Compiled Accounting Standard **AASB 3**

Business Combinations

This compilation was prepared on 6 March 2006 taking into account amendments made up to and including 22 June 2005.

Prepared by the staff of the Australian Accounting Standards Board.

Australian Government

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BASIS FOR CONCLUSIONS ON IFRS 3
(available to AASB online subscribers or through the IASB)

Australian Accounting Standard AASB 3 *Business Combinations* (as amended at 22 June 2005) is set out in paragraphs 1 – 77 and Appendices A – B. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in this Standard are in *italics* the first time they appear in the Standard. AASB 3 is to be read in the context of other Australian Accounting Standards, including AASB 1048 *Interpretation and Application of Standards*, which identifies the Australian Accounting Interpretations. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

COMPILATION DETAILS

Accounting Standard AASB 3 *Business Combinations* as amended

This compilation takes into account amendments up to and including 22 June 2005 and was prepared on 6 March 2006 by the staff of the Australian Accounting Standards Board (AASB).

This compilation is not a separate Accounting Standard made by the AASB. Instead, it is a representation of AASB 3 (July 2004) as amended by other Accounting Standards, which are listed in the Table below.

Table of Standards

Standard	**Date made**	**Application date** ***(annual reporting periods … on or after …)***	**Application, saving or transitional provisions**
AASB 3	15 Jul 2004		
AASB 2005-6	22 Jun 2005	*(beginning)* 1 Jan 2006	see (a) below

(a) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2006.

Table of Amendments

Paragraph affected	**How affected**	**By … [paragraph]**
2	amended	AASB 2005-6 [6]
3(b)	added	AASB 2005-6 [7]
Aus3.1	deleted	AASB 2005-6 [8]
Aus3.2	deleted	AASB 2005-6 [8]
Heading after 9	added	AASB 2005-6 [9]
10-13	added	AASB 2005-6 [10]
Aus56.1	deleted	AASB 2005-6 [11]
57	amended	AASB 2005-6 [12]
62	amended	AASB 2005-6 [13]
67	amended	AASB 2005-6 [14]
A *Defined Terms*	amended	AASB 2005-6 [15]
A *Additional Australian Defined Terms*	deleted	AASB 2005-6 [16]
B9	amended	AASB 2005-6 [17]

COMPARISON WITH INTERNATIONAL PRONOUNCEMENTS

AASB 3 and IFRS 3

AASB 3 as amended is equivalent to IFRS 3 *Business Combinations* as issued and amended by the IASB. Paragraphs that have been added to this Standard (and do not appear in the text of the equivalent IASB Standard) are identified with the prefix "Aus", followed by the number of the relevant IASB paragraph and decimal numbering.

Compliance with IFRS 3

Entities that comply with the requirements of AASB 3 as amended will simultaneously be in compliance with the requirements of IFRS 3.

AASB 3 and IPSASs

International Public Sector Accounting Standards (IPSASs) are issued by the International Public Sector Accounting Standards Board of the International Federation of Accountants.

There is no specific IPSAS dealing with accounting for business combinations at present.

ACCOUNTING STANDARD AASB 3

The Australian Accounting Standards Board made Accounting Standard AASB 3 *Business Combinations* under section 334 of the *Corporations Act 2001* on 15 July 2004.

This compiled version of AASB 3 incorporates subsequent amendments contained in other AASB Standards made by the AASB up to and including 22 June 2005 (see Compilation Details).

ACCOUNTING STANDARD AASB 3

BUSINESS COMBINATIONS

Objective

1 The objective of this Standard is to specify the financial reporting by an entity when it undertakes a *business combination*. In particular, it specifies that all business combinations should be accounted for by applying the purchase method. Therefore, the acquirer recognises the acquiree's identifiable assets, liabilities and *contingent liabilities* at their *fair values* at the *acquisition date*, and also recognises *goodwill*, which is subsequently tested for impairment rather than amortised.

Application

Aus1.1 This Standard applies to:

(a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a *reporting entity*;

(b) general purpose financial reports of each other reporting entity; and

(c) financial reports that are, or are held out to be, general purpose financial reports.

Aus1.2 This Standard applies to annual reporting periods beginning on or after 1 January 2005.

[Note: For application dates of paragraphs changed or added by an amending Standard, see Compilation Details.]

Aus1.3 This Standard shall not be applied to annual reporting periods beginning before 1 January 2005.

Aus1.4 The requirements specified in this Standard apply to the financial report where information resulting from their application is material in accordance with AASB 1031 *Materiality*.

Aus1.5 When applicable, this Standard supersedes:

(a) AASB 1015 *Acquisitions of Assets* as notified in the *Commonwealth of Australia Gazette* No S 527, 5 November 1999;

(b) AASB 1013 *Accounting for Goodwill* as notified in the *Commonwealth of Australia Gazette* No S 206, 14 June 1996;

(c) AAS 21 *Acquisitions of Assets* as issued in November 1999; and

(d) AAS 18 *Accounting for Goodwill* as issued in June 1996.

Aus1.6 AASB 1015, AASB 1013, AAS 21 and AAS 18 remain applicable until superseded by this Standard.

Aus1.7 Notice of this Standard was published in the *Commonwealth of Australia Gazette* No S 294, 22 July 2004.

Scope

2 Except as described in paragraph 3, entities shall apply this Standard when accounting for business combinations.

3 This Standard does not apply to:

(a) business combinations in which separate entities or businesses are brought together to form a *joint venture*;

(b) *business combinations involving entities or businesses under common control*;

(c) business combinations involving two or more *mutual entities*; and

(d) business combinations in which separate entities or businesses are brought together to form a reporting entity by contract alone without the obtaining of an ownership interest (for example, combinations in which separate entities are brought together by contract alone to form a dual listed corporation).

Aus3.1 [Deleted by the AASB]

Aus3.2 [Deleted by the AASB]

Identifying a business combination

4 A business combination is the bringing together of separate entities or *businesses* into one reporting entity. The result of nearly all business combinations is that one entity, the acquirer, obtains *control* of one or more other businesses, the acquiree. If an entity obtains control of one or more other entities that are not businesses, the bringing together of those entities is not a business combination. When an entity acquires a group of assets or net assets that does not constitute a business, it shall allocate the cost of the group between the individual identifiable assets and liabilities in the group based on their relative fair values at the date of acquisition.

5 A business combination may be structured in a variety of ways for legal, taxation or other reasons. It may involve the purchase by an entity of the equity of another entity, the purchase of all the net assets of another entity, the assumption of the liabilities of another entity, or the purchase of some of the net assets of another entity that together form one or more businesses. It may be effected by the issue of equity instruments, the transfer of cash, cash equivalents or other assets, or a combination thereof. The transaction may be between the shareholders of the combining entities or between one entity and the shareholders of another entity. It may involve the establishment of a new entity to control the combining entities or net assets transferred, or the restructuring of one or more of the combining entities.

6 A business combination may result in a parent-subsidiary relationship in which the acquirer is the *parent* and the acquiree a *subsidiary* of the acquirer. In such circumstances, the acquirer applies this Standard in its consolidated financial statements. It includes its interest in the acquiree in any separate financial statements it issues as an investment

in a subsidiary (see AASB 127 *Consolidated and Separate Financial Statements*).

7 A business combination may involve the purchase of the net assets, including any goodwill, of another entity rather than the purchase of the equity of the other entity. Such a combination does not result in a parent-subsidiary relationship.

8 Included within the definition of a business combination, and therefore the scope of this Standard, are business combinations in which one entity obtains control of another entity but for which the date of obtaining control (i.e. the acquisition date) does not coincide with the date or dates of acquiring an ownership interest (i.e. the *date or dates of exchange*). This situation may arise, for example, when an investee enters into share buy-back arrangements with some of its investors and, as a result, control of the investee changes.

9 This Standard does not specify the accounting by venturers for interests in joint ventures (see AASB 131 *Interests in Joint Ventures*).

Business combinations involving entities under common control

10 A business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

11 A group of individuals shall be regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities. Therefore, a business combination is outside the scope of AASB 3 when the same group of individuals has, as a result of contractual arrangements, ultimate collective power to govern the financial and operating policies of each of the combining entities so as to obtain benefits from their activities, and that ultimate collective power is not transitory.

12 An entity can be controlled by an individual, or by a group of individuals acting together under a contractual arrangement, and that individual or group of individuals may not be subject to the financial reporting requirements of Australian Accounting Standards. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a business

combination to be regarded as one involving entities under common control.

13 The extent of *minority interests* in each of the combining entities before and after the business combination is not relevant to determining whether the combination involves entities under common control. Similarly, the fact that one of the combining entities is a subsidiary that has been excluded from the consolidated financial statements of the group in accordance with AASB 127 is not relevant to determining whether a combination involves entities under common control.

