IFRS

STAFF PAPER

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IASB® meeting

Project	**Business Combinations under Common Control**
Paper topic	Feedback on scope
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Purpose

1. This paper summarises feedback on the International Accounting Standards Board (IASB)'s preliminary views on the scope of the Discussion Paper *Business Combinations under Common Control* (Discussion Paper).

2. As explained in Agenda Paper 23, this paper does not ask the IASB for any decisions.

Structure of this paper

3. The paper includes:

   (a) preliminary views (paragraphs 4–6);

   (b) key messages (paragraphs 7–10);

   (c) feedback (paragraphs 11–35);

   (d) question for the IASB; and

   (e) Appendix A—Clarification requests.

Preliminary views

4. The IASB's preliminary view is that it should develop proposals that cover reporting by the receiving entity 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.

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

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

(b) group restructurings—transactions that involve a transfer of a business under common control but do not meet the definition of a business combination in IFRS 3 *Business Combinations*[1];

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

(d) how the receiving entity should report transfers of business under common control generally in its consolidated financial statements, and not how the receiving entity should report in its separate financial statements an investment in a subsidiary received in a common control transaction[2].

6. Paragraphs 1.10–1.23 of the Discussion Paper explain the IASB's reasons for these preliminary views.

Key messages

7. Almost all respondents agree that the project should cover the receiving entity's reporting for the types of transactions which would be covered in the project applying

[1] For simplicity, the Discussion Paper used the term 'business combinations under common control' to refer to all transfers of a business under common control, even if they do not meet the definition of a business combination in IFRS 3. We have used the term business combination under common control (BCUCC) in this paper to also refer to any transfer of a business under common control.

[2] If the transaction involves the transfer of an unincorporated business, the possible reporting requirements developed in this project would also apply in other types of financial statements prepared by the receiving entity such as its separate financial statements.

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.

8. A few respondents suggest excluding transactions preceded by an acquisition from an external party or followed by (or conditional on) a sale of the combining entities to an external party from the project's scope.

9. Most respondents suggest also covering:
   (a) the receiving entity's reporting in its separate financial statements for an investment in a subsidiary received in a common control transaction;
   (b) the reporting by other entities—most commonly the transferring entity; and/or
   (c) other common control transactions (such as transfers of investments in associates between entities under common control).

10. Some respondents suggest covering the matters discussed in paragraph 9 by expanding the scope of the BCUCC project whilst others suggest covering these matters in a separate project(s) to avoid delaying the BCUCC project.

Feedback

11. Eighty-six comment letters include feedback on the preliminary views about scope. We also received feedback through outreach meetings with stakeholders. Our analysis summarises separately feedback on:
   (a) transitory control (paragraphs 13–17);
   (b) group restructurings (paragraphs 18–21);
   (c) separate financial statements (paragraphs 22–26);
   (d) reporting by other entities (paragraphs 27–32); and
   (e) other common control transactions (paragraphs 33–35).

12. Many respondents ask the IASB to clarify particular terms and aspects of the preliminary view. Appendix A summarises these requests.

Transitory control

Background

13. Paragraph 1.16 of the Discussion Paper says:

> In describing business combinations under common control, IFRS 3 requires that common control is 'not transitory' but does not provide guidance on that notion[3]. Some stakeholders have raised questions about the meaning of 'transitory control', for example, in submissions to the IFRS Interpretations Committee. Those questions arise when considering whether particular combinations are outside the scope of IFRS 3. The [IASB] has not yet considered whether to clarify the meaning of 'transitory control' because the outcome of this project could lead to the [IASB] modifying or removing the scope exclusion in IFRS 3. However, in the light of those application questions, the [IASB] has reached the preliminary view that its proposals should cover all transfers of businesses in which all of the combining companies are ultimately controlled by the same party, irrespective of whether the transfer is:
>
> (a) preceded by an acquisition from an external party or followed by a sale of one or more of the combining companies to an external party (that is, a party outside the group); or
>
> (b) conditional on a sale of the combining companies to an external party, such as in an initial public offering (see Example 4 in Appendix B [to the Discussion Paper]).

Feedback

14. Almost all respondents agree with the preliminary view to develop proposals that cover transactions preceded by an acquisition from an external party or followed by (or conditional on) a sale of the combining companies to an external party. They say doing so would reduce diversity in accounting for these transactions.

[3] Paragraph B1 of IFRS 3 says '… A business combination involving entities or businesses under common control is 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.'

15. A few respondents disagree with this preliminary view. These respondents say the substance of such transactions is similar to business combinations within the scope of IFRS 3 and accordingly, these transactions should be in the scope of IFRS 3. One national standard-setter says IFRS 3 already defines the scope of BCUCCs and this has been applied well in its jurisdiction.

16. Respondents also:

    (a) suggest clarifying the notion of transitory control if the IASB decides to retain the notion in IFRS 3 (many respondents);

    (b) say the preliminary view could result in unintended consequences or create opportunities for accounting arbitrage (some respondents)—see paragraph 17 for examples; and

    (c) suggest removing the notion of 'transitory control' from IFRS 3 (one national standard-setter).

