



Memorandum

To:	AASB members	Date:	1 July 2014
From:	Kala Kandiah	Agenda Item:	7.1 (M139)
Subject:	Stapling Arrangements - Review of IFRS IC Agenda Decision	File:	

Action

Decide whether to take any further action on the issue of accounting for business combinations achieved by contract alone, in light of the IFRS Interpretations Committee's (the Committee's) Final Agenda Decision – identification of the acquirer in accordance with IFRS 3 *Business Combinations* and the parent in accordance with IFRS 10 *Consolidated Financial Statements* in a stapling arrangement.

Background

- 1 The AASB wrote to the Committee in September 2013 seeking clarification on the accounting for a business combination achieved by contract alone.¹ The below extract from the AASB comment letter to the Committee in September 2013 summarises the AASB's request for clarification:

We are writing to seek clarification of the IFRS Interpretation Committee's position on the interaction of the IFRS 3 *Business Combinations* requirement for entities to identify an acquirer, with the requirement in IFRS 10 *Consolidated Financial Statements* for entities to prepare consolidated financial statements when control exists.

Specifically, we are seeking clarification as to whether, in circumstances where an acquirer has been identified for a business combination achieved by contract alone, such as in a stapling arrangement, with no entity/party to the business combination having 'control' over the other entities, the 'acquirer' is the parent for the purposes of preparing consolidated financial statements under IFRS 10.

- 2 In response, the Committee issued a Tentative Agenda Decision in January 2014.² At its February 2014 meeting, the AASB decided to write to the Committee expressing its support for the Committee's Tentative Agenda Decision³ and reiterating in its submission that the issue is not confined to stapling arrangements alone. Consequently, the AASB's submission

1 http://www.aasb.gov.au/admin/file/content102/c3/Letter_IFRS_IC-combination_by_contract_consolidation_11_9_13.pdf
(accessed 5 June 2014)

2 <http://media.ifrs.org/2014/IFRIC/January/IFRIC-Update-January-2014%20V2.pdf> (accessed 5 June 2014)

3 http://www.aasb.gov.au/admin/file/content102/c3/AASB_Minutes_M136_13_February_2014_unsigned.pdf
(accessed 5 June 2014)

encouraged the Committee to document other types of business combinations achieved by contract alone in the decision. The below extract from the submission summarises the AASB comment letter to the Committee in February 2014:⁴

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.

IFRS Interpretations Committee meeting – May 2014

- 3 The Committee issued the following Final Agenda Decision outlining the reasons for not adding the issue to its agenda in the May 2014 *IFRIC Update*:⁵

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 (as revised in 2008) for identifying an acquirer with the requirements in IFRS 10 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

⁴ http://www.aasb.gov.au/admin/file/content102/c3/M137_3.7_Ltr_IFRS_IC_tentative_decision_IFRS3_IFRS10_stapling_arrangements_19_Feb_2014.pdf (accessed 5 June 2014)

⁵ <http://media.ifrs.org/2014/IFRIC/May/IFRIC-Update-May-2014.pdf> (accessed 5 June 2014)

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 IFRS 3 (as revised in 2008) requires that one of the combining entities in a business combination must be 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 IFRS 3 (as revised in 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 are 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 the IASB Update for 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.

4 [deleted from public version of the memo]

Options on further action to be taken by the AASB Board

5 AASB staff have identified four options for how the Board could address the accounting for business combinations achieved by contract alone in light of the Committee’s Agenda Decision.

(a) Issue an AASB Agenda Decision⁶

As the Committee's Agenda Decision is focussed on stapling arrangements, the AASB could issue a broader Agenda Decision that captures other types of business combinations achieved by contract alone. The AASB could make it clear in its Agenda Decision that:

- the definition of a business combination in AASB 3 *Business Combinations* includes transactions in which none of the combining entities obtains control of the other combining entities, for example in business combinations achieved by contract alone including stapling arrangements; and
- the combining entity that is identified as the acquirer in such transactions for the purpose of AASB 3 should prepare consolidated financial statements of the combined entity in accordance with AASB 10 *Consolidated Financial Statements*.

The above action would help avoid any diversity in practice within Australia arising when accounting for business combinations achieved by contract alone.

(b) Issue an AASB Interpretation

The Board could issue an Australian Interpretation on the issue to make it explicitly clear that:

- the definition of a business combination in AASB 3 *Business Combinations* includes transactions in which none of the combining entities obtains control of the other combining entities, for example in business combinations achieved by contract alone including stapling arrangements; and
- the combining entity that is identified as the acquirer in such transactions for the purpose of AASB 3 should prepare consolidated financial statements of the combined entity in accordance with AASB 10 *Consolidated Financial Statements*.

The above action would provide authoritative guidance for entities preparing general purpose financial statements in Australia and would help avoid any diversity in practice arising within Australia.

(c) Capture the AASB views on the Committee's Agenda Decision in an Australian context in the AASB minutes

The Board could capture its views on the Committee's Agenda Decision in an Australian context in the AASB minutes, noting that the Agenda Decision would be relevant to other types of business combinations achieved by contract alone as well. This would, albeit in a non-authoritative manner, make it clear to constituents that the Committee's

⁶ Guidance to issuing an AASB Agenda Decision or an AASB Interpretation is in the Interpretations and Improvements Model document http://www.aasb.gov.au/admin/file/content102/c3/AASB_Interpretations_and_Improvements_Model_Feb_2012.pdf.

Agenda Decision would be relevant to other types of business combinations achieved by contract alone as well.

- (d) Not take any further action at this stage and direct staff to continue monitoring the issue

Although the Committee's Agenda Decision is focussed on stapling arrangements, it could be applied by analogy to other types of business combinations achieved by contract. On that basis, the Board could decide not to take any further action at this stage and direct staff to continue monitoring the issue.

AASB staff recommendation

- 6 AASB staff consider that the Committee's Agenda Decision clearly addresses the issue of (i) accounting for a business combination and (ii) preparation of consolidation financial statements for a stapling arrangement when no entity/party to the business combination has 'control'.
- 7 Although AASB staff acknowledge that the Committee's Agenda Decision refers specifically to only one example – stapling arrangements, AASB staff consider that the Committee's Agenda Decision provides sufficient guidance, by analogy, on accounting for other types of business combinations achieved by contract alone.
- 8 AASB staff do not expect diversity in practice to arise in Australia, particularly as the Committee's Agenda Decision refers to stapling arrangements (which is a common type of business combination achieved by contract alone in Australia). AASB staff also note that the issue of accounting for business combinations achieved by contract alone is not an Australian specific issue and that the AASB considers that a unique domestic interpretation of IFRS would be warranted only in rare and exceptional circumstances⁷.
- 9 Consequently, consistent with the AASB's policy of verbatim IFRS adoption with minimal Australian specific guidance, AASB staff recommend that the Board does not take any further action at this stage and direct AASB staff to continue monitoring the issue (option (d) in paragraph 5).

Question 1 for the Board

Does the Board agree with the staff recommendation in paragraph 9 above?

⁷ Refer to part (b) on page one of the AASB's Interpretations and Improvements Model → http://www.aasb.gov.au/admin/file/content102/c3/AASB_Interpretations_and_Improvements_Model_Feb_2012.pdf.