Method of Accounting

14 All business combinations shall be accounted for by applying the purchase method.

15 The purchase method views a business combination from the perspective of the combining entity that is identified as the acquirer. The acquirer purchases net assets and recognises the assets acquired and liabilities and contingent liabilities assumed, including those not previously recognised by the acquiree. The measurement of the acquirer's assets and liabilities is not affected by the transaction, nor are any additional assets or liabilities of the acquirer recognised as a result of the transaction, because they are not the subjects of the transaction.

Application of the Purchase Method

16 Applying the purchase method involves the following steps:

(a) identifying an acquirer;

(b) measuring the cost of the business combination; and

(c) allocating, at the acquisition date, the cost of the business combination to the assets acquired and liabilities and contingent liabilities assumed.

Identifying the acquirer

17 An acquirer shall be identified for all business combinations. The acquirer is the combining entity that obtains control of the other combining entities or businesses.

18 Because the purchase method views a business combination from the acquirer's perspective, it assumes that one of the parties to the transaction can be identified as the acquirer.

19 Control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities. A combining entity shall be presumed to have obtained control of another combining entity when it acquires more than one-half of that other entity's voting rights, unless it can be demonstrated that such ownership does not constitute control. Even if one of the combining entities does not acquire more than one-half of the voting rights of another combining entity, it might have obtained control of that other entity if, as a result of the combination, it obtains:

(a) power over more than one-half of the voting rights of the other entity by virtue of an agreement with other investors; or

(b) power to govern the financial and operating policies of the other entity under a statute or an agreement; or

(c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body of the other entity; or

(d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body of the other entity.

20 Although sometimes it may be difficult to identify an acquirer, there are usually indications that one exists. For example:

(a) if the fair value of one of the combining entities is significantly greater than that of the other combining entity, the entity with the greater fair value is likely to be the acquirer;

(b) if the business combination is effected through an exchange of voting ordinary equity instruments for cash or other assets, the entity giving up cash or other assets is likely to be the acquirer; and

(c) if the business combination results in the management of one of the combining entities being able to dominate the selection of the management team of the resulting combined entity, the entity whose management is able so to dominate is likely to be the acquirer.

21 In a business combination effected through an exchange of equity interests, the entity that issues the equity interests is normally the

acquirer. However, all pertinent facts and circumstances shall be considered to determine which of the combining entities has the power to govern the financial and operating policies of the other entity (or entities) so as to obtain benefits from its (or their) activities. In some business combinations, commonly referred to as reverse acquisitions, the acquirer is the entity whose equity interests have been acquired and the issuing entity is the acquiree. This might be the case when, for example, a private entity arranges to have itself 'acquired' by a smaller public entity as a means of obtaining a stock exchange listing. Although legally the issuing public entity is regarded as the parent and the private entity is regarded as the subsidiary, the legal subsidiary is the acquirer if it has the power to govern the financial and operating policies of the legal parent so as to obtain benefits from its activities. Commonly the acquirer is the larger entity; however, the facts and circumstances surrounding a combination sometimes indicate that a smaller entity acquires a larger entity. Guidance on the accounting for reverse acquisitions is provided in paragraphs B1-B15 of Appendix B.

22 When a new entity is formed to issue equity instruments to effect a business combination, one of the combining entities that existed before the combination shall be identified as the acquirer on the basis of the evidence available.

23 Similarly, when a business combination involves more than two combining entities, one of the combining entities that existed before the combination shall be identified as the acquirer on the basis of the evidence available. Determining the acquirer in such cases shall include a consideration of, amongst other things, which of the combining entities initiated the combination and whether the assets or revenues of one of the combining entities significantly exceed those of the others.

Cost of a business combination

24 The acquirer shall measure the cost of a business combination as the aggregate of:

(a) the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree; plus

(b) any costs directly attributable to the business combination.

25 The acquisition date is the date on which the acquirer effectively obtains control of the acquiree. When this is achieved through a single exchange transaction, the date of exchange coincides with the

acquisition date. However, a business combination may involve more than one exchange transaction, for example when it is achieved in stages by successive share purchases. When this occurs:

(a) the cost of the combination is the aggregate cost of the individual transactions; and

(b) the date of exchange is the date of each exchange transaction (i.e. the date that each individual investment is recognised in the financial report of the acquirer), whereas the acquisition date is the date on which the acquirer obtains control of the acquiree.

26 Assets given and liabilities incurred or assumed by the acquirer in exchange for control of the acquiree are required by paragraph 24 to be measured at their fair values at the date of exchange. Therefore, when settlement of all or any part of the cost of a business combination is deferred, the fair value of that deferred component shall be determined by discounting the amounts payable to their present value at the date of exchange, taking into account any premium or discount likely to be incurred in settlement.

27 The published price at the date of exchange of a quoted equity instrument provides the best evidence of the instrument's fair value and shall be used, except in rare circumstances. Other evidence and valuation methods shall be considered only in the rare circumstances when the acquirer can demonstrate that the published price at the date of exchange is an unreliable indicator of fair value, and that the other evidence and valuation methods provide a more reliable measure of the equity instrument's fair value. The published price at the date of exchange is an unreliable indicator only when it has been affected by the thinness of the market. If the published price at the date of exchange is an unreliable indicator or if a published price does not exist for equity instruments issued by the acquirer, the fair value of those instruments could, for example, be estimated by reference to their proportional interest in the fair value of the acquirer or by reference to the proportional interest in the fair value of the acquiree obtained, whichever is the more clearly evident. The fair value at the date of exchange of monetary assets given to equity holders of the acquiree as an alternative to equity instruments may also provide evidence of the total fair value given by the acquirer in exchange for control of the acquiree. In any event, all aspects of the combination, including significant factors influencing the negotiations, shall be considered. Further guidance on determining the fair value of equity instruments is set out in AASB 139 *Financial Instruments: Recognition and Measurement*.

28 The cost of a business combination includes liabilities incurred or assumed by the acquirer in exchange for control of the acquiree. Future losses or other costs expected to be incurred as a result of a combination are not liabilities incurred or assumed by the acquirer in exchange for control of the acquiree, and are not, therefore, included as part of the cost of the combination.

29 The cost of a business combination includes any costs directly attributable to the combination, such as professional fees paid to accountants, legal advisers, valuers and other consultants to effect the combination. General administrative costs, including the costs of maintaining an acquisitions department, and other costs that cannot be directly attributed to the particular combination being accounted for are not included in the cost of the combination: they are recognised as an expense when incurred.

30 The costs of arranging and issuing financial liabilities are an integral part of the liability issue transaction, even when the liabilities are issued to effect a business combination, rather than costs directly attributable to the combination. Therefore, entities shall not include such costs in the cost of a business combination. In accordance with AASB 139, such costs shall be included in the initial measurement of the liability.

31 Similarly, the costs of issuing equity instruments are an integral part of the equity issue transaction, even when the equity instruments are issued to effect a business combination, rather than costs directly attributable to the combination. Therefore, entities shall not include such costs in the cost of a business combination. In accordance with AASB 132 *Financial Instruments: Disclosure and Presentation*, such costs reduce the proceeds from the equity issue.

Adjustments to the cost of a business combination contingent on future events

32 When a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer shall include the amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is *probable* and can be measured reliably.

33 A business combination agreement may allow for adjustments to the cost of the combination that are contingent on one or more future events. The adjustment might, for example, be contingent on a specified level of profit being maintained or achieved in future periods, or on the market price of the instruments issued being maintained. It is usually possible to estimate the amount of any such adjustment at the

time of initially accounting for the combination without impairing the reliability of the information, even though some uncertainty exists. If the future events do not occur or the estimate needs to be revised, the cost of the business combination shall be adjusted accordingly.

34 However, when a business combination agreement provides for such an adjustment, that adjustment is not included in the cost of the combination at the time of initially accounting for the combination if it either is not probable or cannot be measured reliably. If that adjustment subsequently becomes probable and can be measured reliably, the additional consideration shall be treated as an adjustment to the cost of the combination.

35 In some circumstances, the acquirer may be required to make a subsequent payment to the seller as compensation for a reduction in the value of the assets given, equity instruments issued or liabilities incurred or assumed by the acquirer in exchange for control of the acquiree. This is the case, for example, when the acquirer guarantees the market price of equity or debt instruments issued as part of the cost of the business combination and is required to issue additional equity or debt instruments to restore the originally determined cost. In such cases, no increase in the cost of the business combination is recognised. In the case of equity instruments, the fair value of the additional payment is offset by an equal reduction in the value attributed to the instruments initially issued. In the case of debt instruments, the additional payment is regarded as a reduction in the premium or an increase in the discount on the initial issue.

