Australian Accounting Standard **AAS 21**

November 1999

Acquisitions of Assets

Prepared by the
Public Sector Accounting Standards Board of the
Australian Accounting Research Foundation and by the
Australian Accounting Standards Board

Issued by the
Australian Accounting Research Foundation
on behalf of the **Australian Society of Certified Practising Accountants** and **The Institute of Chartered Accountants in Australia**

Obtaining a Copy of this Accounting Standard

Copies of this Standard are available for purchase from the Australian Accounting Research Foundation by contacting:

The Customer Service Officer
Australian Accounting Research Foundation
211 Hawthorn Road
Caulfield Victoria 3162
AUSTRALIA

Phone: (03) 9524 3637
Fax: (03) 9524 3687
E-mail: publications@aarf.asn.au
Web site: www.aarf.asn.au

Other enquiries:

Phone: (03) 9524 3600
Fax: (03) 9523 5499
E-mail: standard@aarf.asn.au

COPYRIGHT

© 1999 Australian Accounting Research Foundation (AARF). The text, graphics and layout of this Accounting Standard are protected by Australian copyright law and the comparable law of other countries. No part of the Accounting Standard may be reproduced, stored or transmitted in any form or by any means without the prior written permission of the AARF except as permitted by law.

ISSN 1034-3717

CONTENTS

MAIN FEATURES OF THE STANDARD … page 5

Section and page number

1 Application … 7

2 Scope … 7

3 Operative Date … 8

4 Purpose of Standard … 8

5 Identifying an Acquirer … 9

6 Initial Measurement of Acquired Assets … 9

Reconstructions Within an Economic Entity … 10

7 Deferred Settlement … 10

8 Cost of Acquisition Contingent on Future Events … 12

9 Transaction Costs Arising on the Issue of Equity Instruments … 12

10 Disclosures … 13

11 Transitional Provisions … 14

12 Definitions … 15

Cost of Acquisition … 19

Property, Plant and Equipment … 19

Purchase Consideration … 20

Dividends out of Pre-Acquisition Reserves … 20

Non-Reciprocal Transfers … 21

Reconstructions Within an Economic Entity … 22

CONFORMITY WITH INTERNATIONAL AND NEW ZEALAND ACCOUNTING STANDARDS … page 24

BACKGROUND TO REVISION … page 25
DISSENTING VIEWS … page 28

Defined words appear in *italics* the first time they appear in a section. The definitions are in Section 12. Standards are printed in **bold** type and commentary in light type.

MAIN FEATURES OF THE STANDARD

The Standard requires:

(a) acquired assets, other than where the acquisition is a reconstruction within an economic entity, to be measured at the acquisition date at the cost of acquisition

(b) where an entity or operation is acquired, other than where the acquisition is a reconstruction within an economic entity, the identifiable assets acquired (and, where applicable, identifiable liabilities assumed) to be measured at the acquisition date at their fair values as at the acquisition date. Any difference between the cost of acquisition and the aggregate of the fair values of the identifiable assets acquired (less, where applicable, the aggregate of the fair values of the identifiable liabilities assumed) is required to be accounted for in accordance with Australian Accounting Standard AAS 18 "Accounting for Goodwill"

(c) an acquirer to account for a reconstruction within an economic entity by either:

    (i) measuring at the acquisition date the acquired entity or operation at the cost of acquisition. This means that the identifiable assets acquired (and, where applicable, identifiable liabilities assumed) are measured at their fair values as at the acquisition date, with any difference between the cost of acquisition and the aggregate of the fair values of the identifiable assets acquired (less, where applicable, the aggregate of the fair values of the identifiable liabilities assumed) accounted for in accordance with AAS 18; or

    (ii) measuring at the acquisition date the assets acquired (and, where applicable, liabilities assumed) at their carrying amounts determined in accordance with Australian Accounting Standards immediately prior to the reconstruction within an economic entity

(d) the fair value of any cash consideration to be given in a deferred settlement to be determined by discounting the amounts payable to their present value as at the acquisition date. The discount rate used must be the incremental borrowing rate applicable to the entity had finance for the acquisition been obtained from an independent financier under comparable terms and conditions to those in the purchase agreement

(e) where it is probable that the cost of acquisition will vary because it is contingent upon future events and the amount of the variation can be reliably measured at the acquisition date, the amount of the variation to be included in the cost of acquisition. Where the amount of the variation cannot be reliably measured at the acquisition date, the cost of acquisition is adjusted when the amount of the variation can be reliably measured

(f) transaction costs arising on the issue of equity instruments to be recognised by the issuer of the equity instruments directly in equity

(g) specific disclosures in relation to acquisitions resulting in the entity obtaining control of another entity or operation.

AUSTRALIAN ACCOUNTING STANDARD

AAS 21 “ACQUISITIONS OF ASSETS”

1 Application

1.1 This Standard applies to:

(a) *general purpose financial reports* of each *reporting entity* to which Accounting Standards operative under the Corporations Law do not apply; or

(b) financial reports that are held out to be general purpose financial reports by an *entity* which is not a reporting entity, and to which Accounting Standards operative under the Corporations Law do not apply.

1.1.1 Accounting Standards operative under the Corporations Law apply to companies and to other entities required by legislation, ministerial directive or other government authority to apply such Standards. Reporting entities which are not required to apply Accounting Standards operative under the Corporations Law are required to apply this Standard.

2 Scope

2.1 This Standard applies to *acquisitions*, other than exchanges or swaps of goods or services of the same nature and value that do not involve cash consideration.

2.1.1 An acquisition may involve the acquisition of an individual *asset*, a group of assets, or net assets. This Standard prescribes the accounting for acquisitions of assets and, to the extent they form part of the net assets of an *entity* or operation acquired, the accounting for the *liabilities* assumed.

