

Invitation to Comment

March 2005

The Definition of “Contribution by Owners”

Prepared by the
Australian Accounting Standards Board



Australian Government

**Australian Accounting
Standards Board**

Commenting on this Invitation to Comment

The AASB is seeking comment on a proposed amendment to the reference to contribution by owners in AASB 3 *Business Combinations*. Constituents are encouraged to respond to the AASB by 22 April 2005. Comments should be addressed to:

The Chairman
Australian Accounting Standards Board
PO Box 204, Collins St West Vic 8007
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E-mail: standard@asb.com.au

A copy of all non-confidential submissions will be placed on public record on the AASB's web site: www.aasb.com.au.

Obtaining a Copy of this Invitation to Comment

This Invitation to Comment is available on the AASB's web site www.aasb.com.au. Alternatively, any individual or organisation may obtain one printed copy of this Invitation to Comment without charge until 22 April 2005 by contacting:

The Customer Service Officer	Phone: (03) 9617 7637
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Purpose of this Invitation to Comment

The AASB issued AASB 3 *Business Combinations* in July 2004. The AASB has become aware of some concerns that the presence of the Australian definition of “contribution by owners” in AASB 3 appears to create inconsistencies with International Financial Reporting Standards (IFRSs). The AASB has considered various options for dealing with these concerns and has reached a preliminary conclusion on amendments to AASB 3 that it plans to reissue in May 2005 and that would take effect immediately. The AASB is seeking comments from constituents before it finalises these amendments.

Background

Business Combinations

In the process of making AASB 3 the AASB noted:

- (a) IFRS 3 *Business Combinations* does not apply to a business combination of entities (or operations of entities) under common control;
- (b) AASB 1015 *Acquisitions of Assets* prescribes the use of the purchase method for these business combinations; and
- (c) the history behind AASB 1015, including the Parliamentary disallowance of paragraphs that would have permitted the use of carrying amounts.

The AASB decided to amend the scope of AASB 3 and require business combinations for entities under common control to use the purchase method, as was previously required by AASB 1015.

AASB 3 paragraph 56 articulates the accounting required for the excess of an acquirer’s interest in the net fair value of an acquiree’s identifiable assets, liabilities and contingent liabilities over cost. As a consequence of its decision to amend the scope of AASB 3, the AASB added paragraph Aus56.1 to articulate the treatment of a business combination of entities under common control for the excess of an acquirer’s interest and include a definition of contribution by owners from the version of AASB 1004 *Revenue* issued in June 1998. Paragraph Aus56.1 reads as follows:

Aus56.1 Notwithstanding paragraph 56, in respect of business combinations involving entities or businesses within the same reporting entity, if the acquirer’s interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with

paragraph 36 exceeds the cost of the business combination, the acquirer shall recognise the excess as:

- (a) a contribution by owners, when and only when it satisfies the definition of contribution by owners; and
- (b) a gain in any other case.

AASB 3 Appendix A contains the definition of contribution by owners:

future economic benefits that have been contributed to the entity by parties external to the entity, other than those which result in liabilities of the entity, that give rise to a financial interest in the net assets of the entity which:

- (a) conveys entitlement both to distributions of future economic benefits by the entity during its life, such distributions being at the discretion of the ownership group or its representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or
- (b) can be sold, transferred or redeemed.

Some commentators consider since IFRS 3 does not apply to a business combination of entities under common control, that the meaning ascribed to equity under the IFRS *Framework* should apply. This might require equity treatment for a discount on acquisition arising in a step-up acquisition for consolidation purposes. However, the discount on acquisition may not meet the definition of contribution by owners in AASB 3, and commentators have claimed this would effectively require the discount to be recognised in profit or loss.

Share-based Payment

Although the term contribution by owners is defined in AASB 3, it may be applied more broadly, for example, to share-based payment transactions in situations where a subsidiary entity receives services from its employees as consideration for equity instruments of the entity's parent provided to those employees. When the subsidiary does not pay the parent for the equity instruments, the current International Financial Reporting Interpretations Committee (IFRIC) view expressed at recent meetings of IFRIC is that the subsidiary has received an equity contribution. Some commentators have advised the AASB that they consider that the definition of contribution by owners might be used to prevent the recognition in the financial statements of the subsidiary of such an increase in its equity.

Tax Consolidation

The Urgent Issues Group (UIG) has been addressing the classification of tax-consolidation related transactions between the head entity in the tax consolidated group and a wholly-owned subsidiary. These transactions include the head entity's assumption of the current tax obligations of the subsidiary and any transactions under a tax funding arrangement between entities in a group. The AASB has become aware of the UIG's view that, in the context of tax consolidation, the transactions between the head entity and wholly-owned subsidiaries would not normally result in the establishment of a financial interest in the net assets of the subsidiaries under the definition of contribution by owners, and thus would not be able to be classified as equity.