Allocating the cost of a business combination to the assets acquired and liabilities and contingent liabilities assumed

36 The acquirer shall, at the acquisition date, allocate the cost of a business combination by recognising the acquiree’s identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria in paragraph 37 at their fair values at that date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*, which shall be recognised at fair value less costs to sell. Any difference between the cost of the business combination and the acquirer’s interest in the net fair value of the identifiable assets, liabilities and contingent liabilities so recognised shall be accounted for in accordance with paragraphs 51-57.

37 **The acquirer shall recognise separately the acquiree's identifiable assets, liabilities and contingent liabilities at the acquisition date only if they satisfy the following criteria at that date:**

(a) in the case of an asset other than an *intangible asset*, it is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be measured reliably;

(b) in the case of a liability other than a *contingent liability*, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and its fair value can be measured reliably; and

(c) in the case of an intangible asset or a contingent liability, its fair value can be measured reliably.

38 The acquirer's income statement shall incorporate the acquiree's profits and losses after the acquisition date by including the acquiree's income and expenses based on the cost of the business combination to the acquirer. For example, depreciation expense included after the acquisition date in the acquirer's income statement that relates to the acquiree's depreciable assets shall be based on the fair values of those depreciable assets at the acquisition date, that is, their cost to the acquirer.

39 Application of the purchase method starts from the acquisition date, which is the date on which the acquirer effectively obtains control of the acquiree. Because control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities, it is not necessary for a transaction to be closed or finalised at law before the acquirer obtains control. All pertinent facts and circumstances surrounding a business combination shall be considered in assessing when the acquirer has obtained control.

40 Because the acquirer recognises the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria in paragraph 37 at their fair values at the acquisition date, any minority interest in the acquiree is stated at the minority's proportion of the net fair value of those items. Paragraphs B16 and B17 of Appendix B provide guidance on determining the fair values of the acquiree's identifiable assets, liabilities and contingent liabilities for the purpose of allocating the cost of a business combination.

Acquiree's identifiable assets and liabilities

41 In accordance with paragraph 36, the acquirer recognises separately as part of allocating the cost of the combination only the identifiable assets, liabilities and contingent liabilities of the acquiree that existed at the acquisition date and satisfy the recognition criteria in paragraph 37. Therefore:

(a) the acquirer shall recognise liabilities for terminating or reducing the activities of the acquiree as part of allocating the cost of the combination only when the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*; and

(b) the acquirer, when allocating the cost of the combination, shall not recognise liabilities for future losses or other costs expected to be incurred as a result of the business combination.

42 A payment that an entity is contractually required to make, for example, to its employees or suppliers in the event that it is acquired in a business combination is a present obligation of the entity that is regarded as a contingent liability until it becomes probable that a business combination will take place. The contractual obligation is recognised as a liability by that entity in accordance with AASB 137 when a business combination becomes probable and the liability can be measured reliably. Therefore, when the business combination is effected, that liability of the acquiree is recognised by the acquirer as part of allocating the cost of the combination.

43 However, an acquiree's restructuring plan whose execution is conditional upon its being acquired in a business combination is not, immediately before the business combination, a present obligation of the acquiree. Nor is it a contingent liability of the acquiree immediately before the combination because it is not a possible obligation arising from a past event whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the acquiree. Therefore, an acquirer shall not recognise a liability for such restructuring plans as part of allocating the cost of the combination.

44 The identifiable assets and liabilities that are recognised in accordance with paragraph 36 include all of the acquiree's assets and liabilities that the acquirer purchases or assumes, including all of its financial assets and financial liabilities. They might also include assets and liabilities not previously recognised in the acquiree's financial report, for example, because they did not qualify for recognition before the

acquisition. For example, a tax benefit arising from the acquiree's tax losses that was not recognised by the acquiree before the business combination qualifies for recognition as an identifiable asset in accordance with paragraph 36 if it is probable that the acquirer will have future taxable profits against which the unrecognised tax benefit can be applied.

Acquiree's intangible assets

45 In accordance with paragraph 37, the acquirer recognises separately an intangible asset of the acquiree at the acquisition date only if it meets the definition of an intangible asset in AASB 138 *Intangible Assets* and its fair value can be measured reliably. This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquiree if the project meets the definition of an intangible asset and its fair value can be measured reliably. AASB 138 provides guidance on determining whether the fair value of an intangible asset acquired in a business combination can be measured reliably.

46 A non-monetary asset without physical substance must be identifiable to meet the definition of an intangible asset. In accordance with AASB 138, an asset meets the identifiability criterion in the definition of an intangible asset only if it:

(a) is separable, that is, capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or

(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Acquiree's contingent liabilities

47 Paragraph 37 specifies that the acquirer recognises separately a contingent liability of the acquiree as part of allocating the cost of a business combination only if its fair value can be measured reliably. If its fair value cannot be measured reliably:

(a) there is a resulting effect on the amount recognised as goodwill or accounted for in accordance with paragraph 56; and

(b) the acquirer shall disclose the information about that contingent liability required to be disclosed by AASB 137.

Paragraph B16(l) of Appendix B provides guidance on determining the fair value of a contingent liability.

48 After their initial recognition, the acquirer shall measure contingent liabilities that are recognised separately in accordance with paragraph 36 at the higher of:

(a) the amount that would be recognised in accordance with AASB 137; and

(b) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with AASB 118 *Revenue.*

49 The requirement in paragraph 48 does not apply to contracts accounted for in accordance with AASB 139 *Financial Instruments: Recognition and Measurement*. However, loan commitments excluded from the scope of AASB 139 that are not commitments to provide loans at below-market interest rates are accounted for as contingent liabilities of the acquiree if, at the acquisition date, it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or if the amount of the obligation cannot be measured with sufficient reliability. Such a loan commitment is, in accordance with paragraph 37, recognised separately as part of allocating the cost of a combination only if its fair value can be measured reliably.

50 Contingent liabilities recognised separately as part of allocating the cost of a business combination are excluded from the scope of AASB 137. However, the acquirer shall disclose for those contingent liabilities the information required to be disclosed by AASB 137 for each class of provision.

Goodwill

51 The acquirer shall, at the acquisition date:

(a) recognise goodwill acquired in a business combination as an asset; and

(b) initially measure that goodwill at its cost, being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with paragraph 36.

52 Goodwill acquired in a business combination represents a payment made by the acquirer in anticipation of future economic benefits from assets that are not capable of being individually identified and separately recognised.

53 To the extent that the acquiree's identifiable assets, liabilities or contingent liabilities do not satisfy the criteria in paragraph 37 for separate recognition at the acquisition date, there is a resulting effect on the amount recognised as goodwill (or accounted for in accordance with paragraph 56). This is because goodwill is measured as the residual cost of the business combination after recognising the acquiree's identifiable assets, liabilities and contingent liabilities.

54 After initial recognition, the acquirer shall measure goodwill acquired in a business combination at cost less any accumulated impairment losses.

55 Goodwill acquired in a business combination shall not be amortised. Instead, the acquirer shall test it for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired, in accordance with AASB 136 *Impairment of Assets*.

Excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost

56 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:

(a) reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination; and

(b) recognise immediately in profit or loss any excess remaining after that reassessment.

Aus56.1 [Deleted by the AASB]

57 A gain recognised in accordance with paragraph 56 could comprise one or more of the following components:

(a) errors in measuring the fair value of either the cost of the combination or the acquiree's identifiable assets, liabilities or contingent liabilities. Possible future costs arising in respect of the acquiree that have not been reflected correctly in the fair value of the acquiree's identifiable assets, liabilities or contingent liabilities are a potential cause of such errors; or

(b) a requirement in an accounting standard to measure identifiable net assets acquired at an amount that is not fair value, but is treated as though it is fair value for the purpose of allocating the cost of the combination. For example, the guidance in Appendix B on determining the fair values of the acquiree's identifiable assets and liabilities requires the amount assigned to tax assets and liabilities to be undiscounted; or

(c) a bargain purchase.

Business combination achieved in stages

58 A business combination may involve more than one exchange transaction, for example when it occurs in stages by successive share purchases. If so, each exchange transaction shall be treated separately by the acquirer, using the cost of the transaction and fair value information at the date of each exchange transaction, to determine the amount of any goodwill associated with that transaction. This results in a step-by-step comparison of the cost of the individual investments with the acquirer's interest in the fair values of the acquiree's identifiable assets, liabilities and contingent liabilities at each step.

59 When a business combination involves more than one exchange transaction, the fair values of the acquiree's identifiable assets, liabilities and contingent liabilities may be different at the date of each exchange transaction. Because:

(a) the acquiree's identifiable assets, liabilities and contingent liabilities are notionally restated to their fair values at the date of each exchange transaction to determine the amount of any goodwill associated with each transaction; and

(b) the acquiree's identifiable assets, liabilities and contingent liabilities must then be recognised by the acquirer at their fair values at the acquisition date,

any adjustment to those fair values relating to previously held interests of the acquirer is a revaluation and shall be accounted for as such. However, because this revaluation arises on the initial recognition by the acquirer of the acquiree's assets, liabilities and contingent liabilities, it does not signify that the acquirer has elected to apply an accounting policy of revaluing those items after initial recognition in accordance with, for example, AASB 116 *Property, Plant and Equipment*.