2.1.2 Exchanges or swaps of goods or services of the same nature and value may occur in restricted circumstances, such as exchanges of commodities like oil, motor vehicles or milk, where suppliers exchange or swap inventories in various locations to fulfil demand on a timely basis in a particular location. In these circumstances the goods or services exchanged are homogeneous. Exchanges or swaps of goods or services of the same nature and value do not

include exchanges of, for example, items of property, plant and equipment or exchanges of businesses. The accounting for an exchange or swap of goods or services of the same nature and value which does not involve cash consideration is addressed in Australian Accounting Standard AAS 15 "Revenue".

2.1.3 A *non-reciprocal transfer* does not fall within the definition of an acquisition. Therefore, the accounting for such transfers is not dealt with in this Standard, but rather in AAS 15. However, some transactions comprise both reciprocal and non-reciprocal components. Paragraphs 12.1.10 to 12.1.14 provide guidance on identifying such transactions.

2.1.4 The standards specified in this Standard apply to the financial report where information resulting from their application is material in accordance with Australian Accounting Standard AAS 5 "Materiality".

3 Operative Date

3.1 This Standard applies to reporting periods beginning on or after 1 January 2000.

3.2 This Standard may be applied to reporting periods beginning before 1 January 2000.

3.2.1 Australian Accounting Standard AAS 21 "Accounting for the Acquisition of Assets (including Business Entities)", as issued in December 1985, continues to apply to reporting periods that begin before 1 January 2000. However, where an *entity* elects to apply this Standard early in accordance with paragraph 3.2, it will not also be obliged to comply with AAS 21, as issued in December 1985, for the reporting periods to which the election applies.

3.3 When operative, this Standard supersedes Australian Accounting Standard AAS 21 "Accounting for the Acquisition of Assets (including Business Entities)", as issued in December 1985.

4 Purpose of Standard

4.1 The purpose of this Standard is to:

(a) prescribe the accounting for *acquisitions*

(b) **require specific disclosures to be made in relation to acquisitions that result in the *entity* obtaining *control* of another entity or operation.**

5 Identifying an Acquirer

5.1 An acquirer must be identified for all combinations of *entities* or operations.

5.1.1 The view adopted in this Standard is that an acquirer can be identified for all combinations of entities or operations. Accordingly, this Standard requires the purchase method of accounting to be applied to all combinations of entities or operations (other than *reconstructions within an economic entity*). Under the purchase method of accounting, acquired *assets* are measured at their *cost of acquisition*.

6 Initial Measurement of Acquired Assets

6.1 Subject to paragraphs 6.3 and 6.4, where there is an *acquisition*, the acquired *assets* must be measured at the *acquisition date* at the *cost of acquisition*.

6.2 Subject to paragraphs 6.3 and 6.4, where an *entity* or operation is acquired, the identifiable assets acquired (and, where applicable, identifiable *liabilities* assumed) must be measured at the acquisition date at their *fair values* as at the acquisition date. Any difference between the cost of acquisition and the aggregate of the fair values of the identifiable assets acquired (less, where applicable, the aggregate of the fair values of the identifiable liabilities assumed) must be accounted for in accordance with Australian Accounting Standard AAS 18 "Accounting for Goodwill".

6.2.1 Where there is an acquisition of a group of assets or net assets, it is necessary to apportion the cost of acquisition to the individual assets acquired (and, where applicable, liabilities assumed). Where a group of assets acquired does not form an entity or operation, the cost of acquisition is apportioned to each asset in proportion to the fair values of the assets as at the acquisition date.

6.2.2 Where a group of assets or net assets acquired forms an entity or operation, the cost of acquisition is apportioned to each asset acquired (and, where applicable, liability assumed) by measuring the

identifiable assets acquired (and, where applicable, identifiable liabilities assumed) at their fair values as at the acquisition date. Any difference between the cost of acquisition of the entity or operation and the aggregate of the fair values of the identifiable assets acquired (less, where applicable, the aggregate of the fair values of identifiable liabilities assumed) is accounted for in accordance with AAS 18.

6.2.3 Paragraph 6.1 requires the acquisition of an *ownership interest* to be initially measured at its cost of acquisition (subject to paragraphs 6.3 and 6.4). Where the acquisition gives rise to *significant influence* over the acquiree, the investment in the acquiree is subsequently accounted for in accordance with Australian Accounting Standard AAS 14 "Accounting for Investments in Associates". Where the acquisition gives rise to *control* of the acquiree, the investment in the acquiree is subsequently accounted for in the consolidated financial report in accordance with Australian Accounting Standard AAS 24 "Consolidated Financial Reports".

Reconstructions Within an Economic Entity

6.3 Where there is a *reconstruction within an economic entity*, the acquirer must account for the acquisition:

(a) in accordance with paragraphs 6.1 and 6.2; or

(b) by measuring at the acquisition date the assets acquired (and, where applicable, liabilities assumed) at their *carrying amounts* determined in accordance with Australian Accounting Standards immediately prior to the reconstruction within an economic entity.

6.4 Where there is a reconstruction within an economic entity and the acquirer elects to account for the acquisition in accordance with paragraph 6.3(b), the vendor entity must account for its acquisition of the acquirer's *equity instruments* by measuring those equity instruments at the aggregate of the carrying amounts immediately prior to the reconstruction within an economic entity of the assets transferred to (less, where applicable, liabilities assumed by) the acquirer.

7 Deferred Settlement

7.1 Where settlement of all or any part of any cash consideration to be given in an *acquisition* is deferred, the *fair value* of the cash

consideration must be determined by discounting the amounts payable to their present value as at the *acquisition date*.

7.2 The discount rate used to determine the present value of the cash consideration must be the *entity's* incremental borrowing rate, being the rate applicable to the entity if finance for the acquisition were obtained from an independent financier under comparable terms and conditions to those in the purchase agreement.

7.2.1 The *cost of acquisition* of an acquired *asset*, group of assets, or net assets is the fair value of the assets or *equity instruments* given or, where settlement is deferred, the fair value of the *liabilities* incurred as at acquisition date plus any incidental costs directly attributable to the acquisition. Where settlement is deferred, the economic substance of the transaction is that the payments in the future include a cost related to financing the deferred settlement. Accordingly, measuring the acquired asset, group of assets, or net assets at the nominal amount payable may give rise to a material misstatement.