The Four Options

As a result of the representations noted above, the AASB has considered four options for dealing with the issue.

1. Do nothing.

Given the risk that the treatments currently required in Australia might diverge from the approach required under IFRSs, the AASB does not consider option 1 to be viable.

2. Alter the definition of contribution by owners to address the identified difference in accounting.

In the context of the IASB work on its accounting concepts project, that includes addressing the elements, a new definition of contribution by owners may prove to be problematic. Accordingly, the AASB does not consider option 2 to be viable.

3. Delete the definition of contribution by owners and rewrite AASB 3 paragraph Aus56.1, AASB 1004 *Contributions* and UIG Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities* using generic language that does not create potential inconsistencies with IFRSs.

The AASB considers that the use of generic language would make AASB 1004 and Interpretation 1038 more difficult to understand, particularly since the contribution by owners definition is now widely used and understood in the public sector and among not-for-profit entities generally. Accordingly, the AASB does not consider option 3 to be viable.

4. Delete the definition of contribution by owners from AASB 3 and rewrite AASB 3 paragraph Aus56.1 to make it consistent with the

accounting under IFRSs, but retain the definition in AASB 1004 and Interpretation 1038.

The AASB considers this option enables for-profit entities to be quarantined from the potential for inconsistencies that might flow from the definition of contribution by owners whilst retaining the usefulness of the definition for not-for-profit entities. An amendment to AASB 3 would ensure that the accounting treatment required of a business combination of entities under common control, is the accounting treatment that would be available under the *Framework*. Under this proposal, AASB 1004 which applies only to not-for-profit entities and Interpretation 1038 which applies only to public sector entities would continue to contain the requirements for contributions and continue to carry the contribution by owners definition.

AASB Preliminary Conclusions

The AASB proposes to remove the definition of contribution by owners from Appendix A, AASB 3 and amend paragraph Aus56.1.

The AASB acknowledge that Option 4 does not overcome the potential for non-compliance with IFRSs by not-for-profit entities that might arise from retaining the definition in AASB 1004. A potential risk with Option 4 is that not-for-profit entities might not be able, even if they wished, to recognise equity for:

- (i) a reconstruction within a reporting entity;
- (ii) a share-based payment; or
- (iii) tax consolidation accounting.

The AASB does not consider this risk to be a major disadvantage of Option 4 since:

- (i) most not-for-profit entities are likely to be non-compliant with IFRSs, through the application of other Australian Standards;
- (ii) not-for-profit entities have generally shown little interest in making a statement of compliance with IFRSs; and
- (iii) the likelihood of the risk arising is remote, given that not-for-profit entities are:

- (a) able to elect to account for a reconstruction within a reporting entity by measuring at the acquisition date the assets acquired at their carrying amount;
- (b) not likely to have share-based payments; and
- (c) not likely to be involved in tax consolidation accounting.

The manner of implementing the AASB's preliminary conclusion is illustrated in the Appendix to this Invitation to Comment. This shows the proposed amendments as mark-up to the sections of AASB 3 affected by this preliminary conclusion.

Request for Comments

The AASB invites comments on the preliminary conclusion outlined above.

The AASB seeks comment on whether constituents support the adoption of Option 4, or would prefer Options 1, 2 or 3.

In particular, the AASB is interested in knowing if constituents consider that there exist circumstances in which the excess dealt with in paragraph Aus56.1 would meet the definition of income.

APPENDIX

This Appendix shows relevant sections of AASB 3 marked up for the amendments proposed in Option 4 of this Invitation to Comment.

Aus56.1 Notwithstanding paragraph 56, in respect of business combinations involving entities or businesses within the same reporting entity, if the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with paragraph 36 exceeds the cost of the business combination, the acquirer shall recognise the excess as:

- (a) ~~a contribution by owners, when and only when it satisfies the definition of contribution by owners; equity when it is a contribution by equity participants; and~~
- (b) ~~a gain in any other case when it meets the definition of income.~~

Appendix A

~~Contribution by owners~~

~~future economic benefits that have been contributed to the entity by parties external to the entity, other than those which result in liabilities of the entity, that give rise to a financial interest in the net assets of the entity which:~~

- (a) ~~conveys entitlement both to distributions of future economic benefits by the entity during its life, such distributions being at the discretion of the ownership group or its representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or~~
- (b) ~~can be sold, transferred or redeemed.~~