STAFF PAPER

13–14 May 2014

IFRS Interpretations Committee Meeting

Project	**IFRS 3 *Business Combinations***		
Paper topic	Identification of the acquirer in accordance with IFRS 3 and the parent in accordance with IFRS 10 in a stapling arrangement		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to clarify the interaction of the requirements in IFRS 3 *Business Combinations* (as revised in 2008) for identifying an acquirer with the requirements in IFRS 10 *Consolidated Financial Statements* for deciding whether control exists. More specifically, the submitter is seeking clarification of whether an acquirer identified for the purpose of IFRS 3 (as revised in 2008) is a parent for the purpose of IFRS 10 in circumstances in which a business combination is achieved by contract alone, such as a stapling arrangement, with no combining entity obtaining control of the other combining entities.

2. The Interpretations Committee discussed this issue in January 2014. As a result of the discussions, the Interpretations Committee tentatively decided not to add this issue to its agenda.

3. The objective of this Agenda Paper is to provide an analysis of the comment letters received on the tentative agenda decision and ask whether the Interpretations Committee agrees with the staff recommendation that it should finalise the agenda decision.

4. This Agenda Paper is structured as follows:

   (a) discussions in the January 2014 Interpretations Committee meeting;

(b) comment letter analysis;

(c) staff recommendation;

(d) questions for the Interpretations Committee;

(e) Appendix A—proposed wording for the final agenda decision; and

(f) Appendix B—comment letters.

5. In the following paragraphs, we refer to IFRS 3 as issued in 2004 as 'IFRS 3 (2004)' and refer to IFRS 3 as revised in 2008 as 'IFRS 3 (2008)'.

Discussions in the January 2014 Interpretations Committee meeting

6. In the January 2014 meeting, the Interpretations Committee noted that IFRS 3 (2008) defines a business combination as "a transaction or other event in which an acquirer obtains control of one or more businesses". In addition, IFRS 3 (2008) refers to IFRS 10 for the meaning of the term 'control'. IFRS 10 states that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Hence, the Interpretations Committee observed that an investment is not needed in order for an entity to control another entity.

7. The Interpretations Committee noted that the definition of a business combination in IFRS 3 (2008) includes transactions that are sometimes referred to as 'true mergers' or 'mergers of equals'. Accordingly, it observed that the definition of a business combination in IFRS 3 (2008) includes transactions in which none of the combining entities obtains control of the other combining entities.

8. The Interpretations Committee discussed a stapling arrangement and noted that if the stapling arrangement combines separate entities and businesses by the unification of ownership and voting interests in the combining entities, then such a transaction is a business combination as defined by IFRS 3 (2008).

9. Notwithstanding the fact that IFRS 3 (2008) includes business combinations in which none of the combining entities obtains control of the other combining

entities, the Interpretations Committee noted that paragraph 6 of IFRS 3 (2008) requires that one of the combining entities in a business combination must be identified as the acquirer. Paragraphs B14–B18 of IFRS 3 (2008) provide additional guidance for identifying the acquirer if the guidance in IFRS 10 does not clearly indicate which combining entity is the acquirer.

10. The Interpretations Committee also noted that paragraph B15(a) of IFRS 3 (2008) provides guidance on identifying the acquirer by assessing the relative voting rights in the combined entity after the combination—this guidance explains that the acquirer is usually the combining entity whose owners, as a group, receive the largest portion of the voting rights in the combined entity. This guidance is consistent with the Interpretations Committee's observation that the definition of a business combination includes transactions in which none of the combining entities or businesses is identified as having control of the other combining entities. The Interpretations Committee thought that this guidance would be relevant to identifying which of the combining entities is the acquirer in the stapling transaction being considered.

11. The Interpretations Committee noted that the IASB stated in September 2004 that the intended interaction between IFRS 3 (2004) and IAS 27 *Consolidated and Separate Financial Statements* is that an entity that is identified as the 'acquirer' of another entity in accordance with IFRS 3 (2004) is a 'parent' for the purposes of IAS 27.

