS Accounting Standards can be found here.

[8] Paragraph BC10G of IAS 27 includes examples of potential differences.

[9] IAS 28 notes that many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10 (see also paragraph 37).

we will consider whether those decisions would result in any new inconsistencies and if so, whether and how to address those inconsistencies.

Staff recommendation

32. Based on our analysis, we think the IASB should not expand the scope of the project to address the reporting of an investment in a subsidiary received under common control in separate financial statements.

Other common control transactions

Background and feedback

33. Many respondents say there are transactions under common control other than BCUCCs which fall outside of the scope of the project, such as:

    (a) transfers of investments in associates;

    (b) transfers of investments in joint ventures and joint operations; and

    (c) transfers of assets that are not businesses.

34. These respondents say IFRS Accounting Standards do not provide clear guidance on these transactions and there is diversity in practice. Most of these respondents suggest expanding the scope of the project to include such transactions. They say:

    (a) the IASB should address the accounting for these transactions in both separate and consolidated financial statements (some respondents);

    (b) it is necessary to address these transactions from the perspective of both the receiving and transferring entities (a few respondents).

35. Although the Third Agenda Consultation did not specifically ask for comments about projects on the current work plan, one respondent suggested prioritising a potential project on developing guidance on common control transactions that are outside the scope of the BCUCC project.[10]

[10] See Table 2—Other suggestions for potential projects of Agenda Paper 24E to the IASB's November 2021 meeting.

Staff analysis

36. As discussed in paragraph 5(d), the project aims to fill the gap in IFRS Accounting Standards created by the BCUCC scope exception. Other IFRS Accounting Standards do not exclude common control transactions from their scope. We note the IFRS Interpretations Committee's agenda decision in January 2018 *Contributing property, plant and equipment (IAS 28)* says that 'unless a Standard specifically excludes common control transactions from its scope, an entity applies the applicable requirements in the Standard to common control transactions'.

37. However, we understand some stakeholders in the past raised questions on how an entity accounts for the acquisition of an interest in an associate or joint venture under common control.[11] In particular, those stakeholders questioned how an entity should apply the requirement in paragraph 26 of IAS 28 which states:

> Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.

38. Accordingly, we considered whether the IASB should address the accounting for an acquisition of an associate or a joint venture under common control as part of this project. However, we think doing so could require amending or interpreting paragraph 26 of IAS 28—that paragraph applies beyond just common control transactions and addressing this matter could therefore have wider implications or unintended consequences. We also understand the IASB will likely, as part of considering application questions on IAS 28 in its Equity Method project, need to consider the application of paragraph 26 of IAS 28.

39. Overall, we think it is unnecessary to address other common control transactions as part of this project. We also think reconsidering requirements that apply to those transactions could (a) have wider implications or unintended consequences; and (b)

[11] The IFRS Interpretations Committee discussed the matter at its June and September 2017 meetings.

require significant additional time and effort which could significantly delay the project.

Staff recommendation

40. Based on our analysis, we recommend not expanding the scope of the project to address reporting of common control transactions other than BCUCCs.

Summary of staff recommendations on project scope

41. Based on our analysis, we recommend the IASB does not expand the project scope to address:

    (a) reporting by entities in a BCUCC other than the receiving entity;

    (b) reporting of an investment in a subsidiary received under common control in separate financial statements; or

    (c) reporting of common control transactions other than BCUCCs.

Question 2 for the IASB
Does the IASB agree with our recommendations in paragraph 41?