7.2.2 The terms of an agreement to purchase an asset, group of assets, or net assets are determined by negotiation between the buyer and seller. Subject to other factors that influence the negotiations, the buyer would not accept finance at a cost greater than an alternative source of finance. Accordingly, where settlement of all or any part of any cash consideration is deferred, the amounts payable are discounted at the entity's incremental borrowing rate, notwithstanding that a materially different interest rate may be identified in the purchase agreement.

7.2.3 The entity's incremental borrowing rate provides a measure of the rate of interest implicit in the purchase transaction and takes into account a range of entity-specific factors that enter the negotiation process. In determining this rate, the following factors are considered:

(a) prevailing commercial borrowing rates applicable to the entity

(b) existing financial arrangements of the entity

(c) alternative sources of finance available to the entity as at the acquisition date

(d) other factors that influence the rate at which the entity could obtain finance from an independent financier under

comparable terms and conditions to those in the purchase agreement.

7.2.4 An interest rate such as the national government bond rate ignores such factors as the credit standing of the entity, security provided by the entity and other factors that may enter the negotiation process. Accordingly, this Standard does not permit the national government bond rate to be used unless it is representative of the rate at which the acquiring entity could borrow.

7.2.5 Where settlement of all or any part of any cash consideration is deferred, the amounts discounted to present value in accordance with paragraph 7.1 are pre-tax cash flows. Accordingly, the discount rate used in determining the fair value of liabilities incurred is a pre-tax borrowing rate.

8 Cost of Acquisition Contingent on Future Events

8.1 Where it is probable that the *cost of acquisition* will vary because it is contingent on one or more future events and the amount of the variation can be reliably measured at the *acquisition date*, the amount of the variation must be included in the cost of acquisition. Where the amount of the variation cannot be reliably measured at the acquisition date, the cost of acquisition must be adjusted when the amount of the variation can be reliably measured.

8.1.1 An agreement for an *acquisition* may allow for variations to the cost of acquisition as a result of one or more future events. For example, an agreement for the acquisition of an *entity* or operation may allow for variations to the cost of acquisition which are contingent on a specified level of revenue being achieved in future periods.

9 Transaction Costs Arising on the Issue of Equity Instruments

9.1 *Transaction costs arising on the issue of equity instruments* must be *recognised* by the issuer of those *equity instruments* directly in *equity*.

9.1.1 Transaction costs arising on the issue of equity instruments include costs such as stamp duties and taxes, professional advisers' fees,

underwriting costs and brokerage fees directly related to the issue of the equity instruments. Transaction costs arising on the issue of equity instruments do not include indirect costs associated with the issue of the equity instruments, such as the costs of management time and administrative overheads, or allocations of internal costs that would have been incurred had the equity instruments not been issued. Nor do they include costs of researching and negotiating sources of finance or of ascertaining the suitability or feasibility of particular instruments.

9.1.2 In addition to transaction costs arising on the issue of equity instruments, an *entity* may incur incidental costs directly attributable to an *acquisition*. For example, where an entity issues its own equity instruments as *purchase consideration* for an item of plant and equipment, it may incur, in addition to transaction costs arising on the issue of the equity instruments, incidental costs attributable to bringing the item of plant and equipment to the location and condition necessary for its intended use. In accordance with the definition of *cost of acquisition* in paragraph 12.1, incidental costs directly attributable to the acquisition are included as part of the cost of acquisition.

9.1.3 This Standard does not address the accounting for costs incurred on the issue, origination or arrangement of *financial liabilities* or the accounting for preliminary costs. Australian Accounting Standard AAS 34 "Borrowing Costs" defines "borrowing costs" to encompass the amortisation of ancillary costs incurred in connection with the arrangement of borrowings.

10 Disclosures

10.1 Where an *acquisition* results in the *entity* obtaining *control* of another entity or operation, the following must be disclosed:

(a) the name and a description of the entity or operation acquired

(b) the *acquisition date*

(c) any entities or operations disposed of, or that will be disposed of, as a result of the acquisition

(d) where applicable, the percentage of voting shares acquired

(e) the *cost of acquisition* and a description of the components of the cost of acquisition

(f) the nature and amount of any provisions for restructuring, including provisions for plant closure, that arise as a result of the acquisition and which are *recognised* as at acquisition date.

10.2 Where an acquisition that results in control of an entity or operation being obtained occurs after the *reporting date* but before the *time of completion* of the financial report, the following information must be disclosed:

(a) the name and a description of the entity or operation acquired

(b) the acquisition date

(c) where applicable, the percentage of voting shares acquired

(d) the cost of acquisition and a description of the components of the cost of acquisition.

10.3 Where an acquisition that results in control of an entity or operation being obtained occurs after the reporting date but before the time of completion of the financial report, the following information must be disclosed unless it is impracticable to do so:

(a) any entities or operations disposed of, or that will be disposed of, as a result of the acquisition

(b) the nature and amount of any provisions for restructuring, including provisions for plant closure, that arise as a result of the acquisition.

Where it is impracticable to disclose this information, that fact must be disclosed.

11 Transitional Provisions

11.1 Where practicable and subject to paragraph 11.3, the accounting policies required by this Standard must be applied as at the beginning of the reporting period to which this Standard

is first applied. Where this gives rise to initial adjustments which would otherwise be *recognised* in *net profit or loss/result*, the net amount of those adjustments, including any adjustments to deferred income tax balances, must be adjusted against retained profits (surplus) or accumulated losses (deficiencies) as at the beginning of the reporting period to which this Standard is first applied.

11.2 Where it is not practicable to determine the initial adjustment referred to in paragraph 11.1, the amounts at which the *assets* acquired (and, where applicable, *liabilities* assumed) were initially recognised are deemed to have been determined in accordance with this Standard.