17. Respondents provide examples of BCUCCs that could result in unintended consequences or create opportunities for accounting arbitrage as follows:

    (a) a wholly-owned receiving entity could avoid applying the acquisition method when it acquires a business from an external party by having another group entity acquire the business and then undertaking a BCUCC (applying the preliminary views, the receiving entity would apply the book-value method using the transferred entity's book values)[4]; and

    (b) a new holding entity set up to acquire a business would be within the project's scope if it were set up by an entity selling a business to a party outside the group prior to the sale and not in the project's scope if it were set up by the entity acquiring the business (in which case the new holding entity would apply IFRS 3 when it acquires the business).

[4] Respondents raise similar concerns when commenting on the IASB's preliminary view on requiring a receiving entity to use the book values of the transferred business. Those comments will be presented to the IASB at a future meeting together with other feedback on the IASB's preliminary views on applying a book-value method.

Group restructurings

Background

18. Paragraph 1.15 of the Discussion Paper says:

> The project is also considering transactions—sometimes called group restructurings—that involve a transfer of a business under common control but do not meet the definition of a business combination in IFRS 3. For example, some transactions might not meet that definition if they involve transferring a business to a newly established parent company. The [IASB] has reached a preliminary view that it should develop proposals on all transfers of a business under common control, even if the transfer does not meet the definition of a business combination in IFRS 3 (see Example 3 in Appendix B [to the Discussion Paper]). For simplicity, this Discussion Paper uses the term 'business combination under common control' to refer to all such transfers.

Feedback

19. Almost all respondents agree with the preliminary view that the proposals should cover reporting for all transfers of a business under common control including group restructurings. They say doing so would reduce diversity in accounting for these transactions. One accountancy body disagrees with the preliminary view and says, for consistency with IFRS 3's definition of business combinations, the project should cover only those transactions that meet that definition.

20. Some respondents requested clarifications as follows:

    (a) some of these respondents say the Discussion Paper does not clearly define group restructurings and request clarification or application guidance. They ask whether particular transactions would be 'group restructurings' and therefore in the scope of the project, including for example:

        (i) forming a new entity at the top of an existing group for purposes of restructuring without changing shareholders' ultimate ownership interests;

(ii) amalgamation of two businesses under common control into a single entity in which there is no clear receiving entity or transferred business; and

(iii) a 'hive-up' transaction in which the business in a subsidiary is transferred to a parent.

(b) one respondent says including group restructurings in the scope of the project could give rise to some application challenges that the IASB would need to clarify—for example in applying the acquisition method to transactions that are not business combinations as defined by IFRS 3.[5]

21. One accountancy body suggests addressing group restructurings as a separate project if keeping them within the scope of the project would be likely to delay the project.

Separate financial statements

Background

22. As explained in paragraphs 1.20–1.23 of the Discussion Paper, in general, the project addresses how a receiving company should report transfers of businesses under common control in its consolidated financial statements. If the combination involves the transfer of an unincorporated business, the possible reporting requirements developed in this project would also apply in other types of financial statements prepared by the receiving company such as its separate financial statements. However, the project is not addressing how a receiving company should report in its separate financial statements an investment in a subsidiary received in a common control transaction. That topic is addressed by IAS 27 *Separate Financial Statements*.

Feedback

23. Most respondents agree with the preliminary view.

24. Some respondents disagree with the preliminary view and suggest addressing the receiving company's reporting in its separate financial statements for an investment in a subsidiary received in a common control transaction. Of these respondents:

[5] We will present feedback on applying the acquisition method at a future meeting.

(a) many acknowledge IFRS 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 others 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.

25. A few of the respondents in paragraph 24 suggest addressing the receiving entity's reporting in its separate financial statements for an investment in a subsidiary received in a common control transaction as part of the BCUCC project. They say a BCUCC should be measured consistently at fair value or book value in the separate and consolidated financial statements of the receiving entity.

[6] In the past, some stakeholders have raised questions about the meaning of 'cost' in IAS 27 (not specifically for common control transactions), for example, in submissions to the IFRS Interpretations Committee.

26. However, many of the respondents in paragraph 24 suggest undertaking a separate project to address the receiving entity's reporting in its separate financial statements for an investment in a subsidiary received in a common control transaction and other common control transactions (see paragraphs 33–35).

Reporting by other entities

Background

27. As explained in paragraphs 1.17–1.19 of the Discussion Paper, the project considers reporting requirements for the receiving entity in a BCUCC. The project does not consider reporting requirements for other entities involved in the BCUCC. The Discussion Paper notes IFRS Standards already contain requirements for other entities involved in BCUCC as follows:

   (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.

Feedback

28. Most respondents agree with the preliminary view. However, as explained in paragraphs 29–32, some respondents suggest also considering the reporting by other entities involved in the BCUCC.

Transferring entity

29. Some respondents suggest also addressing a transferring entity's reporting of a BCUCC.

   (a) a few acknowledge IFRS 10 includes requirements for the transferring entity's reporting but say those requirements could result in not faithfully representing the economic substance of the transaction. They say 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 say 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.