12. The Interpretations Committee noted that the meaning of the term 'acquirer' has not changed since 2004 and that the term 'control' is used consistently between IFRS 3 (2008) and IFRS 10. It also noted that the notion in IFRS 3 (2008) that a business combination could occur even if none of the combining entities obtains control of the other combining entities has not changed from IFRS 3 (2004).

13. Accordingly, the Interpretations Committee observed that the IASB's statement on the interaction between IFRS 3 (2004) and IAS 27 remains valid in respect of the interaction between IFRS 3 (2008) and IFRS 10.

14. Consequently, the Interpretations Committee observed that the combining entity in the stapling arrangement that is identified as the acquirer for the purpose of

IFRS 3 (2008) should prepare consolidated financial statements of the combined entity in accordance with IFRS 10.

15. The Interpretations Committee noted that there is little diversity in practice for the accounting for business combinations achieved by contract alone. It further noted, on the basis of the analysis on the requirements and guidance in IFRS 3 (2008) and IFRS 10, that it does not expect diversity to emerge in the future.

16. Accordingly, the Interpretations Committee tentatively decided not to add this issue to its agenda.

Comment letter analysis

17. We received two comment letters on the tentative agenda decision during the comment period, which ended on 14 April 2014. The discussions raised in those comment letters are largely divided into two aspects:

    (a) the scope of business combinations achieved by contract alone that is addressed in the tentative agenda decision; and

    (b) the interaction between the requirements for identifying an acquirer in IFRS 3 (2008) and the definition of a parent in IFRS 10.

18. For the full text of the comment letters, refer to Appendix B of this Agenda Paper.

The scope of business combinations achieved by contract alone in the tentative agenda decision

19. One respondent[1] agrees with the observations of the Interpretations Committee described in the tentative agenda decisions. However, they state that the issue is not confined to stapling arrangements, but is a broader issue that could impact business combinations achieved by contract alone. Thus, they encourage the Interpretations Committee to consider documenting the agenda decision to include these types of business combinations that are achieved by contract alone, to help avoid diversity in practice.

[1] AASB.

Staff response

20. We do not think that the Interpretations Committee's observations in the tentative agenda decision are limited to a stapling arrangement. In particular, the Interpretations Committee observed that:

    (a) the definition of a business combination in IFRS 3 (2008) includes transactions in which none of the combining entities or businesses is identified as having control of the other combining entities;

    (b) notwithstanding the above, paragraph 6 of IFRS 3 (2008) requires that one of the combining entities in a business combination is identified as the acquirer; and

    (c) the IASB stated in September 2004 that the intended interaction between IFRS 3 (2004) and IAS 27 is that an entity that is identified as the 'acquirer' of another entity in accordance with IFRS 3 (2004) is a 'parent' for the purposes of IAS 27. This IASB's statement on the interaction between IFRS 3 (2004) and IAS 27 remains valid in respect of the interaction between IFRS 3 (2008) and IFRS 10.

21. We are of the view that the observations described above would provide sufficient basis for developing an appropriate accounting policy for other types of combinations of businesses that are achieved by contract alone. We think that the Interpretations Committee considered a stapling arrangement as an example of applying the observations to such combinations of businesses.

22. As a result of the analysis of the stapling arrangement, the Interpretations Committee provided observations specific to the stapling arrangement as follows:

    (a) if a stapling arrangement combines separate entities and businesses by the unification of ownership and voting interests in the combining entities, then the transaction is a business combination as defined by IFRS 3 (2008); and

    (b) the guidance in paragraph B15(a) of IFRS 3 (2008) would be relevant to identifying an acquirer in the stapling arrangement.

(c) the combining entity in the stapling arrangement that is identified as the acquirer for the purpose of IFRS 3 (2008) should prepare consolidated financial statements of the combined entity in accordance with IFRS 10

23. We think that the observation in paragraph 22(a) may not be the case for all contracts that combine two or more businesses. For example, in the case of a formation of dual-listed corporation[2], there may not be unification of ownership and voting interests in the combining entities.