60 Before qualifying as a business combination, a transaction may qualify as an investment in an associate and be accounted for in accordance with AASB 128 *Investments in Associates* using the equity method. If so, the fair values of the investee's identifiable net assets at the date of each earlier exchange transaction will have been determined previously in applying the equity method to the investment.

Initial accounting determined provisionally

61 The initial accounting for a business combination involves identifying and determining the fair values to be assigned to the acquiree's identifiable assets, liabilities and contingent liabilities and the cost of the combination.

62 If the initial accounting for a business combination can be determined only provisionally by the end of the period in which the combination is effected because either the fair values to be assigned to the acquiree's identifiable assets, liabilities or contingent liabilities or the cost of the combination can be determined only provisionally, the acquirer shall account for the combination using those provisional values. The acquirer shall recognise any adjustments to those provisional values as a result of completing the initial accounting:

(a) within twelve months of the acquisition date; and

(b) from the acquisition date. Therefore:

(i) the carrying amount of an identifiable asset, liability or contingent liability that is recognised or adjusted as a result of completing the initial accounting shall be calculated as if its fair value at the acquisition date had been recognised from that date;

(ii) goodwill or any gain recognised in accordance with paragraph 56 shall be adjusted from the acquisition date by an amount equal to the adjustment to the fair value at the acquisition date of the identifiable asset, liability or contingent liability being recognised or adjusted;

(iii) comparative information presented for the periods before the initial accounting for the combination is complete shall be presented as if the initial accounting had been completed from the acquisition date. This includes any additional depreciation, amortisation or other profit or loss effect recognised as a result of completing the initial accounting.

Adjustments after the initial accounting is complete

63 Except as outlined in paragraphs 33, 34 and 65, adjustments to the initial accounting for a business combination after that initial accounting is complete shall be recognised only to correct an error in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. Adjustments to the initial accounting for a business combination after that accounting is complete shall not be recognised for the effect of changes in estimates. In accordance with AASB 108, the effect of a change in estimates shall be recognised in the current and future periods.

64 AASB 108 requires an entity to account for an error correction retrospectively, and to present the financial report as if the error had never occurred by restating the comparative information for the prior period(s) in which the error occurred. Therefore, the carrying amount of an identifiable asset, liability or contingent liability of the acquiree that is recognised or adjusted as a result of an error correction shall be calculated as if its fair value or adjusted fair value at the acquisition date had been recognised from that date. Goodwill or any gain recognised in a prior period in accordance with paragraph 56 shall be adjusted retrospectively by an amount equal to the fair value at the acquisition date (or the adjustment to the fair value at the acquisition date) of the identifiable asset, liability or contingent liability being recognised (or adjusted).

Recognition of deferred tax assets after the initial accounting is complete

65 If the potential benefit of the acquiree's income tax loss carry-forwards or other deferred tax assets did not satisfy the criteria in paragraph 37 for separate recognition when a business combination is initially accounted for but is subsequently realised, the acquirer shall recognise that benefit as income in accordance with AASB 112 *Income Taxes*. In addition, the acquirer shall:

(a) reduce the carrying amount of goodwill to the amount that would have been recognised if the deferred tax asset had been recognised as an identifiable asset from the acquisition date; and

(b) recognise the reduction in the carrying amount of the goodwill as an expense.

However, this procedure shall not result in the creation of an excess as described in paragraph 56, nor shall it increase the amount of any gain previously recognised in accordance with paragraph 56.

Disclosure

66 An acquirer shall disclose information that enables users of its financial report to evaluate the nature and financial effect of business combinations that were effected:

(a) during the period;

(b) after the reporting date but before the financial report is authorised for issue.

67 To give effect to the principle in paragraph 66(a), the acquirer shall disclose the following information for each business combination that was effected during the period:

(a) the names and descriptions of the combining entities or businesses;

(b) the acquisition date;

(c) the percentage of voting equity instruments acquired;

(d) the cost of the combination and a description of the components of that cost, including any costs directly attributable to the combination. When equity instruments are issued or issuable as part of the cost, the following shall also be disclosed:

(i) the number of equity instruments issued or issuable; and

(ii) the fair value of those instruments and the basis for determining that fair value. If a published price does not exist for the instruments at the date of exchange, the significant assumptions used to determine fair value shall be disclosed. If a published price exists at the date of exchange but was not used as the basis for determining the cost of the combination, that fact shall be disclosed together with: the reasons the published price was not used; the method and significant assumptions used to attribute a value to the equity instruments; and the aggregate amount of the difference between the value attributed to, and the published price of, the equity instruments;

(e) details of any operations the entity has decided to dispose of as a result of the combination;

(f) the amounts recognised at the acquisition date for each class of the acquiree's assets, liabilities and contingent liabilities, and, unless disclosure would be impracticable, the carrying amounts of each of those classes, determined in accordance with Australian Accounting Standards, immediately before the combination. If such disclosure would be impracticable, that fact shall be disclosed, together with an explanation of why this is the case;

(g) the amount of any excess recognised in profit or loss in accordance with paragraph 56, and the line item in the income statement in which the excess is recognised;

(h) a description of the factors that contributed to a cost that results in the recognition of goodwill – a description of each intangible asset that was not recognised separately from goodwill and an explanation of why the intangible asset's fair value could not be measured reliably – or a description of the nature of any excess recognised in profit or loss in accordance with paragraph 56; and

(i) the amount of the acquiree's profit or loss since the acquisition date included in the acquirer's profit or loss for the period, unless disclosure would be impracticable. If such disclosure would be impracticable, that fact shall be disclosed, together with an explanation of why this is the case.

68 The information required to be disclosed by paragraph 67 shall be disclosed in aggregate for business combinations effected during the reporting period that are individually immaterial.

69 If the initial accounting for a business combination that was effected during the period was determined only provisionally as described in paragraph 62, that fact shall also be disclosed together with an explanation of why this is the case.

70 To give effect to the principle in paragraph 66(a), the acquirer shall disclose the following information, unless such disclosure would be impracticable:

(a) the revenue of the combined entity for the period as though the acquisition date for all business combinations effected during the period had been the beginning of that period;

(b) the profit or loss of the combined entity for the period as though the acquisition date for all business combinations effected during the period had been the beginning of the period.

If disclosure of this information would be impracticable, that fact shall be disclosed, together with an explanation of why this is the case.

71 To give effect to the principle in paragraph 66(b), the acquirer shall disclose the information required by paragraph 67 for each business combination effected after the reporting date but before the financial report is authorised for issue, unless such disclosure would be impracticable. If disclosure of any of that information would be impracticable, that fact shall be disclosed, together with an explanation of why this is the case.

72 An acquirer shall disclose information that enables users of its financial report to evaluate the financial effects of gains, losses, error corrections and other adjustments recognised in the current period that relate to business combinations that were effected in the current or in previous periods.

73 To give effect to the principle in paragraph 72, the acquirer shall disclose the following information:

(a) the amount and an explanation of any gain or loss recognised in the current period that:

(i) relates to the identifiable assets acquired or liabilities or contingent liabilities assumed in a business combination that was effected in the current or a previous period; and

(ii) is of such size, nature or incidence that disclosure is relevant to an understanding of the combined entity's financial performance;

(b) if the initial accounting for a business combination that was effected in the immediately preceding period was determined only provisionally at the end of that period, the amounts and explanations of the adjustments to the provisional values recognised during the current period;

(c) the information about error corrections required to be disclosed by AASB 108 for any of the acquiree's identifiable assets, liabilities or contingent liabilities, or changes in the values assigned to those items, that the acquirer recognises during the current period in accordance with paragraphs 63 and 64.

74 An entity shall disclose information that enables users of its financial report to evaluate changes in the carrying amount of goodwill during the period.

75 To give effect to the principle in paragraph 74, the entity shall disclose a reconciliation of the carrying amount of goodwill at the beginning and end of the period, showing separately:

(a) the gross amount and accumulated impairment losses at the beginning of the period;

(b) additional goodwill recognised during the period except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with AASB 5;

(c) adjustments resulting from the subsequent recognition of deferred tax assets during the period in accordance with paragraph 65;

(d) goodwill included in a disposal group classified as held for sale in accordance with AASB 5 and goodwill derecognised during the period without having previously been included in a disposal group classified as held for sale;

(e) impairment losses recognised during the period in accordance with AASB 136;

(f) net exchange differences arising during the period in accordance with AASB 121 *The Effects of Changes in Foreign Exchange Rates*;

(g) any other changes in the carrying amount during the period; and

(h) the gross amount and accumulated impairment losses at the end of the period.

