STAFF PAPER

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IASB Meeting

Project	**Business combinations under common control**
Paper topic	Scope of the research project

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Background and introduction

1. Paragraph B1 of IFRS 3 *Business Combinations* describes a business combination under common control as 'a business combination in which all of 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'. Business combinations under common control are excluded from the scope of IFRS 3. Arguably, business combinations under common control are different from other business combinations because:
   (a) they are directed transactions rather than arm's-length exchanges and therefore the transaction price might not be representative of the fair value of the transferred business; and
   (b) the purpose of such transactions could be different from the purpose of business combinations that are not under common control.
2. On the basis of the views received during the 2011 Agenda Consultation, the IASB identified business combinations under common control as a priority research project.
3. This paper discusses the interaction between the following topics:
   (a) transactions under common control that are not business combinations;
   (b) business combinations under common control; and

(c) new basis accounting issues in transactions other than business combinations under common control (ie other cases in which it may be appropriate to update carrying values of the entity's assets and liabilities to their current values)[1].

4. The objective of the paper is to identify the types of transactions that should be included within the scope of the research project on business combinations under common control.

5. At this stage, the staff are not asking the IASB for decisions on further questions related to the scope of the project such as:

   (a) Which entity's financial statement should the project address—eg the acquirer's, the acquiree's, the transferor's, the ultimate parent's;

   (b) Which financial statements should the project address—eg consolidated, separate, individual; and

   (c) Which aspects of accounting and reporting should the project address—eg recognition, measurement, presentation and disclosure.

6. The staff think that these matters can only be answered once the research work on the types of transactions within the scope of the project has progressed.

Staff recommendation

7. The staff recommend that at this stage the IASB proceeds with a narrow scope project that focuses on top priority issues—business combinations under common control that are currently excluded from the scope of IFRS 3 and group restructurings that are not business combinations. In conducting the project, the staff recommend that the IASB places a particular focus on transactions that involve third parties, such as existing or new non-controlling interest or transactions that are followed on with an IPO, and considers the needs of relevant users.

[1] In this paper, the term 'new basis' is used in a narrow sense, ie the new basis of accounting for assets and liabilities in the *same* reporting entity. The so-called 'push down' accounting is one example of the application of the new basis as understood in that narrow sense. Some understand the term 'new basis' in a broader sense, ie adjusting the values of assets and liabilities either in the same or in a different reporting entity. The application of the acquisition method by an acquirer in a business combination is an example of the new basis understood in that broader sense.

8. The staff also recommend that the IASB considers the need to clarify the description of business combinations under common control, including the meaning of 'common control'.

9. The staff do not recommend that the IASB considers other types of transactions under common control, transfer pricing or the broader new basis issues at this stage. However, the IASB could decide to consider those issues in the future.

Structure of the paper

10. This paper provides:

    (a) a brief background of the IASB's project on business combinations under common control (paragraphs 11–24);

    (b) simple examples of basic transactions that the IASB could consider including in the scope of that project (paragraphs 25–29);

    (c) staff discussion of the implications of the scope of the project for the comparability in reporting those transactions (paragraphs 30–48); and

    (d) a question for the IASB.

Background

11. IAS 22 *Business Combinations* originally issued in November 1983 and subsequently revised/amended in 1993, 1996, 1998 and 1999, did not deal with transactions among enterprises under common control (paragraph 7 of IAS 22). There was no guidance in IAS 22 on what constitutes 'common control'.

12. In 2001, the IASB decided to review the *definition* of 'transactions among enterprises under common control' as part of the first phase of the Business Combinations project, and deferred the review of the *accounting* for such transactions to a future phase of the project.

13. Pursuant to the decision of the IASB, IFRS 3 *Business Combinations* issued in March 2004, which was the outcome of the first phase of the Business Combinations project,

retained the scope exclusion but included guidance on determining when entities are considered to be under common control.

14. Although the accounting for business combinations under common control was supposed to be considered in the second phase of the Business Combinations project, the revised IFRS 3 that was issued in January 2008 retained the scope exclusion and the relevant guidance.