24. In addition, we think that the guidance in paragraphs B15-B18 of IFRS 3 (2008) for identifying the acquirer does not apply in the same manner in all business combinations because the facts and circumstances are different from transaction to transaction. Hence, the guidance in paragraph B15(a) of IFRS 3 (2008), which is referred to in the tentative agenda decision, might not identify the acquirer in other types of business combinations that were achieved by contract alone.

25. Furthermore, we note that the observation in paragraph 22(c) only explains the application of the general observation in paragraph 20(c) to the stapling arrangement.

26. We think that the Interpretations Committee would need to analyse all types of business combinations achieved by contract alone that it was to include as examples in its agenda decision. We do not think that it would be efficient for the Interpretations Committee to do, nor do we think that it is necessary.

27. Furthermore, we note that the results of our outreach indicate that other types of business combinations achieved by contract alone are not widespread.

28. Consequently, we think that the Interpretations Committee should not address other types of business combinations achieved by contract alone in its agenda decision.

[2] A dual-listed corporation (DLC) generally refers to a structure in which two entities function as a single operating business through a legal equalisation agreement, but retain separate legal identities and stock exchange listings.

The interaction between the requirements for identifying an acquirer in IFRS 3 (2008) and the definition of a parent in IFRS 10

29. The other respondent[3] states that the Interpretations Committee has not adequately addressed the issue raised by the submitter. They note that IFRS 10 defines a parent as an entity that controls one or more entities, while IFRS 3 specifically contemplates business combinations such as 'true mergers' or 'mergers of equals' in which neither party obtains control of the other. Thus, they think that the Interpretations Committee should provide further consideration of the interaction between the two IFRSs.

30. More specifically, the respondent are concerned that:

    (a) <u>The validity of the IASB's statement</u>: the Interpretations Committee's analysis is largely on the basis of the IASB Update in September 2004 in respect of the predecessors to IFRS 3 (2008) and IFRS 10. It is questionable whether the observation of the IASB is still valid because the definitions of a 'business combination' and 'control' have changed.

    (b) <u>Interaction between the IASB's statement and the reassessment requirements in IFRS 10</u>: it is unclear how the statement of the IASB should be applied within the context of the reassessment requirement in paragraph 8 of IFRS 10. From the wording in the tentative agenda decision, it appears that a reassessment would not occur, which is contrary to the reassessment requirement.

31. Thus, they ask the Interpretations Committee to seek confirmation from the IASB that the statement made in 2004 is still valid. If it is confirmed, then the requirements in IFRS 10 should be amended by incorporating the IASB's statement, following consideration of how the IASB's statement would interact with the continuous reassessment requirement in IFRS 10.

[3] Deloitte.

Staff response to the issue related to the validity of the IASB's statement

32. We think that the key basis for the Interpretations Committee to support that the IASB's statement in 2004 remains valid in respect of IFRS 3 (2008) and IFRS 10 was that:

    (a) the meaning of the term 'acquirer' has not changed since 2004;

    (b) a business combination could occur even when no combining entity obtains control of other combining entities both in IFRS 3 (2004) and IFRS 3 (2008), despite the fact that the definition of a business combination changed in 2008; and

    (c) the term 'control' has been used consistently between the Business Combinations Standard and the Consolidated Financial Statements Standard, although the definition of the term 'control' have changed since 2004.

33. Thus, we think that the Interpretations Committee's observation on the validity of the IABS's statement are not affected by the fact that the definition of the term 'control' and a 'business combination' has changed since 2004.

Staff response to the issue related to the Interaction between the IASB's statement and the reassessment requirement in IFRS 10

34. Paragraph 8 of IFRS 10 states:

    > 8 An investor shall consider all facts and circumstances when assessing whether it controls an investee. The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7 (see paragraphs B80–B85).

35. We note that the requirement for reassessment of control in IFRS 10 does not have an exception for consolidated financial statements of entities that are combined in a business combination achieved by contract alone. Thus, we think that the reassessment requirement applies to the consolidated financial statements of the entities brought together as a result of a business combination achieved by contract alone in IFRS 3 (2008).