76 The entity discloses information about the recoverable amount and impairment of goodwill in accordance with AASB 136 in addition to the information required to be disclosed by paragraph 75(e).

77 If in any situation the information required to be disclosed by this Standard does not satisfy the objectives set out in paragraphs 66, 72 and 74, the entity shall disclose such additional information as is necessary to meet those objectives.

Transitional Provisions and Effective Date of IFRS 3

78 [Deleted by the AASB]

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Withdrawal of Other IASB Pronouncements

86 [Deleted by the AASB]

87 [Deleted by the AASB]

APPENDIX A

DEFINED TERMS

This appendix is an integral part of AASB 3.

<table>
<tr><td>acquisition date</td><td>The date on which the acquirer effectively obtains control of the acquiree.</td></tr>
<tr><td>agreement date</td><td>The date that a substantive agreement between the combining parties is reached and, in the case of publicly listed entities, announced to the public. In the case of a hostile takeover, the earliest date that a substantive agreement between the combining parties is reached is the date that a sufficient number of the acquiree’s owners have accepted the acquirer’s offer for the acquirer to obtain control of the acquiree.</td></tr>
<tr><td>business</td><td>An integrated set of activities and assets conducted and managed for the purpose of providing:
(a) a return to investors; or
(b) lower costs or other economic benefits directly and proportionately to policyholders or participants.
A business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate revenues. If goodwill is present in a transferred set of activities and assets, the transferred set shall be presumed to be a business.</td></tr>
<tr><td>business combination</td><td>The bringing together of separate entities or businesses into one reporting entity.</td></tr>
<tr><td>business combination involving entities or businesses under common control</td><td>A business combination in which all of the combining entities or businesses ultimately are controlled by the same party or parties both before and after the combination, and that control is not transitory.</td></tr>
<tr><td>contingent liability</td><td>Contingent liability has the meaning given to it in AASB 137 Provisions, Contingent Liabilities and Contingent Assets, that is:</td></tr>
</table>

(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not **probable** that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) the amount of the obligation cannot be measured with sufficient reliability.

control	The power to govern the financial and operating policies of an entity or **business** so as to obtain benefits from its activities.
date of exchange	When a **business combination** is achieved in a single exchange transaction, the date of exchange is the **acquisition date**. When a **business combination** involves more than one exchange transaction, for example when it is achieved in stages by successive share purchases, the date of exchange is the date that each individual investment is recognised in the financial report of the acquirer.
fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
goodwill	Future economic benefits arising from assets that are not capable of being individually identified and separately recognised.
intangible asset	Intangible asset has the meaning given to it in AASB 138 *Intangible Assets*, that is, an identifiable non-monetary asset without physical substance.
joint venture	Joint venture has the meaning given to it in AASB 131 *Interests in Joint Ventures*, that is, a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control.

minority interest	That portion of the profit or loss and net assets of a **subsidiary** attributable to equity interests that are not owned, directly or indirectly through **subsidiaries**, by the **parent**.
mutual entity	An entity other than an investor-owned entity, such as a mutual insurance company or a mutual cooperative entity, that provides lower costs or other economic benefits directly and proportionately to its policyholders or participants.
parent	An entity that has one or more **subsidiaries**.
probable	More likely than not.
reporting entity	An entity in respect of which it is reasonable to expect the existence of users who rely on the entity's general purpose financial report for information that will be useful to them for making and evaluating decisions about the allocation of resources. A reporting entity can be a single entity or a group comprising a **parent** and all of its **subsidiaries**.
subsidiary	An entity, including an unincorporated entity such as a partnership, that is **controlled** by another entity (known as the **parent**).

Additional Australian Defined Terms

[Deleted by the AASB]

APPENDIX B

APPLICATION SUPPLEMENT

This appendix is an integral part of AASB 3.

Reverse acquisitions

B1 As noted in paragraph 21, in some business combinations, commonly referred to as reverse acquisitions, the acquirer is the entity whose equity interests have been acquired and the issuing entity is the acquiree. This might be the case when, for example, a private entity arranges to have itself ‘acquired’ by a smaller public entity as a means of obtaining a stock exchange listing. Although legally the issuing public entity is regarded as the parent and the private entity is regarded as the subsidiary, the legal subsidiary is the acquirer if it has the power to govern the financial and operating policies of the legal parent so as to obtain benefits from its activities.

B2 An entity shall apply the guidance in paragraphs B3-B15 when accounting for a reverse acquisition.

B3 Reverse acquisition accounting determines the allocation of the cost of the business combination as at the acquisition date and does not apply to transactions after the combination.

Cost of the business combination

B4 When equity instruments are issued as part of the cost of the business combination, paragraph 24 requires the cost of the combination to include the fair value of those equity instruments at the date of exchange. Paragraph 27 notes that, in the absence of a reliable published price, the fair value of the equity instruments can be estimated by reference to the fair value of the acquirer or the fair value of the acquiree, whichever is more clearly evident.

B5 In a reverse acquisition, the cost of the business combination is deemed to have been incurred by the legal subsidiary (i.e. the acquirer for accounting purposes) in the form of equity instruments issued to the owners of the legal parent (i.e. the acquiree for accounting purposes). If the published price of the equity instruments of the legal subsidiary is used to determine the cost of the combination, a calculation shall be made to determine the number of equity instruments the legal subsidiary would have had to issue to provide the same percentage ownership interest of the combined entity to the owners of the legal parent as they have in the combined entity as a result of the reverse acquisition. The fair value of the number of equity instruments so calculated shall be used as the cost of the combination.

B6 If the fair value of the equity instruments of the legal subsidiary is not otherwise clearly evident, the total fair value of all the issued equity instruments of the legal parent before the business combination shall be used as the basis for determining the cost of the combination.

Preparation and presentation of consolidated financial statements

B7 Consolidated financial statements prepared following a reverse acquisition shall be issued under the name of the legal parent, but described in the notes as a continuation of the financial statements of the legal subsidiary (i.e. the acquirer for accounting purposes). Because the consolidated financial statements represents a continuation of the financial statements of the legal subsidiary:

(a) the assets and liabilities of the legal subsidiary shall be recognised and measured in those consolidated financial statements at their pre-combination carrying amounts.

(b) the retained earnings and other equity balances recognised in those consolidated financial statements shall be the retained earnings and other equity balances of the legal subsidiary immediately before the business combination.

(c) the amount recognised as issued equity instruments in those consolidated financial statements shall be determined by adding to the issued equity of the legal subsidiary immediately before the business combination the cost of the combination determined as described in paragraphs B4-B6. However, the equity structure appearing in those consolidated financial statements (i.e. the number and type of equity instruments issued) shall reflect the equity structure of the legal parent, including the equity instruments issued by the legal parent to effect the combination.

(d) comparative information presented in those consolidated financial statements shall be that of the legal subsidiary.

B8 Reverse acquisition accounting applies only in the consolidated financial statements. Therefore, in the legal parent's separate financial statements, if any, the investment in the legal subsidiary is accounted for in accordance with the requirements in AASB 127 *Consolidated and Separate Financial Statements* on accounting for investments in an investor's separate financial statements.

B9 Consolidated financial statements prepared following a reverse acquisition shall reflect the fair values of the assets, liabilities and contingent liabilities of the legal parent (i.e. the acquiree for accounting purposes). Therefore, the cost of the business combination shall be allocated by measuring the identifiable assets, liabilities and contingent liabilities of the legal parent that satisfy the recognition criteria in paragraph 37 at their fair values at the acquisition date. Any excess of the cost of the combination over the acquirer's interest in the net fair value of those items shall be accounted for in accordance with paragraphs 51-55. Any excess of the acquirer's interest in the net fair value of those items over the cost of the combination shall be accounted for in accordance with paragraph 56.

Minority interest

B10 In some reverse acquisitions, some of the owners of the legal subsidiary do not exchange their equity instruments for equity instruments of the legal parent. Although the entity in which those owners hold equity instruments (the legal subsidiary) acquired another entity (the legal parent), those owners shall be treated as a minority interest in the consolidated financial statements prepared after the reverse acquisition. This is because the owners of the legal subsidiary that do not exchange their equity instruments for equity instruments of the legal parent have an interest only in the results and net assets of the legal subsidiary, and not in the results and net assets of the combined entity. Conversely, all of the owners of the legal parent, notwithstanding that the legal parent is regarded as the acquiree, have an interest in the results and net assets of the combined entity.

B11 Because the assets and liabilities of the legal subsidiary are recognised and measured in the consolidated financial statements at their pre-combination carrying amounts, the minority interest shall reflect the minority shareholders' proportionate interest in the pre-combination carrying amounts of the legal subsidiary's net assets.

Earnings per share

B12 As noted in paragraph B7(c), the equity structure appearing in the consolidated financial statements prepared following a reverse acquisition reflects the equity structure of the legal parent, including the equity instruments issued by the legal parent to effect the business combination.