15. In December 2007, the IASB decided to add the project on business combinations under common to its agenda. The relevant agenda paper considered whether the following issues should be included in the scope of the project:

    (a) accounting for the business combinations under common control in the acquirer's separate and consolidated financial statements;

    (b) a description of a combination between entities or businesses under common control (eg the meaning of 'transitory' [control]);

    (c) all new basis accounting issues (for example, whether an entity's assets and liabilities should be remeasured as a consequence of a borrowing transaction or a capital restructuring); and

    (d) all transactions between entities under common control (for example, sharing the same intellectual capital, exchanging employees or selling goods and services to each other).

16. The agenda paper recommended that the scope of the project should focus on the acquirer's separate and consolidated financial statements and could also include a review of the description of a business combination under common control to address application questions.

17. The agenda paper also recommended that new basis issues other than those in business combinations under common control, as well as transactions under common control that are not business combinations, should be excluded from the scope of the project. The agenda paper argued that whereas there is merit in conducting a comprehensive review of all those issues, such a review would require significant time and staff resources and could cause a delay in issuing the guidance on business combinations under common control. The agenda paper also acknowledged the

potential implications of the accounting for business combinations under common control for the accounting for other common control transactions and hence the need to monitor such potential implications throughout the project.

18. The IASB decided that the project will examine the definition of a business combination under common control and the methods of accounting for those transactions in the acquirer's consolidated and separate financial statements. The IASB observed that similar issues arise with respect to accounting for demergers, such as a spin-off of a subsidiary or business and decided to include demergers in the scope of the project.

19. In November 2008, the IASB issued IFRIC 17 *Distributions of Non-cash Assets to Owners*. IFRIC 17 addressed the accounting for non-reciprocal transfers of non-cash assets by an entity to its owners from the transferring entity's perspective. IFRIC 17 excluded from its scope distributions of non-cash assets that are ultimately controlled by the same party or parties before and after the distribution. For example, a distribution of all shares in the entity's subsidiary to the entity's owners would be within the scope of IFRIC 17 if no party or parties control the transferring entity. However, such a distribution would be outside of the scope of IFRIC 17 if the transferring entity is under the control of another party or parties—that is, if it is a distribution under common control. The IFRIC noted that such distributions are often conducted for the purpose of group restructuring and in the light of the IASB's decision to add to its agenda a project on common control transactions it decided not to include such transactions in the scope of the Interpretation.

20. In 2009, the project on business combinations under common control was put on hold because of the changed priorities of the IASB resulting from the global financial crisis. Little or no work had been performed on the project by that time.

21. In 2011, the IASB sought feedback on its priorities in the Agenda Consultation. Business combinations under common control were identified as a high priority project by most respondents, including users. However, views on the scope of the project were mixed. Some respondents believed that the issues could be resolved in a narrow-scope project and others believed that a comprehensive project might be necessary. Users specifically indicated the need not only for consistent accounting for

but also for consistent and transparent disclosure of information about business combination under common control.

22. In September 2013, the staff presented to the IASB an update on the status of the research project. That agenda paper identified the work performed by the national standard-setters on transactions under common control in 2011-2012 as a helpful basis for the research project and outlined the staff's planned approach to the research. No decisions have been made.

23. In June 2014, the staff discussed the potential scope of the research project with the Accounting Standards Advisory Forum (ASAF). Most ASAF members believed that the scope of the project should be narrow and focus on the most pervasive application issues—business combinations under common control and group restructurings. They noted that if the scope of the project is broad, it would likely take a long time to complete the project and would delay the issuance of the much needed guidance. Most ASAF members specifically stated that the IASB should not consider the broader new basis issues or transfer pricing issues at this stage. They noted that the IASB could consider any further related issues in the future.

24. Many ASAF members made other comments about the scope. Some ASAF members emphasised that particular attention should be given to transactions where third parties are involved, eg an existing or new non-controlling interest. Some ASAF members believed that the description of a 'business combination under common control' should be clarified. Some ASAF members emphasised that the IASB should not only consider accounting in the consolidated financial statements of the acquirer but also accounting in the acquirer's separate financial statements and in the financial statements of other parties to the transaction. Other ASAF members, in contrast, believed that at this stage the IASB should focus on consolidated financial statements of the acquirer only.