11.3 Where a *reconstruction within an economic entity* occurred prior to the beginning of the reporting period to which this Standard is first applied, the accounting for that *acquisition* must not subsequently be adjusted as a result of the application of this Standard.

12 Definitions

12.1 In this Standard:

acquisition* means obtaining *control of an asset, group of assets, or net assets* in exchange for a *cost of acquisition

***acquisition date* means the date on which an acquirer obtains control of an asset, group of assets, or net assets (the terms 'pre-acquisition' and 'post-acquisition' must be read as deriving from this definition)**

***assets* means future economic benefits controlled by the *entity* as a result of past transactions or other past events**

***carrying amount* means, in relation to an *asset* or a *liability*, the amount at which the asset or liability is recorded in the accounting records as at a particular date**

***contributions by owners* means 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

(b) can be sold, transferred or redeemed

control **means the capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in pursuing the objectives of the controlling entity**

control of an asset, group of assets, or net assets **means the capacity of the entity to benefit from the asset, group of assets, or net assets in the pursuit of the entity's objectives and to deny or regulate the access of others to that benefit**

cost of acquisition **means the** ***purchase consideration*** **plus any incidental costs directly attributable to the** ***acquisition***

economic entity **means a group of entities comprising the** ***parent entity*** **and each of its** ***subsidiaries***

entity **means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives**

equity **means the residual interest in the assets of the entity after deduction of its liabilities**

equity instrument **means any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities**

expenses **means consumptions or losses of future economic benefits in the form of reductions in assets or increases in liabilities of the entity, other than those relating to distributions to owners, that result in a decrease in** ***equity*** **during the reporting period**

fair value **means the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction**

financial liability **means any liability that is a contractual obligation:**

(a) to deliver cash or another financial asset to another entity; or

(b) to exchange financial instruments with another entity under conditions that are potentially unfavourable

general purpose financial report **means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs**

liabilities **means future sacrifices of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events**

net profit or loss/result **means:**

(a) in the case of an entity that is not an *economic entity*, profit or loss/result after income tax expense (income tax revenue) from ordinary activities and extraordinary items

(b) in the case of an entity that is an economic entity, profit or loss/result after income tax expense (income tax revenue) from ordinary activities and extraordinary items, before adjustment for that portion that can be attributed to outside equity interest

non-reciprocal transfer **means a transfer in which the entity receives assets or services or has liabilities extinguished without directly giving approximately equal value in exchange to the other party or parties to the transfer**

ownership interest **means the equity interest held by an entity directly, and/or indirectly through another entity**

parent entity **means an entity which *controls* another entity**

purchase consideration **means the *fair value* as at the *acquisition date* of assets given, *equity instruments* issued, or liabilities undertaken by the acquiring entity**

***recognised* means reported on, or incorporated in amounts reported on, the face of the *statement of financial performance* or the statement of financial position (whether or not further disclosure of the item is made in the notes)**

***reconstruction within an economic entity* means an acquisition in which:**

(a) control of a group of assets forming an entity or operation or net assets forming an entity or operation is transferred from one entity in an economic entity (the vendor entity) to another entity in the same economic entity (the acquirer); or

(b) the direct *ownership interests* in the ultimate parent entity of an economic entity held by each of the owners of that parent entity are transferred to a newly-formed entity (the acquirer);

where the acquirer only issues its own equity instruments as purchase consideration, and the ultimate owners and the relative ownership interests of the ultimate owners of the entity or operation being transferred remain unchanged as a result of the acquisition

***reporting date* means the end of the reporting period to which the financial report relates**

***reporting entity* means an entity (including an economic entity) in respect of which it is reasonable to expect the existence of users dependent on *general purpose financial reports* for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources**

***significant influence* means the capacity of an entity to affect substantially (but not control) either, or both, of the financial and operating policies of another entity**

***statement of financial performance* means profit and loss statement or other operating statement as referred to in other Australian Accounting Standards**

***subsidiary* means an entity which is controlled by a parent entity**

***time of completion* means:**

(a) in the case entities required to produce a financial report in accordance with the Corporations Law – the date of the Directors' Declaration

(b) in the case of other entities – the date of final approval of the financial report by the management or governing body of the entity, whichever is applicable

***transaction costs arising on the issue of equity instruments* means the costs that are incurred directly in connection with the issue of those equity instruments and which would not have been incurred had those equity instruments not been issued.**

Cost of Acquisition

12.1.1 The amount of the cost of acquisition is determined after deducting any trade discounts, rebates and other similar items.

12.1.2 An acquirer may incur incidental costs that are directly related to an acquisition. Such costs are included as part of the cost of acquisition. General administrative costs, including the costs of maintaining an acquisitions department, and other costs that cannot be directly attributed to the particular acquisition being accounted for are not included in the cost of acquisition but are *recognised* in *net profit or loss/result* as an *expense* as incurred.

Property, Plant and Equipment

12.1.3 The cost of acquisition of an item of property, plant and equipment includes import duties, non-refundable purchase taxes and any other incidental costs directly attributable to bringing the asset to the location and condition necessary for its intended use.

12.1.4 Examples of incidental costs directly attributable to bringing an item of property, plant and equipment to the location and condition necessary for its intended use include:

(a) the cost of site preparation

(b) initial delivery and handling costs

(c) installation costs

(d) professional fees for architects and engineers.

12.1.5 General administrative costs and other costs which cannot be directly attributed to bringing the item of property, plant and equipment to the location and condition necessary for its intended use are not included in the cost of acquisition, but are recognised in net profit or loss/result as an expense as incurred. Initial operating losses incurred prior to an item of property, plant and equipment achieving planned performance are also excluded from the cost of acquisition. Start-up and pre-production costs are included in the cost of acquisition where they are necessary to bring the item of property, plant and equipment to the location and condition necessary for its intended use.