(b) a few others say IFRS standards (such as IFRS 10, IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, IAS 27 and IFRIC 17 *Distributions of Non-cash Assets to Owners*) do not provide sufficient guidance for the transferring entity's reporting. For example, Deloitte Touche Tohmatsu Limited says:

> …the [IASB] may want to consider whether the distribution of a business under common control should also be brought into the scope of the project. These transactions are currently also subject to a 'common control' scope exclusion (from IFRIC 17) and may be the corresponding transaction for the transferor in a BCUCC…

30. These respondents suggest 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.

31. A few respondents raise similar questions about the reporting by the transferring entity but suggest addressing the reporting by the transferring entity as a separate project to avoid delaying the BCUCC project.

Controlling party

32. A few respondents suggest exploring the effects of, and providing guidance on, the reporting of a BCUCC in the separate and/or consolidated financial statements of the ultimate controlling party, either as part of the BCUCC project or a separate project.

Other common control transactions

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 between entities under common control;

    (b) transfers of investments in joint ventures and joint operations between entities under common control; and

    (c) transfers of assets that are not businesses between entities under common control.

34. These respondents say IFRS 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. Some of the respondents who comment on other common control transactions suggest addressing these transactions as a separate project to avoid delaying the BCUCC project. One respondent suggests not addressing these transactions to ensure the scope of the project remains manageable.

Question for the IASB
Does the IASB have any questions or comments on the feedback discussed in this paper? Specifically:

(a) is there any feedback that is unclear?

(b) are there any points you think the IASB did not consider in developing the Discussion Paper but should consider in the re-deliberations?

(c) are there any points you would like staff to research further for re-deliberations?

Appendix A—Clarification requests

A1. The table below summarises requests to clarify specific terminology or aspects of the IASB's preliminary views on scope.

Feedback topic	Details (if specified)
1. Use of the phrase 'business combinations under common control' in Discussion Paper	Respondents say using the term 'business combinations under common control' to also include transfers that do not meet the definition of a business combination (such as group restructurings) is confusing—they suggest using the phrase 'transfers of a business under common control' instead.
2. Use of the term 'company' in Discussion Paper	Respondents say using the term 'company' could be confusing because the project also addresses transfers of an unincorporated business and suggest using 'entity' or 'business' instead.
3. Meaning of 'transfer of a business' as used in the Discussion Paper	Respondents ask whether the transfer of an ownership interest in an entity under common control which on its own does not constitute a transfer of a business from the transferor's perspective (such as a transfer of 30% interest in an entity to another entity that already owned 30% in that entity—that is, a business combination achieved in stages as described in paragraph 41 of IFRS 3) is a 'transfer of a business' and therefore within the scope of the project?
4. Meaning of 'BCUCC' in IFRS 3	Respondents ask whether some transactions such as a distribution of dividend to an entity under common control when there is a transfer of a business involved meets the definition of a business combination under common control in IFRS 3[7].
5. Transactions with common ownership or joint control	Paragraph 1.16 of the Discussion Paper refers to ultimate control by the same 'party' (see paragraph 13 of this paper). Respondents ask whether:

[7] See paragraph 13 of this paper.

Feedback topic	Details (if specified)
	(a) the intention of the IASB is to limit the scope of its project to transactions in which there is ultimately a single controlling party (a single individual or entity); and (b) the following transactions are in scope of the project: (i) common ownership transactions, that is transactions in which the receiving entity and the transferring entity are held by the same group of shareholders who do not collectively control the entities[8] and who may have differing ownership interests in the receiving and transferring entities; and (ii) transfer of an entity in which all of the combining entities are ultimately under *joint control* by the same parties both before and after the transfer is a transfer under common control.
6. Multiple arrangements or single arrangements with more than one transaction	One respondent suggests providing guidance to support the assessment of whether a single arrangement includes more than one transaction and when multiple arrangements should be combined as a single transaction. The respondent says this guidance would help ensure a transfer of a business is not artificially broken into multiple transfers of assets. It says the existing guidance in IFRS 3, on transactions that are separate from a business combination, and in IFRS 10 and other IFRS Standards on arrangements that should be combined, may be relevant.
7. Separate financial statements —impairment	One respondent asks whether a parent 'hiving up' the business in a subsidiary is an indicator of impairment for its investment in the subsidiary from the perspective of separate financial statements.

[8] Paragraph B2 of IFRS 3 says 'a group of individuals shall be regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities...'

Feedback topic	Details (if specified)
8. Determining what is a 'business'	One respondent asks whether, for consistency with IFRS 3, the use of the optional concentration test in IFRS 3[9] is permitted in determining whether the acquired set of activities and assets is not a business?
9. Investment entities	The comment letter from CPA Australia and Chartered Accountants Australia and New Zealand says: The DP does not contemplate BCUCC that may arise within a group whose ultimate controlling parent meets the definition of an 'Investment Entity' under IFRS 10 *Consolidated Financial Statements* and is subject to the Investment Entity exception from preparing consolidated financial statements under that standard. While we have not received any feedback in respect of BCUCC that may arise in such circumstances, we suggest the [IASB] considers this aspect.

[9] Paragraphs B7A–B7C of IFRS 3.