Examples of transactions for potential inclusion in the scope

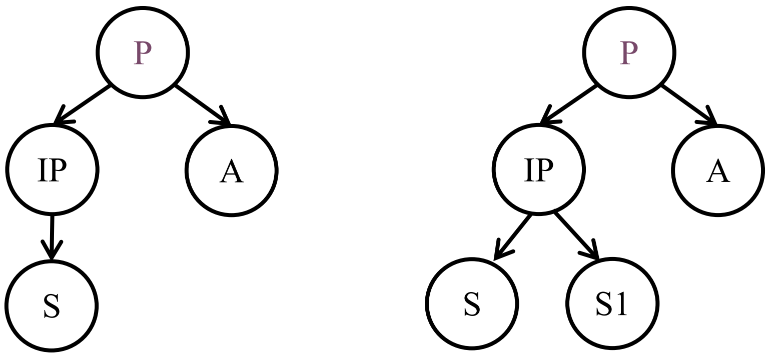
25. The following basic examples illustrate, in principle, the types of transactions that could be included in the scope of the project. The examples by no means represent the entirety of the vast variety of transactions that take place in practice nor common

variations of such transactions that might need to be considered by the IASB depending on the scope of the project. Instead, the examples are intended to facilitate the discussion by providing a broad illustration of the potential scope.

26. Each example involves demerging a controlled business into a newly formed separate legal entity. However, depending on who controls that newly formed entity, the transaction would fall into a different category of transactions and depending on the scope of the project might be accounted for differently.

Example 1—group restructuring

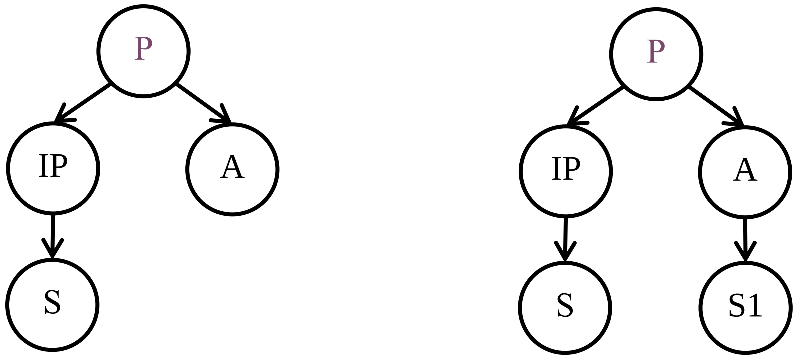
Entity IP is controlled by Entity P and controls Entity S. Entity S comprises two businesses. Entity IP demerges one of those businesses into a newly formed entity S1 that it also controls.



27. Example 1 represents a transaction under common control but is not a business combination under common control. This is because there are no combining entities or businesses. Instead, the immediate parent continues to control the demerged business. Another type of transaction under common control that is not a business combination would be a transfer within a group of a group of assets that do not represent a business.

Example 2—business combination under common control

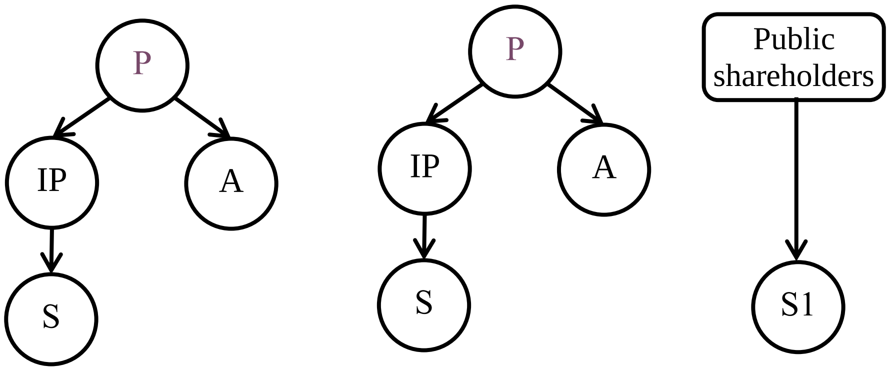
Entity IP is controlled by Entity P and controls Entity S. Entity S comprises two businesses. Entity IP demerges one of those businesses into a newly formed entity S1 that is controlled by Entity A, an entity that is also controlled by Entity P. Entity A is a reporting entity.



28. Example 2 represents a business combination under common control where the combining entities, or businesses, are Entity S1 and Entity A, which are both controlled by Entity P before and after the transaction[2].