Purchase Consideration

12.1.6 Where equity instruments or non-monetary assets are provided as all or part of the purchase consideration, the fair value of the asset, group of assets or net assets acquired may, in some instances, provide a reasonable indication of the fair value of the equity instruments issued or non-monetary assets given by the acquirer.

12.1.7 Where marketable securities are provided as all or part of the purchase consideration, the fair value of those securities is normally their market price as at the acquisition date. However, in some instances the notional price at which they could be placed in the market is a better indicator of fair value.

12.1.8 Where there is infrequent activity in a market or where the market is not well established, quoted market prices may not be indicative of the fair value of the assets or equity instruments given as purchase consideration. In these circumstances, estimation techniques such as reference to the current market value of another asset or equity instrument that is substantially the same, or discounted cash flow analysis are used to determine fair value. In applying discounted cash flow techniques, a current market-determined risk-adjusted discount rate is used which reflects such factors as the expected rate of return prevailing in the market for an investment having a similar exposure to risk.

Dividends out of Pre-Acquisition Reserves

12.1.9 The acquisition of shares in an acquiree constitutes the acquisition of all or a proportion of the acquiree's equity as at the acquisition date. Dividends received by the acquirer which are identified as being paid out of the acquiree's pre-acquisition reserves, including retained profits (surplus) to the date of acquisition, represent a return by the acquiree to the acquirer of part of the original equity

acquired. Accordingly, the amount of the purchase consideration is reduced by the amount of any such dividends.

Non-Reciprocal Transfers

12.1.10 The transfer of an asset to a recipient for no purchase consideration represents a *non-reciprocal transfer* (contribution) and is therefore excluded from the scope of this Standard. Contributions other than *contributions by owners* are accounted for by the recipient in accordance with Australian Accounting Standard AAS 15 "Revenue".

12.1.11 A transfer is non-reciprocal where the parties to the transfer do not receive approximately equal value in exchange. An exchange of approximately equal value occurs where the parties to the transfer obtain mutual economic benefits. Value is not received in exchange where an entity transfers assets to another entity and only derives benefit from satisfying its objectives of providing benefits to others.

12.1.12 The transfer of an asset in an arm's-length exchange transaction at a discount represents a reciprocal transfer as both parties to the transaction directly obtain mutual economic benefits. Such an acquisition is accounted for in accordance with this Standard at the fair value of the consideration given.

12.1.13 Where an asset is transferred at a price which intentionally is significantly lower than its fair value and the objective of the transferor in entering into the transaction is to provide benefits to others altruistically or for public purposes, the transfer comprises two distinct transactions: a reciprocal transaction to the extent that sales proceeds are given in exchange; and a non-reciprocal transfer to the extent that the fair value of the asset transferred exceeds the purchase consideration. An example of such a transfer is where a donor transfers a building to an entity at a price which intentionally is significantly lower than its fair value. Where an asset is transferred at a price which is significantly lower than its fair value and that transaction is not an arm's-length transaction, it may be necessary to consider the fair value of the asset received by the transferee to determine whether the transaction comprises a reciprocal and a non-reciprocal component.

12.1.14 Where the transfer of an asset comprises a reciprocal component and a non-reciprocal component that is not a contribution by owners:

(a) the reciprocal component is recognised by the recipient in accordance with this Standard at the fair value of the consideration given

(b) the non-reciprocal component is recognised by the recipient as a contribution in accordance with AAS 15, as the excess of the fair value of the asset received over the consideration given.

This will result in the recipient recognising the asset received at its fair value, revenue of an amount equal to the excess of the fair value of the asset received over the consideration, and a liability or reduction in an asset of an amount equal to the consideration. For example, where a donor transfers a building with a fair value of $100,000 to an entity for $10,000, the entity recognises an asset (building) of $100,000, revenue (contribution) of $90,000, and a liability or a reduction in an asset for the consideration of $10,000.

Reconstructions Within an Economic Entity

12.1.15 The following are examples of *reconstructions within an economic entity*, provided the acquirer only issues its own equity instruments as purchase consideration:

(a) the transfer from one wholly-owned subsidiary in an economic entity to another wholly-owned subsidiary in the same economic entity of control of:

(i) a group of assets forming an entity or operation or net assets forming an entity or operation; or

(ii) a direct ownership interest in another entity in that economic entity

(b) the transfer from a parent entity of an economic entity to its wholly-owned subsidiary of control of:

(i) a group of assets forming an entity or operation or net assets forming an entity or operation; or

(ii) a direct ownership interest in another entity in that economic entity

(c) the introduction of a new ultimate parent entity, provided the ultimate owners and the relative ownership interests of the ultimate owners of the acquiree remain unchanged as a result of the acquisition.

12.1.16 The transfer from one subsidiary in an economic entity to another subsidiary in the same economic entity of control of a group of

assets forming an entity or operation or net assets forming an entity or operation in exchange for the issuing by the acquirer of its own equity instruments is not a reconstruction within an economic entity where the subsidiaries have equity participants other than the parent entity, unless the ultimate owners of the subsidiaries and their relative ownership interests are the same for each of the subsidiaries.

CONFORMITY WITH INTERNATIONAL AND NEW ZEALAND ACCOUNTING STANDARDS

Conformity with International Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity with International Accounting Standard IAS 22 "Business Combinations", to the extent that IAS 22 addresses the accounting for and disclosures about the initial recognition of business combinations, except that:

(a) IAS 22 requires the uniting of interests method to be applied in certain rare circumstances;

(b) IAS 22 requires transaction costs arising on the issue of equity instruments to be included as part of the cost of acquisition where the equity instruments are issued as purchase consideration for a business combination; and

(c) IAS 22 includes requirements in relation to the recognition of certain liabilities as part of the initial recognition of a business combination. The accounting for these liabilities will be addressed in the Australian Accounting Standard arising from Exposure Draft ED 88 "Provisions and Contingencies".

Conformity with New Zealand Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity with Statement of Standard Accounting Practice SSAP-8 "Accounting for Business Combinations", to the extent that SSAP-8 addresses the accounting for and disclosures about the initial recognition of business combinations, except that SSAP-8 requires the uniting of interests method to be applied in certain rare circumstances.