36. We think that the reassessment of control was implicitly required for the consolidated financial statements of entities that were consolidated in accordance with IAS 27. This is because we note that:

    (a) the definition of a subsidiary in paragraph 4 of IAS 27 used the present tense by stating that "a *subsidiary* is an entity…that is controlled by another entity (known as the parent)"; and

    (b) the guidance for loss of control in paragraphs 32 to 37 of IAS 27 stated that "a parent can lose control of a subsidiary with or without a change in absolute or relative ownership levels." IAS 27 then went on to give some examples of how loss of control could come about through events or transactions. We think that this indicates that events or transactions affecting the parent's control over its subsidiary was the trigger for reassessment of control and, where appropriate, accounting for a loss of control.

37. Accordingly, we think that the requirement to reassess control in the light of changing circumstances has not changed since 2004. Consequently, we do not think that the introduction of the explicit requirement in IFRS 10 for a parent to reassess control affects the Interpretations Committee's conclusions in its agenda decision.

Post-implementation review of IFRS 3 (2008) and IFRS 10

38. We note that on 30 January 2014 the IASB began the public consultation stage of its review of IFRS 3 (2008) by publishing a Request for Information (RfI) on experience with, and the effect of, implementing the IFRS. The RfI seeks feedback on whether the IFRS provides information that is useful to users of financial statements, whether there are areas of the IFRS that represent implementation challenges and whether unexpected costs have arisen when preparing, auditing or enforcing the requirements of the IFRS. The comment period on the RfI will end on 30 May 2014.

39. We also expect that the post-implementation review of IFRS 10, which was effective for annual periods beginning on or after 1 January 2013, will likely start towards the end of 2015.

40. We will share the discussions of the Interpretations Committee on this issue with the staff who are working on, or will work on the post-implementation reviews of those IFRSs in order to help the IASB analyse issues related to business combinations achieved by contract alone.

Staff recommendation

41. In summary, we think that:

    (a) the Interpretations Committee should not address other types of business combinations achieved by contract alone in its agenda decision;

    (b) the Interpretations Committee's observation on the validity of the IASB's statement is not affected by the changes to the definition of the term 'control' and a 'business combination' since 2004; and

    (c) the introduction of the explicit requirement in IFRS 10 for a parent to reassess control does not affect the Interpretations Committee's conclusions in its agenda decision.

42. Accordingly, we recommend to the Interpretations Committee that it should finalise the agenda decision without modifications to the wording except for minor edits. The proposed wording of the final agenda decision is presented in Appendix A to this Agenda Paper.

Questions for the Interpretations Committee

Questions
1. Does the Interpretations Committee agree with the staff's recommendation that the Interpretations Committee should finalise its

decision not to add the issue to its agenda?

2. If the answer to Question 1 is ‘Yes’, does the Interpretations Committee agree with the wording of the final agenda decision in Appendix A to this Agenda Paper?

Appendix A—Proposed wording for the final agenda decision

A1. The following text presents the proposed wording for the final agenda decision, highlighting differences from the wording of the tentative agenda decision published in January 2014 (new text is underlined and deleted text is struck through).

IFRS 3 *Business Combinations*—identification of the acquirer in accordance with IFRS 3 and the parent in accordance with IFRS 10 *Consolidated Financial Statements* in a stapling arrangement

The Interpretations Committee received a request to clarify the interaction of the requirements in IFRS 3 *Business Combinations* (as revised in 2008) for identifying an acquirer with the requirements in IFRS 10 *Consolidated Financial Statements* for deciding whether control exists. More specifically, the submitter is seeking clarification of whether an acquirer identified for the purpose of IFRS 3 (as revised in 2008) is a parent for the purpose of IFRS 10 in circumstances in which a business combination is achieved by contract alone, such as a stapling arrangement, with no combining entity obtaining control of the other combining entities.

IFRS 3 (as revised in 2008) defines a business combination as “a transaction or other event in which an acquirer obtains control of one or more businesses”. In addition, IFRS 3 (as revised in 2008) refers to IFRS 10 for the meaning of the term ‘control’. IFRS 10 states that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Hence, the Interpretations Committee observed that an investment is not needed in order for an entity to control another entity.