Example 3—spin-off to public shareholders

Entity IP is controlled by Entity P and controls Entity S. Entity S comprises two businesses. Entity IP demerges one of those businesses into a newly formed entity S1 that is disposed of to two public shareholders.



[2] If S1 were not a business but rather a group of assets, that transaction would fall into the same category as Example 1 rather than Example 2—that is transactions under common control that are not business combinations.

29. Example 3 does not represent a transaction under common control. This is because the demerged business is not controlled by the same party before and after the transaction.

Staff discussion and analysis

Business combinations under common control

30. The IASB could decide to only include in the scope of the project transactions that meet the description of business combinations under common control in IFRS 3—represented by Example 2—and potentially to also clarify that description, including what is meant by 'common control', to address common application questions. As part of clarifying the description, the IASB could also consider the findings of the post-implementation review of IFRS 3, particularly what is meant by a 'business'. Also, within this scope, the IASB could specifically consider the issues that were raised with the Interpretations Committee, including by International Organization of Securities Commissions (IOSCO)—accounting for group restructurings contingent on a successful IPO in which the original parent loses control.

31. If the IASB were to limit the scope to those transactions, the key question the IASB would need to answer would be how to account for such transactions from the **acquiring entity's perspective**. For example, for an acquirer that prepares consolidated financial statements, the IASB would need to decide whether the acquisition method, the predecessor carrying values method or a different accounting method should be applied to some or all of those transactions. The IASB would also need to decide which set(s) of the financial statements of the acquirer the project should capture—consolidated, separate or both.

32. The IASB could also decide to consider the accounting from the **acquired entity's perspective** in a business combination under common control[3], for example whether the carrying values of that entity's assets and liabilities should be adjusted to their current values in the acquired entity's financial statements as a result of the

[3] New basis accounting issues in other than business combinations under common control are discussed in paragraphs 36-41.

transaction (ie the application of the so called 'push down accounting' in a business combination under common control).[4]

Interaction with other transactions under common control

33. The conclusions the IASB would reach for business combinations under common control could have implications on the analysis of the accounting for other transactions under common control and the broader issues of transfer pricing.

34. For example, if the IASB decided that the acquirer in a business combination under common control should apply the acquisition method to account for some or all of those transactions, the following questions could arise:

    (a) In Example 1, in which a business is demerged but remains under control of the same immediate parent—is it appropriate to also adjust the carrying values of assets and liabilities comprising the demerged business to their current values in the immediate parent's financial statements?

    (b) Is it appropriate to recognise any assets transferred or services rendered between group entities at their fair values rather than at the transaction price, if it is different? If so, how should that difference be accounted for? Would those conclusions also apply to transactions between related parties that are not part of the same group?

35. Similar questions could arise if the IASB decided that the acquirer in a business combination under common control should apply the predecessor method to account for some or all of those transactions. For example, one could raise a question over whether all transactions under common control—or even all transactions between related parties—should be accounted for at the predecessor value rather than the transaction price, if it is different.

36. Accordingly, to increase the comparability and consistency of the accounting treatment, the IASB could decide to also include within the scope of the project a comprehensive consideration of the accounting for transactions under common

[4] IFRS 3 only addresses the application of the acquisition method of accounting for business combinations from the *acquiring entity's* perspective. Current IFRSs do not permit or require adjusting the carrying values of the *acquired entity's* assets and liabilities in the acquired entity's financial statements as a result of a business combination.

control that are not business combinations—or even a consideration of all related party transactions—or it could decide to include none or only a subset of such transactions in the scope of the project. For example, the IASB could decide to address transactions represented by Example 1—a group restructuring that does not involve a business combination.

37. Consistent with the staff conclusions in the December 2007 paper and the feedback received from ASAF, the staff acknowledge the interaction between accounting for business combinations under common control and other transactions under common control and also the broader transfer pricing issues—and the need to consider that interaction as the project progresses. Nevertheless, the staff do not believe that including a comprehensive review of *all* transactions under common control and the broader transfer pricing issues as part of this project is appropriate.

38. The staff note that inconsistencies between accounting for business combinations and other acquisitions that are *not* under common control already exist under the current IFRSs—ie the accounting for a business combination under IFRS 3 is different from the accounting for an acquisition of a group of assets (and liabilities), or indeed for a single asset under the applicable IFRSs. The staff therefore do not see much merit in addressing similar potential inconsistencies merely in the context of transactions under common control. However, if at a future date the IASB decided to consider inconsistencies between, for example, the accounting for business combinations and the accounting for an acquisition of a group of assets and liabilities that do not constitute a business, the IASB could consider those topics for transactions that are under common control and those that are not.