BACKGROUND TO REVISION

This section does not form part of the Standard. It is a summary of the reasons for the current revision to the Standard.

1 The reissue of the Standard is part of a program being undertaken by the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation and the Australian Accounting Standards Board (the Boards) to achieve greater harmony between Australian accounting standards and those of the International Accounting Standards Committee.

2 The reissue of the Standard follows consideration of the responses received on Exposure Draft ED 84 "Acquisition of Assets", which was prepared by the Boards and released in October 1997, and on the Invitation to Comment "Acquisition of Assets", which was prepared by the Boards and released in December 1998. ED 84 contained proposals aimed at harmonising with those requirements of International Accounting Standard IAS 22 "Business Combinations" relating to the accounting for the initial recognition of business combinations. The Invitation to Comment contained two proposals in relation to the accounting for acquisitions of assets on which the Boards sought comments. One related to the accounting for internal reconstructions. The other related to the accounting for transaction costs arising on the issue of equity instruments.

3 Consistent with the proposals in ED 84, the Standard prohibits the use of the uniting of interests method, and requires the purchase method of accounting to be applied to all combinations of entities or operations other than reconstructions within an economic entity. Under the purchase method of accounting, acquired assets are measured at their cost of acquisition.

Principal Changes from the Previous Standard

4 The Standard requires an acquirer to account for a reconstruction within an economic entity by either:

(a) measuring at the acquisition date the acquired entity or operation at the cost of acquisition. This means that the identifiable assets acquired (and, where applicable, identifiable liabilities assumed) are measured at their fair values as at the acquisition date, with any difference between the cost of acquisition and the aggregate of the fair values of the identifiable assets acquired (less, where

applicable, the aggregate of the fair values of the identifiable liabilities assumed) accounted for in accordance with Australian Accounting Standard AAS 18 "Accounting for Goodwill"; or

(b) measuring at the acquisition date the assets acquired (and, where applicable, liabilities assumed) at their carrying amounts determined in accordance with Australian Accounting Standards immediately prior to the reconstruction within an economic entity.

Australian Accounting Standard AAS 21 "Accounting for the Acquisition of Assets (including Business Entities)" as issued in December 1985 required the purchase method of accounting to be applied to all business combinations, however excluded from its scope intra-group reconstructions in which a new holding company completely replaced an existing holding company. Accounting Standard AASB 1015 "Accounting for the Acquisition of Assets" as issued in November 1988 required the purchase method of accounting to be applied to all business combinations.

5 The Standard clarifies that an exchange or swap of goods or services of the same nature and value is not included within the scope of the Standard.

6 Consistent with the proposals in ED 84, the Standard requires the fair value of any cash consideration to be given in a deferred settlement to be determined by discounting the amounts payable to their present value as at the acquisition date. The discount rate used is the incremental borrowing rate applicable to the entity had finance for the acquisition been obtained from an independent financier under comparable terms and conditions to those in the purchase agreement.

7 Consistent with the proposals in the Invitation to Comment, the Standard requires transaction costs arising on the issue of equity instruments to be recognised by the issuer of the equity instruments directly in equity.

Noteworthy Differences from ED 84

8 ED 84 proposed excluding reconstructions within an economic entity from the requirements of the Standard, and defined a reconstruction within an economic entity as:

(a) a transfer of ownership interest in an entity, or control of an operation, between entities in an economic entity that does not result in a change in the ownership group of the entity or operation that is being transferred and there is no change in the relative interests of the ownership group; or

(b) the complete replacement of a parent entity with a newly formed entity where the relative interests of the ownership group of the parent entity are unchanged.

After considering respondents' comments on the proposals in ED 84 and the Invitation to Comment, the Boards decided to include an amended definition of reconstruction within an economic entity in the Standard and to include requirements in the Standard in relation to the accounting for reconstructions within an economic entity. The amended definition includes within its scope the transfer from one entity in an economic entity to another entity in the same economic entity of control of a group of assets forming an entity or operation or net assets forming an entity or operation, provided the acquirer only issues its own equity instruments as purchase consideration, and the ultimate owners and the relative ownership interests of the ultimate owners of the entity or operation being transferred remain unchanged as a result of the acquisition.

9 ED 84 did not propose to exclude from the scope of the Standard exchanges or swaps of goods or services of the same nature and value. Such transactions have been excluded from the scope of the Standard to ensure consistency with Australian Accounting Standard AAS 15 "Revenue".

DISSENTING VIEWS

The Public Sector Accounting Standards Board (PSASB) of the Australian Accounting Research Foundation and the Australian Accounting Standards Board (AASB) approved Australian Accounting Standard AAS 21 "Acquisitions of Assets" in November 1999. Ken Spencer, Chairman of the AASB, Jayne Godfrey, Ian Hammond and Wayne Lonergan, members of the AASB, and Graham Peirson, a member of the PSASB, wish to express dissenting views on the Standard. Their dissenting views, which do not form part of the Standard, are set out below.

1 Mr Spencer, Professor Godfrey, Mr Hammond, Mr Lonergan, and Professor Peirson strongly support the work of the AASB and the PSASB in developing Australian Accounting Standards, and believe that, except for the matters outlined below, AAS 21 will improve the quality of financial reporting in Australia.

Reconstructions Within an Economic Entity

2 Mr Spencer, Professor Godfrey, Mr Hammond, Mr Lonergan and Professor Peirson were unable to vote in favour of the issue of AAS 21 because they believe that acquisitions of assets falling within the definition of "reconstruction within an economic entity" should not be permitted to be accounted for by measuring at the acquisition date the assets acquired (and, where applicable, liabilities assumed) at their carrying amounts immediately prior to the reconstruction within an economic entity.

