

TREASURY ANALYSIS – INTERNATIONAL ACCOUNTING STANDARDS

AASB 3 “Business Combinations” and AASB 2005-6 replace AAS 18 “Accounting for Goodwill” and AAS 21 “Acquisition of Assets”

Major impact of changes

- Business combinations involving entities or businesses under common control are excluded from the scope of AASB 3 (as a result of amendments by AASB 2005-6).
- Goodwill cannot be amortised. Instead, it is subject to an annual impairment test under AASB 136 *Impairment of Assets*.
- Discount on acquisition is immediately recognised as revenue.
- Fair value of assets acquired includes intangible assets and contingent liabilities of the acquiree.

Key features of Standard

- AASB 3 *Business Combinations* consolidates and substantially replicates the requirements of AAS 18 *Accounting for Goodwill* and requirements in AAS 21 *Acquisition of Assets* in respect of business combinations, except for the matters discussed in main differences below.
- AASB 2005-6 limits the scope of AASB 3 by excluding business combinations involving entities or businesses under common control. This Standard has been early adopted in the NSW public sector to apply from 2005/06. Therefore, this Treasury Analysis is based on AASB 3, as amended by AASB 2005-6.

Main differences compared to previous Australian requirements

Impairment of goodwill

- Under AASB 3, after initial recognition, goodwill shall be tested for impairment annually by applying AASB 136 *Impairment of Assets* (para 54).
- However, amortisation of goodwill, previously required under AAS 18, is prohibited under AASB 3 (para 55).

Discount on acquisition

- Where the acquirer’s interest in the net fair value of acquiree’s identifiable assets, liabilities and contingent liabilities exceeds cost, the acquirer must reassess the identification and measurement of cost. Any remaining excess shall be recognised immediately as income (AASB 3 para 56). Previously, under AAS 18, a discount on acquisition was recognised by proportionately reducing the fair value of assets acquired, with any remaining balance recognised as income.

Fair Value of Net Assets Acquired

- Intangible assets and contingent liabilities of the acquiree are recognised as part of the fair value of the net assets acquired if the fair value can be measured reliably (para 37). Here probability is a factor in measuring the intangible asset or contingent liability (instead of a recognition criterion). This approach in AASB 3 is inconsistent with AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* and was not permitted prior to AEIFRS adoption. The IASB argues that the acquirer has paid a reduced/(increased) price because of the existence of the contingent liability/(intangible asset).

The Scope of AASB 3 is more narrow

- AASB 3's generic requirements have a more limited scope than AAS 21, because AASB 3 only applies to 'business combinations' (para 1). This is defined in Appendix A as follows:
 - *Business combination* is "the bringing together of *separate entities or businesses* into one reporting entity" (AASB 3 Appendix A). In turn,
 - *Business* is then defined as "*an integrated set of activities and assets* conducted...for the purpose of providing:
 - (a) a return to investors, or
 - (b) lower costs or other economic benefits directly to...participants.A business generally consists of inputs, processes...and resulting outputs...to generate revenues."
 - But, if an acquisition is not a business combination, AASB 3 para 4 requires the acquisition cost to be allocated between the assets acquired.

Business combinations involving entities under common control

- AASB 3, as amended by AASB 2005-6, excludes from its scope "*business combinations involving entities or businesses under common control*". Previously, AAS 21 allowed assets acquired as part of a reconstruction within an economic entity to be measured either at fair value or at their carrying amounts determined in accordance with Accounting Standards immediately prior to the reconstruction within an economic entity.

Impact on the public sector

- AASB 3, as amended by AASB 2005-6, has limited application to the public sector, as it excludes business combinations involving entities under common control. Instead, reconstructions within the NSW public sector are addressed as part of UIG Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities*. UIG 1038 clarifies when a contribution is a contribution by owners and allows contributions to be designated as contributions by owners.
- Further, Treasury Policy Paper TPP 06-7 *Contributions by Owners Made to Wholly-Owned Public Sector Entities* designates certain transfers of assets / liabilities as contributions by owners. The Policy provides that transfers must be valued at fair value, except transfers of assets between AAS 29 government departments, which can be measured at their carrying amounts determined immediately prior to the reconstruction. This is consistent with previous practice (& NSWTC 01/11 which is now superseded).

Policy and Implementation issues (see attached)

Mandating Options

- AASB 1 *First-time Adoption of AEIFRS* provides that an entity may elect not to apply AASB 3 retrospectively. Treasury has mandated the exemption - ie agencies will be required not to apply AASB 3 to past business combinations.
- AASB 2005-06, which amends AASB 3 to exclude business combinations involving entities under common control, applies to annual reporting periods beginning on or after 1 January 2006, with early adoption permitted. Treasury has mandated that AASB 2005-6 must be early adopted from 2005/06 (refer NSWTC 06/14). This means that reconstructions within the public sector are accounted for in accordance with UIG 1038 and TPP 06-7.

This summary has been written in general terms and is intended for general reference only. Agencies should review the contents of the AASB Standard to determine its application in particular circumstances.

ATTACHMENT
SUMMARY OF POLICY, IMPLEMENTATION & SYSTEM ISSUES
AASB 3 “BUSINESS COMBINATIONS”
TREASURY & AGENCIES

	Issue	Treasury Policy		System/ Implementation Issue	Mandate Options for GFS Harmonisation	Budget / Total State Sector Issue
		Mandate Option	Additional Guidance			
1	AASB 1 <i>First-time Adoption of AEIFRS</i> provides that an entity may elect not to apply AASB 3 retrospectively. Treasury has mandated the exemption - ie agencies will be required not to adopt AASB 3 to past business combinations.	✓				
2	AASB 2005-6 applies to annual reporting periods beginning on or after 1 January 2006, with early adoption permitted.	✓ Early adopt				