B13 For the purpose of calculating the weighted average number of ordinary shares outstanding (the denominator) during the period in which the reverse acquisition occurs:

(a) the number of ordinary shares outstanding from the beginning of that period to the acquisition date shall be deemed to be the number of ordinary shares issued by the legal parent to the owners of the legal subsidiary; and

(b) the number of ordinary shares outstanding from the acquisition date to the end of that period shall be the actual number of ordinary shares of the legal parent outstanding during that period.

B14 The basic earnings per share disclosed for each comparative period before the acquisition date that is presented in the consolidated financial statements following a reverse acquisition shall be calculated by dividing the profit or loss of the legal subsidiary attributable to ordinary shareholders in each of those periods by the number of ordinary shares issued by the legal parent to the owners of the legal subsidiary in the reverse acquisition.

B15 The calculations outlined in paragraphs B13 and B14 assume that there were no changes in the number of the legal subsidiary's issued ordinary shares during the comparative periods and during the period from the beginning of the period in which the reverse acquisition occurred to the acquisition date. The calculation of earnings per share shall be appropriately adjusted to take into account the effect of a change in the number of the legal subsidiary's issued ordinary shares during those periods.

Allocating the cost of a business combination

B16 This Standard requires an acquirer to recognise the acquiree's identifiable assets, liabilities and contingent liabilities that satisfy the relevant recognition criteria at their fair values at the acquisition date. For the purpose of allocating the cost of a business combination, the acquirer shall treat the following measures as fair values.

(a) For financial instruments traded in an active market the acquirer shall use current market values.

(b) For financial instruments not traded in an active market the acquirer shall use estimated values that take into consideration features such as price-earnings ratios, dividend yields and expected growth rates of comparable instruments of entities with similar characteristics.

(c) For receivables, beneficial contracts and other identifiable assets the acquirer shall use the present values of the amounts to be received, determined at appropriate current interest rates, less allowances for uncollectibility and collection costs, if necessary. However, discounting is not required for short-term receivables, beneficial contracts and other identifiable assets when the difference between the nominal and discounted amounts is not material.

(d) For inventories of:

   (i) finished goods and merchandise the acquirer shall use selling prices less the sum of (1) the costs of disposal and (2) a reasonable profit allowance for the selling effort of the acquirer based on profit for similar finished goods and merchandise;

   (ii) work in progress the acquirer shall use selling prices of finished goods less the sum of (1) costs to complete, (2) costs of disposal and (3) a reasonable profit allowance for the completing and selling effort based on profit for similar finished goods; and

   (iii) raw materials the acquirer shall use current replacement costs.

(e) For land and buildings the acquirer shall use market values.

(f) For plant and equipment the acquirer shall use market values, normally determined by appraisal. If there is no market-based evidence of fair value because of the specialised nature of the item of plant and equipment and the item is rarely sold, except as part of a continuing business, an acquirer may need to estimate fair value using an income or a depreciated replacement cost approach.

(g) For intangible assets the acquirer shall determine fair value:

   (i) by reference to an active market as defined in AASB 138 *Intangible Assets*; or

(ii) if no active market exists, on a basis that reflects the amounts the acquirer would have paid for the assets in arm's length transactions between knowledgeable willing parties, based on the best information available (see AASB 138 for further guidance on determining the fair values of intangible assets acquired in business combinations).

(h) For net employee benefit assets or liabilities for defined benefit plans the acquirer shall use the present value of the defined benefit obligation less the fair value of any plan assets. However, an asset is recognised only to the extent that it is probable it will be available to the acquirer in the form of refunds from the plan or a reduction in future contributions.

(i) For tax assets and liabilities the acquirer shall use the amount of the tax benefit arising from tax losses or the taxes payable in respect of profit or loss in accordance with AASB 112 *Income Taxes*, assessed from the perspective of the combined entity. The tax asset or liability is determined after allowing for the tax effect of restating identifiable assets, liabilities and contingent liabilities to their fair values and is not discounted.

(j) For accounts and notes payable, long-term debt, liabilities, accruals and other claims payable the acquirer shall use the present values of amounts to be disbursed in settling the liabilities determined at appropriate current interest rates. However, discounting is not required for short-term liabilities when the difference between the nominal and discounted amounts is not material.

(k) For onerous contracts and other identifiable liabilities of the acquiree the acquirer shall use the present values of amounts to be disbursed in settling the obligations determined at appropriate current interest rates.

(l) For contingent liabilities of the acquiree the acquirer shall use the amounts that a third party would charge to assume those contingent liabilities. Such an amount shall reflect all expectations about possible cash flows and not the single most likely or the expected maximum or minimum cash flow.

B17 Some of the above guidance requires fair values to be estimated using present value techniques. If the guidance for a particular item does not refer to the use of present value techniques, such techniques may be used in estimating the fair value of that item.

ILLUSTRATIVE EXAMPLES

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ILLUSTRATIVE EXAMPLES

These examples accompany, but are not part of, AASB 3.

Examples of items acquired in a business combination that meet the definition of an intangible asset

The following guidance provides examples of items acquired in a business combination that meet the definition of an intangible asset and are therefore recognised under AASB 3 separately from goodwill, provided that their fair values can be measured reliably. To meet the definition of an intangible asset a non-monetary asset without physical substance must be identifiable, that is, it must arise from contractual or other legal rights or be separable.

The examples provided below are not intended to be an exhaustive list of items acquired in a business combination that meet the definition of an intangible asset. A non-monetary asset without physical substance acquired in a business combination might meet the identifiability criterion for identification as an intangible asset but not be included in this guidance.

Assets designated with the symbol # are those that meet the definition of an intangible asset because they arise from contractual or other legal rights. Assets designated with the symbol ∗ do not arise from contractual or other legal rights, but meet the definition of an intangible asset because they are separable. Assets designated with the symbol # might also be separable; however, separability is not a necessary condition for an asset to meet the contractual-legal criterion.

A Marketing-related intangible assets

1 Trademarks, trade names, service marks, collective marks and certification marks #

Trademarks are words, names, symbols or other devices used in trade to indicate the source of a product and to distinguish it from the products of others. A service mark identifies and distinguishes the source of a service rather than a product. Collective marks are used to identify the goods or services of members of a group. Certification marks are used to certify the geographical origin or other characteristics of a good or service.

Trademarks, trade names, service marks, collective marks and certification marks may be protected legally through registration with governmental agencies, continuous use in commerce, or by other means. Provided it is protected legally through registration or other means, a trademark or other mark acquired in a business combination is an intangible asset that meets the contractual-legal criterion. Otherwise, a trademark or other mark acquired in a business combination can meet the definition of an intangible asset provided the separability criterion is met, which would normally be the case.

The terms ‘brand’ and ‘brand name’ are often used as synonyms for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise.

2 Internet domain names #

An Internet domain name is a unique alphanumeric name that is used to identify a particular numeric Internet address. Registration of a domain name creates an association between that name and a designated computer on the Internet for the period of the registration. Those registrations are renewable. A registered domain name acquired in a business combination is an intangible asset that meets the contractual-legal criterion.

3 Trade dress (unique colour, shape or package design) #

4 Newspaper mastheads #

5 Non-competition agreements #

B Customer-related intangible assets

1 Customer lists ∗

A customer list consists of information about customers, such as their name and contact information. A customer list may also be in the form of a database that includes other information about the customers such as their order history and demographic information. A customer list does not generally arise from contractual or other legal rights. However, customer lists are valuable and are frequently leased or exchanged. Therefore, a customer list acquired in a business combination normally meets the separability criterion for identification as an intangible asset. However, a customer list acquired in a business combination would not meet that criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its customers.

2 Order or production backlog #

An order or production backlog arises from contracts such as purchase or sales orders. An order or production backlog acquired in a business combination meets the contractual-legal criterion for identification as an intangible asset, even if the purchase or sales orders are cancellable.

3 Customer contracts and the related customer relationships #

If an entity establishes relationships with its customers through contracts, those customer relationships arise from contractual rights. Therefore, customer contracts and the related customer relationships acquired in a business combination meet the contractual-legal criterion for identification as intangible assets. This will be the case even if confidentiality or other contractual terms prohibit the sale or transfer of a contract separately from the acquired entity or business.

Customer relationships also meet the contractual-legal criterion for identification as intangible assets when an entity has a practice of establishing contracts with its customers, regardless of whether a contract exists at the date of acquisition.

As noted in B2, an order or a production backlog arises from contracts such as purchase or sales orders, and is therefore also considered a contractual right. Consequently, if an entity has customer relationships with its customers through these types of contracts, the customer relationships also arise from contractual rights, and therefore meet the contractual-legal criterion for identification as intangible assets.