39. In addition, the staff note that a comprehensive review of all transactions under common control as part of this project would require significant time and staff resources and would likely delay issuing the guidance on the topics for which the perceived diversity in practice, and the consequent need for guidance, are the greatest. Accordingly, in the staff view, the IASB should focus at this time on the top priority issues—and potentially those that are most closely conceptually related.

40. However, in the staff view, the IASB could decide to include *some* of the transactions under common control in the scope of the project—for example those represented by Example 1, ie group restructurings that are not business combinations.

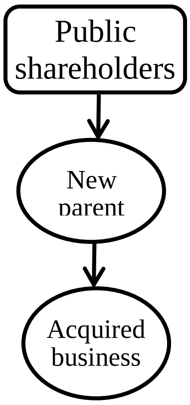
41. The IASB could also decide to place a particular focus on those transactions within the scope of the project that involve third parties.

Interaction with the new basis issues

42. There is also an interaction between the accounting for business combinations under common control and broader new basis issues.

43. Suppose the IASB decides that business combinations under common control should be accounted for by the acquirer under the acquisition method and does not address the broader new basis issues. In this case, in Example 2, assets and liabilities of S1 would be reflected in the financial statements of Entity A at their current values. Hence, if the group subsequently disposes of the combined entity (A+S1), for example in an IPO, the new shareholders would get a different set of values for S1 compared to Example 3, in which S1 is directly disposed of to public shareholders—there is no basis in the current IFRSs to adjust the carrying values of S1 as a result of such a transaction.

44. Suppose the IASB decides that business combinations under common control should be accounted for by the acquirer under the predecessor values method and does not address the broader new basis issues. In this case, in Example 2, the assets and liabilities of S1 would be reflected in the financial statements of Entity A at their predecessor carrying values. In that case, if the group subsequently disposes of the combined entity (A+S1), for example in an IPO, the new shareholders would get the same set of values for S1 as they would in Example 3. However, that set of values would be different compared to a scenario in which the business disposed of—whether it is a combined entity A+S1 as in Example 2 followed by an IPO or entity S1 as in Example 3—is acquired by a controlling party which in its turn is owned by public shareholders, as illustrated below.



45. In this case, the public shareholders would get the fair values of the disposed-of business because the new parent will be required to apply the acquisition method under IFRS 3. This example illustrates the interaction between the broader new basis issues—ie when it is appropriate to adjust the carrying values of assets and liabilities of an entity/business to their current values—with the broader topic of accounting for business combinations, not merely business combinations under common control.

46. It is important to note that, unlike the accounting for business combinations, which looks at the acquirer, the new basis accounting issues look at the acquiree or, more broadly, at the entity that is subject to the transaction. Hence, if the IASB decided to include accounting by the acquiree in a business combination under common control in the scope of the project, as discussed in paragraph 32, there would arguably be more merit in also considering other new basis issues within the scope of this project—compared to a situation in which the IASB only decides to consider the acquirer's financial statements, as discussed in paragraph 31.

47. If the IASB decides to include the consideration of broader new basis issues within the scope of the project, the IASB would also need to consider which new basis it would like to address—for example, whether the IASB would like to assess the appropriateness of the new basis accounting as a result of:

    (a) acquisition of shares in the entity;

    (b) significant lending transactions; and

    (c) other significant transactions.

48. Consistent with the staff conclusions in the December 2007 paper and the feedback received from ASAF, the staff acknowledge the interaction between accounting for business combinations under common control and the broader new basis issues—and the need to consider that interaction as the project progresses. Nevertheless, the staff do not believe that including a broader consideration of new basis issues within the scope of the project is appropriate. The staff note that the new basis issues have not been raised with the IASB as priority issues and addressing them would likely take a

long time and delay the issuance of the much needed guidance on business combinations under common control and group restructurings that are not business combinations, notably those that involve third parties.

49. Staff recommendation is set out in paragraphs 7–9.

Question for the IASB
Does the IASB agree with the staff recommendation in paragraphs 7–9?