The definition of a business combination in IFRS 3 (as revised in 2008) includes transactions in which an acquirer obtains control of one or more businesses. It also includes transactions that are sometimes referred to as ‘true mergers’ or ‘mergers of equals’. In other words, it includes transactions in which none of the combining entities obtains control of the other combining entities. The Interpretations Committee discussed a stapling arrangement and noted that if the stapling arrangement combines separate entities and businesses by the unification of ownership and voting interests in the combining entities, then such a transaction is a business combination as defined by IFRS 3 (as revised in 2008).

Notwithstanding the fact that IFRS 3 (as revised in 2008) includes business combinations in which none of the combining entities obtains control of the other combining entities, the Interpretations Committee noted that paragraph 6 of the Standard requires that one of the combining entities in a business combination <u>must be</u> ~~is~~ identified as the acquirer. Paragraphs B14–B18 of IFRS 3 (as revised in 2008) provide additional guidance for identifying the acquirer if the guidance in IFRS 10 does not clearly indicate which combining entity is the acquirer.

The Interpretations Committee also noted that paragraph B15(a) of the Standard provides guidance on identifying the acquirer by assessing the relative voting rights in the combined entity after the combination—this guidance explains that the acquirer is usually the combining entity whose owners as a group receive the largest portion of the voting rights in the combined entity. This guidance is consistent with the Interpretations Committee's observation that the definition of a business combination includes transactions in which none of the combining entities or businesses is identified as having control of the other combining entities. The Interpretations Committee thought that this guidance would be relevant to identifying which of the combining entities is the acquirer in the stapling transaction considered.

The Interpretations Committee noted that the IASB stated in September 2004 that the intended interaction between IFRS 3 (issued in 2004) and IAS 27 *Consolidated and Separate Financial Statements* is that an entity that is identified as the 'acquirer' of another entity in accordance with IFRS 3 (issued in 2004) is a 'parent' for the purposes of IAS 27. The Interpretations Committee noted that the meaning of the term 'acquirer' has not changed since 2004 and that the term 'control' is used consistently between IFRS 3 (as revised in 2008) and IFRS 10. It also noted that the notion in IFRS 3 (as revised in 2008) that a business combination could occur even if none of the combining entities obtains control of the other combining entities has not changed from IFRS 3 (issued in 2004). Accordingly, the Interpretations Committee observed that the IASB's statement on the interaction between IFRS 3 (issued in 2004) and IAS 27 remains valid in respect of the interaction between IFRS 3 (as revised in 2008) and IFRS 10. Consequently, the Interpretations Committee observed that the combining entity in the stapling arrangement that is identified as the acquirer for the purpose of IFRS 3 (as revised in 2008) should prepare consolidated financial statements of the combined entity in accordance with IFRS 10.

The Interpretations Committee noted that there is little diversity in practice for the accounting for business combinations achieved by contract alone. It further noted that it does not expect diversity to emerge in the future on the basis of the analysis on the requirements and guidance in IFRS 3 (as revised in 2008) and IFRS 10.

Accordingly, the Interpretations Committee [decided] not to add this issue to its agenda.

Appendix B—Comment letters

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20 February 2014

Mr Wayne Upton
Chairman
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UNITED KINGDOM

Dear Wayne

Tentative agenda decision - IFRS 3 *Business Combinations* - identification of the acquirer in accordance with IFRS 3 and the parent in accordance with IFRS 10 *Consolidated Financial Statements* in a stapling arrangement

The AASB is pleased to respond to the IFRS Interpretations Committee's tentative decision (published in the January 2014 IFRIC Update) not to add to its agenda a request to clarify the interaction of the requirements in IFRS 3 *Business Combinations* (as revised in 2008) for identifying an acquirer with the requirements in IFRS 10 *Consolidated Financial Statements* for deciding whether control exists.

The AASB agrees with the IFRS Interpretations Committee's observation that:

- the definition of a business combination in IFRS 3 includes transactions in which none of the combining entities or businesses is identified as having control of the other combining entities; and
- notwithstanding the above, paragraph 6 of IFRS 3 requires that one of the combining entities in a business combination is identified as the acquirer.