4 Non-contractual customer relationships ∗

If a customer relationship acquired in a business combination does not arise from a contract, the relationship is an intangible asset if it meets the separability criterion. Exchange transactions for the same asset or a similar asset provide evidence of separability of a non-contractual customer relationship and might also provide information about exchange prices that should be considered when estimating fair value.

C Artistic-related intangible assets

Artistic-related assets acquired in a business combination meet the criteria for identification as intangible assets if they arise from contractual or legal rights such as those provided by copyright. Copyrights can be transferred either in whole through assignments or in part through licensing agreements. An entity is not precluded from recognising a copyright intangible asset and any related assignments or licence agreements as a single asset, provided they have similar useful lives.

1 Plays, operas and ballets #

2 Books, magazines, newspapers and other literary works #

3 Musical works such as compositions, song lyrics and advertising jingles #

4 Pictures and photographs #

5 Video and audiovisual material, including films, music videos and television programmes #

D Contract-based intangible assets

1 Licensing, royalty and standstill agreements #

2 Advertising, construction, management, service or supply contracts #

3 Lease agreements #

4 Construction permits #

5 Franchise agreements #

6 Operating and broadcasting rights #

7 Use rights such as drilling, water, air, mineral, timber-cutting and route authorities #

8 Servicing contracts such as mortgage servicing contracts #

Contracts to service financial assets are one particular type of contract-based intangible asset. While servicing is inherent in all financial assets, it becomes a distinct asset (or liability):

(a) when contractually separated from the underlying financial asset by sale or securitisation of the assets with servicing retained; or

(b) through the separate purchase and assumption of the servicing.

If mortgage loans, credit card receivables or other financial assets are acquired in a business combination with servicing retained, the inherent servicing rights are not a separate intangible asset because the fair value of those servicing rights is included in the measurement of the fair value of the acquired financial asset.

9 Employment contracts that are beneficial contracts from the perspective of the employer because the pricing of those contracts is below their current market value #

E Technology-based intangible assets

1 Patented technology #

2 Computer software and mask works #

If computer software and program formats acquired in a business combination are protected legally, such as by patent or copyright, they meet the contractual-legal criterion for identification as intangible assets.

Mask works are software permanently stored on a read-only memory chip as a series of stencils or integrated circuitry. Mask works may have legal protection. Mask works with legal protection that are acquired in a business combination also meet the contractual-legal criterion for identification as intangible assets.

3 Unpatented technology ∗

4 Databases ∗

Databases are collections of information, often stored in electronic form (such as on computer disks or files). A database that includes original works of authorship may be entitled to copyright protection. If a database acquired in a business combination is protected by copyright, it meets the contractual-legal criterion for identification as an intangible asset. However, a database typically includes information created as a consequence of an entity's normal operations, such as customer lists, or specialised information such as scientific data or credit information. Databases that are not protected by copyright can be, and often are, exchanged, licensed or leased to others in their entirety or in part. Therefore, even if the future economic benefits from a database do not arise from legal rights, a database acquired in a business combination meets the separability criterion for identification as an intangible asset.

5 Trade secrets such as secret formulas, processes or recipes #

If the future economic benefits from a trade secret acquired in a business combination are legally protected, that asset meets the contractual-legal criterion for identification as an intangible asset. Otherwise, trade secrets acquired in a business combination meet the definition of an intangible asset only if the separability criterion is met, which is often likely to be the case.

Customer relationship intangible assets acquired in a business combination

The following examples illustrate the recognition in accordance with AASB 3 of customer relationship intangible assets acquired in a business combination.

Example 1

Background

Parent obtained control of Supplier in a business combination on 31 December 20X4. Supplier has a five-year agreement to supply goods to Buyer. Both Supplier and Parent believe that Buyer will renew the supply agreement at the end of the current contract. The supply agreement is not separable.

Analysis

The supply agreement (whether cancellable or not) meets the contractual-legal criterion for identification as an intangible asset, and therefore is recognised separately from goodwill, provided its fair value can be measured reliably. Additionally, because Supplier establishes its relationship with Buyer through a contract, the customer relationship with Buyer meets the contractual-legal criterion for identification as an intangible asset. Therefore, the customer relationship intangible asset is also recognised separately from goodwill provided its fair value can be measured reliably. In determining the fair value of the customer relationship, Parent considers assumptions such as the expected renewal of the supply agreement.

Example 2

Background

Parent obtained control of Subsidiary in a business combination on 31 December 20X4. Subsidiary manufactures goods in two distinct lines of business – sporting goods and electronics. Customer purchases from Subsidiary both sporting goods and electronics. Subsidiary has a contract with Customer to be its exclusive provider of sporting goods. However, there is no contract for the supply of electronics to Customer. Both Subsidiary and Parent believe that there is only one overall customer relationship between Subsidiary and Customer.

Analysis

The contract to be Customer's exclusive supplier of sporting goods (whether cancellable or not) meets the contractual-legal criterion for identification as an intangible asset, and is therefore recognised separately from goodwill, provided its fair value can be measured reliably. Additionally, because Subsidiary establishes its relationship with Customer through a contract, the customer relationship with Customer meets the contractual-legal criterion for identification as an intangible asset. Therefore, the customer relationship intangible asset is also recognised separately from goodwill, provided its fair value can be measured reliably. Because there is only one customer relationship with Customer, the fair value of that relationship incorporates assumptions regarding Subsidiary's relationship with Customer related to both sporting goods and electronics.

However, if both Parent and Subsidiary believed there were separate customer relationships with Customer – one for sporting goods and another for electronics – the customer relationship with respect to electronics would be assessed by Parent to determine whether it meets the separability criterion for identification as an intangible asset.

Example 3

Background

Entity A obtained control of Entity B in a business combination on 31 December 20X4. Entity B does business with its customers solely through purchase and sales orders. At 31 December 20X4, Entity B has a backlog of customer purchase orders from 60% of its customers, all of whom are recurring customers. The other 40% of Entity B's customers are also recurring customers. However, as of 31 December 20X4, Entity B does not have any open purchase orders or other contracts with those customers.

Analysis

The purchase orders from 60% of Entity B's customers (whether cancellable or not) meet the contractual-legal criterion for identification as intangible assets, and are therefore recognised separately from goodwill, provided their fair values can be measured reliably. Additionally, because Entity B has established its relationship with 60% of its customers through contracts, those customer relationships meet the contractual-legal criterion for identification as an intangible asset. Therefore, the customer relationship intangible asset is also recognised separately from goodwill provided its fair value can be measured reliably.

Because Entity B has a practice of establishing contracts with the remaining 40% of its customers, its relationship with those customers also arises through contractual rights, and therefore meets the contractual-legal criterion for identification as an intangible asset. Entity A recognises this customer relationship separately from goodwill, provided its fair value can be measured reliably, even though Entity B does not have contracts with those customers at 31 December 20X4.

Example 4

Background

Parent obtained control of Insurer in a business combination on 31 December 20X4. Insurer has a portfolio of one-year motor insurance contracts that are cancellable by policyholders. A reasonably predictable number of policyholders renew their insurance contracts each year.

Analysis

Because Insurer establishes its relationships with policyholders through insurance contracts, the customer relationship with policyholders meets the contractual-legal criterion for identification as an intangible asset. Therefore, the customer relationship intangible asset is recognised separately from goodwill, provided its fair value can be measured reliably. In determining the fair value of the customer relationship intangible asset, Parent considers estimates of renewals and cross-selling. AASB 136 *Impairment of Assets* and AASB 138 *Intangible Assets* apply to the customer relationship intangible asset.

In determining the fair value of the liability relating to the portfolio of insurance contracts, Parent considers estimates of cancellations by policyholders. AASB 4 *Insurance Contracts* permits, but does not require, an expanded presentation that splits the fair value of acquired insurance contracts into two components:

(a) a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and

(b) an intangible asset, representing the fair value of the contractual rights and obligations acquired, to the extent that the liability does not reflect that fair value. This intangible asset is excluded from the scope of AASB 136 and AASB 138. After the business combination, Parent is required to measure that intangible asset on a basis consistent with the measurement of the related insurance liability.

Reverse acquisitions

The following example illustrates the application of the guidance on reverse acquisition accounting provided as an application supplement in paragraphs B1-B15 of Appendix B of AASB 3.

Example 5

This example illustrates the accounting for a reverse acquisition in which Entity A, the entity issuing equity instruments and therefore the legal parent, is acquired in a reverse acquisition by Entity B, the legal subsidiary, on 30 September 20X1. The accounting for any income tax effects is ignored in this example:

Balance sheets of A and B immediately before the business combination

	A	**B**
	CU	CU
Current assets	500	700
Non-current assets	1,300	3,000
	1,800	3,700
Current liabilities	300	600
Non-current liabilities	400	1,100
	700	1,700
Owners' equity		
Retained earnings	800	1,400
Issued equity		
100 ordinary shares	300	
60 ordinary shares		600
	1,100	2,000
	1,800	3,700

Other information

(a) On 30 September 20X1, A issues 2½ shares in exchange for each ordinary share of B. All of B's shareholders exchange their shares in B. Therefore, A issues 150 ordinary shares in exchange for all 60 ordinary shares of B.