3 In their view, reconstructions within an economic entity should be required to be accounted for consistently with the accounting for other acquisitions of assets by applying the purchase method of accounting. This would mean that the identifiable assets acquired (and, where applicable, identifiable liabilities assumed) would be required to be measured at their fair values as at the acquisition date, with any difference between the cost of acquisition and the aggregate of the fair values of the identifiable assets acquired (less, where applicable, the aggregate of the fair values of the identifiable liabilities assumed) accounted for in accordance with Australian Accounting Standard AAS 18 "Accounting for Goodwill".

4 Mr Spencer, Professor Godfrey, Mr Hammond, Mr Lonergan and Professor Peirson note that the users of an entity's general purpose financial report extend beyond just the entity's ownership group to include, for example, employee groups, creditors, lenders, customer groups, potential investors, and the general public. They also note that the objective of general purpose financial reports is to provide

information useful to those users for making and evaluating decisions about the allocation of scarce resources, and that for such information to be useful, it should be prepared in accordance with Australian Accounting Standards. Therefore, Mr Spencer, Professor Godfrey, Mr Hammond, Mr Lonergan and Professor Peirson believe that permitting a departure from the purchase method of accounting for some acquisitions on the basis that they result in no change in the ultimate owners of the entities or operations being acquired and no change in the relative ownership interests of those owners is inconsistent with the reporting entity concept and ignores the information needs of the users of an entity's general purpose financial report.

5 Mr Lonergan also believes that reconstructions within an economic entity should be required to be accounted for by applying the purchase method of accounting for the additional reasons outlined in paragraphs 6 to 20 below.

Undermining the Comparability of Financial Reports

6 Mr Lonergan is of the view that permitting alternative accounting treatments for reconstructions within an economic entity undermines the comparability of financial reports. Comparability is one of the primary qualitative characteristics that financial information should possess if it is to be useful to users of general purpose financial reports.

Demand for a Departure from the Purchase Method of Accounting

7 One of the key arguments put forward in support of permitting a departure from the purchase method of accounting for reconstructions within an economic entity is that, since such transactions result in no change in the ultimate owners of the entities or operations being acquired and no change in the relative ownership interests of those owners, requiring the identifiable assets acquired (and, where applicable, identifiable liabilities assumed) to be measured at their fair values places an unnecessary burden on the acquirer.

8 The Australian Securities and Investments Commission has advised the AASB that, based on the large number of applications it has received for relief from the requirements of the superseded Accounting Standard AASB 1015 "Accounting for the Acquisition of Assets", demand for permitting a departure from the purchase method of accounting is limited to circumstances associated with a planned change in ownership, such as a reconstruction within an economic entity in preparation for a float.

9 Mr Lonergan believes that the absence of any demand for a departure from the purchase method of accounting in circumstances that are not associated with a planned change in ownership invalidates the argument outlined in paragraph 7 in support of permitting a departure from the purchase method of accounting for reconstructions within an economic entity. In the case of reconstructions within an economic entity that take place in preparation of a change in ownership such as a float, Mr Lonergan is of the view that the fair values of the identifiable assets acquired (and, where applicable, liabilities assumed) is key information that should be provided to potential investors and other resource providers so they can make fully informed decisions.

Reconstructions that take place in Preparation of a Change in Ownership

10 An alternative argument put forward in support of permitting a departure from the purchase method of accounting for reconstructions within an economic entity is that, where such a transaction takes place in preparation of a change in ownership such as a float, applying the purchase method results in the assets transferred (and, where applicable, liabilities assumed) being measured on a different basis to that which would have applied had no reconstruction been necessary prior to the change in ownership.

11 Mr Lonergan agrees that this may be the case, however believes it is a consequence of a lack of an Accounting Standard addressing the appropriate measurement basis for the assets and liabilities of an entity which is to be floated. Mr Lonergan believes that the absence of such an Accounting Standard does not provide sufficient justification for permitting alternative accounting treatments for reconstructions within an economic entity.

12 Mr Lonergan is of the view that there is nothing objectionable with using fair value as a measurement attribute, and that information about the fair values of assets and liabilities provides more relevant information to the potential owners of an entity or operation than their carrying amounts based on historical costs. Therefore, where a reconstruction within an economic entity takes place in preparation of a change in ownership, Mr Lonergan believes that transaction provides an opportunity to require more relevant information to be included in the acquirer's general purpose financial report.

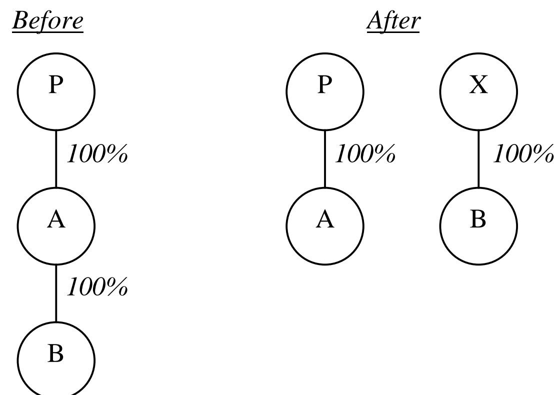
13 In addition, Mr Lonergan believes that permitting such transactions to be accounted for by measuring the assets acquired (and, where applicable, liabilities assumed) at their carrying amounts immediately prior to the reconstruction results in those assets (and, where applicable, liabilities) being measured on a different basis to

that which would have applied in circumstances that are, in substance, the same. The following example illustrates this point.

<u>Example</u>

An economic entity comprises the parent company, P, P's wholly-owned subsidiary, company A, and A's wholly-owned subsidiary, company B. The aggregate of the fair values of B's identifiable assets less the aggregate of the fair values of B's identifiable liabilities is $300,000. The aggregate of the carrying amounts of B's identifiable assets less the aggregate of the carrying amounts of B's identifiable liabilities is $200,000. The directors agree to sell B to a group of individuals not associated with the economic entity for $400,000 cash.