The AASB also agrees with the Interpretations Committee's observation that the IASB's statement on the interaction between IFRS 3 (issued in 2004) and IAS 27 remains valid in respect of the interaction between IFRS 3 (as revised in 2008) and IFRS 10. Further, the AASB agrees that the combining entity in the stapling arrangement that is identified as the acquirer for the purpose of IFRS 3 (as revised in 2008) should prepare consolidated financial statements of the combined entity in accordance with IFRS 10.

However, the AASB would like to reiterate to the Committee that the issue above is not confined to stapling arrangements, but is a broader issue that could impact business combinations achieved by contract alone. We would encourage the Committee to consider documenting the decision to include these types of business combinations to help avoid diversity in practice.

If you have any questions on the comments above, please contact me or Kala Kandiah (kkandiah@aasb.gov.au).

Yours sincerely,

K M. Stevenson

Kevin M. Stevenson
Chairman and CEO

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Wayne Upton
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7 April 2014

Dear Mr Upton

Tentative agenda decision - IFRS 3 *Business Combinations* - identification of the acquirer in accordance with IFRS 3 and the parent in accordance with IFRS 10 *Consolidated Financial Statements* in a stapling arrangement

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretation Committee's publication in the January 2014 IFRIC Update of the tentative agenda decision not to take onto the Committee's agenda a request for clarification of the interaction of the requirements in IFRS 3 for identifying an acquirer with the requirements in IFRS 10 for deciding whether control exists. Specifically whether an acquirer identified for the purpose of IFRS 3 (2008) is a parent for the purpose of IFRS 10 in circumstances in which a business combination is achieved by contract alone.

Whilst we concur with the Interpretations Committee's observation that there is currently little diversity in practice for the accounting for business combinations achieved by contract alone, we do not believe that the Interpretations Committee has adequately addressed the issue raised by the submitter. Given that IFRS 10 defines a parent as an entity that controls one or more entities whereas IFRS 3 specifically contemplates business combinations such as 'true mergers' or 'mergers of equals' in which neither party obtains control of the other, we agree with the submitter that the interaction between IFRS 3 and IFRS 10 for business combinations in which a control relationship may not exist merits further consideration.

In addition, we do not believe that the basis within the tentative agenda decision adequately supports the conclusion that diversity is unlikely to emerge in practice based the Committee's analysis of the requirements and guidance in IFRS 3 (2008) and IFRS 10. The Committee's conclusion appears to be based to a large extent on an IASB Update issued in 2004 in respect of the predecessors to those standards. Although the definition of the term 'acquirer' is consistent between IFRS 3 (2004) and IFRS 3 (2008), the definitions of 'business combination' and of 'control' have changed.

It is also unclear how the statement in the tentative agenda decision that "the combining entity in the stapling arrangement that is identified as the acquirer for the purpose of IFRS 3 (as revised in 2008)

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should prepare consolidated financial statements of the combined entity in accordance with IFRS 10" should be applied in the context of the reassessment requirements of IFRS 10. Taking this statement in isolation, it would appear that a reassessment would not occur even when a subsequent change in facts and circumstances results in a change in the relationship between a 'parent' and a 'subsidiary'. This would, however, be contrary to the requirements of IFRS 10.

We therefore recommend that the Interpretations Committee refer this issue to the IASB seeking affirmation that its 2004 observation related to the interaction between IFRS 3(2004) and IAS 27 continues to apply under IFRS 3(2008) and IFRS 10 and that an 'acquirer' of another entity identified in accordance with IFRS 3(2008) is deemed to be a 'parent' for the purposes of IFRS 10 and that the acquirer should prepare consolidated financial statements regardless of the fact that a control relationship as defined by IFRS 10 does not exist. Should the IASB affirm its 2004 observation, we recommend that, following consideration of how such a requirement would interact with the continuous assessment of control model, it be incorporated into IFRS 10 through an amendment to state that an acquirer identified in accordance with IFRS 3 is to be deemed a parent under IFRS 10 notwithstanding that a control relationship as defined by IFRS10 does not exist.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader