Australian Government

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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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Dear David

ED of Proposed Amendments to IFRS 3 *Business Combinations* – Combinations by Contract Alone or Involving Mutual Entities

Thank you for the opportunity to comment on the ED of Proposed Amendments to IFRS 3 *Business Combinations* – Combinations by Contract Alone or Involving Mutual Entities ("the ED").

The AASB issued the ED in June 2004 in Australia with an Australian Preface as ED 133 *Request for Comment on IASB ED of Proposed Amendments to IFRS 3* Business Combinations – *Combinations by Contract Alone or Involving Mutual Entities* and encouraged Australian constituents to respond to the IASB, with copies of those responses to the AASB. The AASB has prepared its comments after having considered Australian constituents' comments on ED 133.

The AASB is generally supportive of the proposals within the ED. However, we have a number of concerns, including:

- the requirement to prepare financial statements of the combined entities when none of the combining entities has obtained control of the other entities; and
- the preparation of financial statements which present business combinations by contract alone or involving mutual entities that were effected prior to the effective date of the proposed amendments.

These and other concerns of the AASB are explained below in the AASB responses to the IASB specific questions.

Yours sincerely

David Boymal
Chairman

1. IASB SPECIFIC QUESTIONS

Question 1 – Scope

The Exposure Draft proposes:

(a) to remove from IFRS 3 the scope exclusions for business combinations involving two or more mutual entities and business combinations in which separate entities are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest.

(b) to require the acquirer to measure the cost of a business combination as:

(i) the aggregate of the following amounts when the combination is one in which the acquirer and acquiree are both mutual entities:

- *the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities; and*
- *the fair value, at the date of exchange, of any assets given, liabilities incurred or assumed, or equity instruments issued by the acquirer in exchange for control of the acquiree.*

Therefore, goodwill would be recognised in the accounting for such transactions only to the extent of any consideration given by the acquirer in exchange for control of the acquiree.

(ii) the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities when the combination is one in which separate entities or businesses are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest. Therefore, no goodwill would arise in the accounting for such transactions.

Is this an appropriate interim solution to the accounting for such transactions until the Board develops guidance on applying the purchase method to such transactions as part of a subsequent phase of its Business Combinations project? If not, what other approach would you recommend as an interim solution to the accounting for such transactions, and why?

AASB response:

The proposal to remove from IFRS 3 the scope exclusions for combinations by contract alone or involving mutual entities is supported. However, the AASB has a number of concerns regarding the application of this proposal.

1. Requirement to prepare financial statements for the combined entities when none of the combining entities has obtained control of the other entities

In order for business combination accounting to be effective, financial statements that present the combining entities as a single economic entity are necessary. When one of the combining entities obtains control of the other combining entities, this is ultimately achieved via the preparation of consolidated financial statements in accordance with IAS 27 *Consolidated and Separate Financial Statements*. However, when none of the combining entities obtain control of the other combining entities, this raises the question as to which Standard/Interpretation actually requires the preparation of financial statements for the combined entity (because, given the absence of control, consolidated financial statements are not required to be prepared).

This is of particular concern to the AASB given the prevalence of "stapled securities" within Australia. Stapled securities refers to the situation where, for example, some legal entities (commonly a company) listed on the Australian Stock Exchange have issued equity securities which are combined with ("stapled" to) the securities issued by another legal entity (often a trust). In these cases one entity has not acquired, and does not control, the other entity and the separate legal entities have not been combined into a new legal entity. The stapled securities cannot be traded or transferred independently and are quoted at a single price (the stapling of the equity securities of two or more legal entities results in those entities having equity holders in common).

The Australian Accounting Standard that deals with business combinations, AASB 1015 *Acquisitions of* Assets, does not apply to stapled securities because an acquisition has not taken place. In addition, the Australian Accounting Standard dealing with consolidations, AASB 1024 *Consolidated Accounts*, is not applicable because an entity has not obtained control of the another entity.

Currently in Australia, UIG Abstract 13 *The Presentation of the Financial Report of Entities Whose Securities are "Stapled"* ("UIG 13") states that a reporting entity is created when the equity securities of two or more legal entities are issued as a stapled security. UIG 13 also requires the preparation of combined financial statements and explains how these are prepared.

The UIG 13 requirement to prepare combined financial statements is similar to the requirement in the superseded IAS 22 *Business Combinations* to prepare "financial statements of the combined [entity]" where a business combination was a uniting of interests. IAS 22 also contained some guidance as to how these financial statements were to be prepared.

Stapled securities will ultimately be classified as combinations by contract alone and under the proposed amendments to IFRS 3 subject to business combination accounting. This will require the identification of an acquirer (effectively a "deemed" acquirer since none of the combining entities has ultimately obtained control of the other in the stapling). However, in the absence of a Standard/Interpretation akin to UIG 13 or IAS 22 (to the extent it related to unitings of interests) requiring combined financial statements, a question arises as to which financial statements ultimately present the business combination accounting (since IAS 27 only applies where the transaction/event gives rise to a parent-subsidiary relationship).

Some may argue that the reporting entity concept alone requires the preparation of combined financial statements. However the AASB does not consider this to be sufficient and believes that the requirement to prepare such financial statements should be clearly articulated (similar to the requirement for a parent to prepare consolidated financial statements in IAS 27).

The AASB believes that this can be achieved in a number of ways, for example:

(a) articulating that the entity identified as the "deemed" acquirer for the purpose of applying the purchase method is also identified as the "deemed' parent, in which case it would be required to prepare consolidated financial statements in accordance with IAS 27; or

(b) including a requirement within IFRS 3 for financial statements to be prepared for the combined entities (that is, similar to the requirement in UIG 13 and the superseded IAS 22 in the context of unitings of interests).

The AASB believes the latter to be the preferred approach. This is because identification of a "deemed" parent is inconsistent with the definition of parent/control within IAS 27 (as is the case in many staplings, none of the combining entities actually obtain control over the other(s)).

In addition to requiring the preparation of financial statements for the combined entities, IFRS 3 should also prescribe the manner in which these financial statements are to be prepared, for example:

- the consistency of accounting policies;
- the treatment of inter-entity transactions and balances; and
- the treatment of any consideration exchanged to effect the combination (see also 3. below).

This could be achieved by requiring the application of consolidation procedures within IAS 27.

2. Preparation of financial statements which present business combinations by contract alone or involving mutual entities that were effected prior to the effective date of the proposed amendments

Following on from the discussion in 1. above, the AASB believes it is necessary to provide guidance on the preparation of financial statements for the combined entities for combinations effected prior to the effective date of the proposed amendments (particularly where those combinations did not give rise to a parent-subsidiary relationship).

Assuming the IASB adopt the approach identified in 1(b) above, the AASB believes it necessary to state that the requirement to prepare financial statements for the combined entities is also applicable to combinations effected prior to the effective date of the proposed amendments (this will ensure that such financial statements are prepared for all such combinations regardless of when they occurred).

Further, given the fact that these combinations are not subject to the proposed amendments, guidance should be provided indicating that financial statements of each of the combined entities would not be subject to any fair value adjustments for the purpose of preparing the financial statements of the combined entities.

Question 2

The Exposure Draft proposes that no amendments be made to the transitional and effective date requirements in IFRS 3. This would have the effects set out in paragraph 6(a)-(c) above on the accounting for business combinations in which the acquirer and acquiree are both mutual entities or in which separate entities or businesses are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest.

Is this appropriate? If not, what transitional and effective date arrangements would you recommend for such business combinations, and why?

AASB response:

This proposal is supported.