The following diagram illustrates the position before and after the sale where the group of individuals forms a new company, X, to undertake the acquisition:



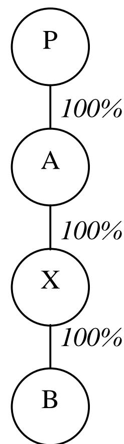
After the sale, X recognises its investment in B in its own financial report at $400,000, and recognises the identifiable assets and liabilities of B in its consolidated financial report at $300,000. X also recognises goodwill of $100,000 in its consolidated financial report.

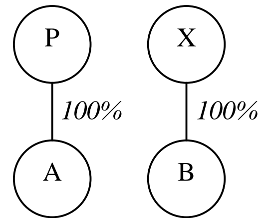
In contrast, the following diagram illustrates the position where:

(a) *the directors of P form a new company, X, which acquires B in a reconstruction within an economic entity; and*

(b) *the group of individuals not associated with the economic entity immediately acquires X for $400,000.*

After the Reconstruction *After the Sale to the Outside Party*





After the reconstruction within an economic entity and the sale of X to the group of individuals not associated with the economic entity, X recognises its investment in B in its own financial report at $200,000, and recognises the identifiable assets and liabilities of B in its consolidated financial report at $200,000. X does not recognise any goodwill in its consolidated financial report.

14 In Mr Lonergan's view, it is inappropriate that in the first case the assets acquired and liabilities assumed by X are recognised at their fair values as at the acquisition date, but not in the second case.

15 Mr Lonergan also believes that, as illustrated in the above example, permitting a departure from the purchase method of accounting for reconstructions within an economic entity provides increased opportunities for entities to avoid the requirements of Australian Accounting Standard AAS 18 "Accounting for Goodwill" where acquisitions are intended to result in a change in the ultimate owners of the entities or operations being acquired.

Impact on Distributable Profits

16 Some support a departure from the purchase method of accounting for reconstructions within an economic entity on the basis that it

adversely affects the ability of some companies within the economic entity to pay dividends. They argue that this is because:

(a) measuring the identifiable assets acquired at their fair values results in higher depreciation in future reporting periods

(b) recognising as goodwill any excess of the cost of acquisition over the aggregate of the fair values of the identifiable assets acquired (less, where applicable, the aggregate of the fair values of the identifiable liabilities assumed) results in higher goodwill amortisation in future reporting periods.

17 Mr Lonergan disagrees that the application of the purchase method for reconstructions within an economic entity adversely affects the ability to pay dividends for the following reasons:

(a) dividends are paid by the legal entity and not the economic entity. Therefore, where a reconstruction within an economic entity involves, for example, the acquisition by one subsidiary of the direct ownership interest in another subsidiary, the recognition of goodwill in the acquirer's consolidated financial report and the measuring of the acquiree's identifiable assets at their fair values in the consolidated financial report does not affect the acquirer's ability to pay dividends

(b) although, in certain circumstances, a reconstruction within an economic entity may affect the acquirer's ability to pay dividends in future reporting periods (for example, where a reconstruction within an economic entity involves the transfer from one subsidiary to another subsidiary of a group of assets forming an entity or operation and the cost of acquisition exceeds the aggregate of the fair values of the identifiable assets acquired), the transaction will result in the vendor entity recognising an immediately distributable gain. The amount of that gain will be equivalent to the aggregate of:

(i) the goodwill transferred; and

(ii) any excess of the aggregate of the fair values of the identifiable assets acquired (less, where applicable, the aggregate of the fair values of the identifiable liabilities assumed) over the aggregate of the former carrying amounts of the identifiable

assets acquired (less, where applicable, the aggregate of the former carrying amounts of the identifiable liabilities assumed)

(c) the requirements of the Corporations Law relating to share capital permit and indeed facilitate in many instances share buy-backs or the return of capital to shareholders where such capital is surplus to the requirements of the entity.

Impact on Equity Value

18 Some support a departure from the purchase method of accounting for reconstructions within an economic entity on the basis that the consequent higher depreciation and goodwill amortisation recognised by the acquirer in future reporting periods reduces the value of the acquirer's equity instruments.

19 Mr Lonergan disagrees with this argument as he believes the value of an entity's equity instruments is determined by expected future cash flows, and not just by expected accounting profits.

Other Adverse Consequences

20 Mr Lonergan believes that permitting a departure from the purchase method of accounting for reconstructions within an economic entity gives rise to the following additional adverse consequences:

(a) the accounting for an acquisition may not reflect the economic substance of the transaction, as the assets acquired (and, where applicable, liabilities assumed) may be recognised by the acquirer at amounts in excess of, or less than, their fair values

(b) holders of the vendor entity's equity instruments may be deprived of profits and/or net worth to which they should be entitled

(c) vendor entity lenders and creditors may be deprived of the protection of asset and interest cover to which they should be entitled

(d) the post acquisition profits of the acquirer may be overstated, resulting in the distribution of excessive profits and/or other distributions to holders of the acquirer's equity instruments. In addition, the acquirer's financial report will fail to reflect that such distributions are actually returns of capital rather than long-term maintainable income.

Determination of Purchase Consideration

21 Mr Lonergan was also unable to vote in favour of issuing AAS 21 because of the requirements in the Standard relating to the determination of purchase consideration.

22 The Standard comments that, where marketable securities are provided as all or part of the purchase consideration, the fair value of those securities is normally their market price as at the acquisition date. Mr Lonergan believes it is incorrect to determine purchase consideration based on the market price of the securities as at the acquisition date for the following reasons:

(a) the market price of the securities as at the acquisition date will be reduced by any premiums for control paid by the acquirer. No such dilution in value would be reflected in the purchase consideration where the acquisition is paid for in cash

(b) the market price of the securities as at the acquisition date will include the impact of events occurring between the date the acquisition is agreed to and the date when control of the assets, group of assets or net assets passes to the acquirer. Therefore, the amount of the purchase consideration will differ from the price at which the agreement is struck

(c) it may result in practical difficulties in preparing offer documents and contracts, as the market price of the securities as at the acquisition date may be difficult, or even impossible, to determine at the time the offer is made.