(b) The fair value of each ordinary share of B at 30 September 20X1 is CU40. The quoted market price of A's ordinary shares at that date is CU12.

(c) The fair values of A's identifiable assets and liabilities at 30 September 20X1 are the same as their carrying amounts, with the exception of non-current assets. The fair value of A's non-current assets at 30 September 20X1 is CU1,500.

Calculating the cost of the business combination

As a result of the issue of 150 ordinary shares by A, B's shareholders own 60% of the issued shares of the combined entity (i.e. 150 shares out of 250 issued shares). The remaining 40% are owned by A's shareholders. If the business combination had taken place in the form of B issuing additional ordinary shares to A's shareholders in exchange for their ordinary shares in A, B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. B's shareholders would then own 60 out of the 100 issued shares of B and therefore 60% of the combined entity.

As a result, the cost of the business combination is CU1,600 (i.e. 40 shares each with a fair value of CU40).

Measuring goodwill

Goodwill is measured as the excess of the cost of the business combination over the net fair value of A's identifiable assets and liabilities. Therefore, goodwill is measured as follows:

	CU	CU
Cost of the business combination		1,600
Net fair value of A's identifiable assets and liabilities:		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	(400)	1,300
Goodwill		300

Consolidated balance sheet at 30 September 20X1

	CU
Current assets [CU700 + CU500]	1,200
Non-current assets [CU3,000 + CU1,500]	4,500
Goodwill	300
	6,000
Current liabilities [CU600 + CU300]	900
Non-current liabilities [CU1,100 + CU400]	1,500
	2,400
Owners' equity	
Retained earnings	1,400
Issued equity	
250 ordinary shares [CU600 + CU1,600] [1]	2,200
	3,600
	6,000

Earnings per share

Assume that B's profit for the annual period ending 31 December 20X0 was CU600, and that the consolidated profit for the annual period ending 31 December 20X1 is CU800. Assume also that there was no change in the number of ordinary shares issued by B during the annual period ending 31 December 20X0 and during the period from 1 January 20X1 to the date of the reverse acquisition (30 September 20X1).

Earnings per share for the annual period ending 31 December 20X1 is calculated as follows:

1 In accordance with paragraph B7(c) of AASB 3, the amount recognised as issued equity instruments in the consolidated financial statements is determined by adding to the issued equity of the legal subsidiary immediately before the business combination [CU600] the cost of the combination [CU1,600]. However, the equity structure appearing in the consolidated financial statements (i.e. the number and type of equity instruments issued) must reflect the equity structure of the legal parent, including the equity instruments issued by the legal parent to effect the combination.

Number of shares deemed to be outstanding for the period from 1 January 20X1 to the acquisition date (i.e. the number of ordinary shares issued by A in the reverse acquisition)	150
Number of shares outstanding from the acquisition date to 31 December 20X1	250
Weighted average number of ordinary shares outstanding [(150 x 9/12) + (250 x 3/12)]	175
Earnings per share [800/175]	CU4.57

Restated earnings per share for the annual period ending 31 December 20X0 is 4.00 (i.e. the profit of B of 600 divided by the number of ordinary shares issued by A in the reverse acquisition).

Minority interest

In the above example, assume that only 56 of B's ordinary shares are tendered for exchange rather than all 60. Because A issues 2½ shares in exchange for each ordinary share of B, A issues only 140 (rather than 150) shares. As a result, B's shareholders own 58.3% of the issued shares of the combined entity (i.e. 140 shares out of 240 issued shares).

The cost of the business combination is calculated by assuming that the combination had taken place in the form of B issuing additional ordinary shares to the shareholders of A in exchange for their ordinary shares in A. In calculating the number of shares that would have to be issued by B, the minority interest is ignored. The majority shareholders own 56 shares of B. For this to represent a 58.3% ownership interest, B would have had to issue an additional 40 shares. The majority shareholders would then own 56 out of the 96 issued shares of B and therefore 58.3% of the combined entity.

As a result, the cost of the business combination is CU1,600 (i.e. 40 shares each with a fair value of CU40). This is the same amount as when all 60 of B's ordinary shares are tendered for exchange. The cost of the combination does not change simply because some of B's shareholders do not participate in the exchange.

The minority interest is represented by the 4 shares of the total 60 shares of B that are not exchanged for shares of A. Therefore, the minority interest is 6.7%. The minority interest reflects the minority shareholders' proportionate interest in the pre-combination carrying amounts of the net assets of the legal subsidiary. Therefore, the consolidated balance sheet is adjusted to show a minority interest of 6.7% of the pre-combination carrying amounts of B's net assets (i.e. CU134 or 6.7% of CU2,000).

The consolidated balance sheet at 30 September 20X1 reflecting the minority interest is as follows:

	CU
Current assets [CU700 + CU500]	1,200
Non-current assets [CU3,000 + CU1,500]	4,500
Goodwill	300
	6,000
Current liabilities [CU600 + CU300]	900
Non-current liabilities [CU1,100 + CU400]	1,500
	2,400
Owners’ equity	
Retained earnings [CU1,400 x 93.3%]	1,306
Issued equity	
240 ordinary shares [CU560 + CU1,600]	2,160
Minority interest	134
	3,600
	6,000

Business combination achieved in stages

The following example illustrates the application of the guidance on business combinations achieved in stages in paragraphs 58-60 of AASB 3. In particular, it deals with successive share purchases that result in an investee previously accounted for at fair value being included as a subsidiary in the consolidated financial statements.

Immediately following the example is a discussion of the outcome of applying the guidance in paragraphs 58-60 of AASB 3 to the example assuming the investee had previously been accounted for at cost or by applying the equity method, rather than at fair value.

Example 6

Investor acquires a 20% ownership interest in Investee (a service company) on 1 January 20X1 for CU3,500,000 cash. At that date, the fair value of Investee's identifiable assets is CU10,000,000, and the carrying amount of those assets is CU8,000,000. Investee has no liabilities or contingent liabilities at that date. The following shows Investee's balance sheet at 1 January 20X1 together with the fair values of the identifiable assets:

	Carrying amounts CU	Fair values CU
Cash and receivables	2,000,000	2,000,000
Land	6,000,000	8,000,000
	8,000,000	10,000,000
Issued equity:		
1,000,000 ordinary shares	5,000,000	
Retained earnings	3,000,000	
	8,000,000	

During the year ended 31 December 20X1, Investee reports a profit of CU6,000,000 but does not pay any dividends. In addition, the fair value of Investee's land increases by CU3,000,000 to CU11,000,000. However, the amount recognised by Investee in respect of the land remains unchanged at CU6,000,000. The following shows Investee's balance sheet at 31 December 20X1 together with the fair values of the identifiable assets:

	Carrying amounts CU	Fair values CU
Cash and receivables	8,000,000	8,000,000
Land	6,000,000	11,000,000
	14,000,000	19,000,000
Issued equity:		
1,000,000 ordinary shares	5,000,000	
Retained earnings	9,000,000	
	14,000,000	

On 1 January 20X2, Investor acquires a further 60% ownership interest in Investee for CU22,000,000 cash, thereby obtaining control. Before obtaining control, Investor does *not* have significant influence over Investee, and accounts for its initial 20% investment at fair value with changes in value included in profit or loss. Investee's ordinary shares have a quoted market price at 31 December 20X1 of CU30 per share.[2]

Throughout the period 1 January 20X1 to 1 January 20X2, Investor's issued equity was CU30,000,000. Investor's only asset apart from its investment in Investee is cash.

Accounting for the initial investment before obtaining control

Investor's initial 20% investment in Investee is measured at CU3,500,000. However, Investee's 1,000,000 ordinary shares have a quoted market price at 31 December 20X1 of CU30 per share. Therefore, the carrying amount of Investor's initial 20% investment is remeasured in Investor's financial report to CU6,000,000 at 31 December 20X1, with the CU2,500,000 increase recognised in profit or loss for the period. Therefore, Investor's balance sheet at 31 December 20X1, before the acquisition of the additional 60% ownership interest, is as follows:

2 Therefore, Investee's market capitalisation at 31 December 20X1 is CU30,000,000. However, Investor paid CU22,000,000 for the additional 60% of the issued shares and control of Investee on 1 January 20X2. This indicates that Investor paid a significant premium for control of Investee.

	CU
Cash	26,500,000
Investment in Investee	6,000,000
	32,500,000
Issued equity	30,000,000
Retained earnings	2,500,000
	32,500,000

Accounting for the business combination

Paragraph 25 of AASB 3 states that when a business combination involves more than one exchange transaction, the cost of the combination is the aggregate cost of the individual transactions, with the cost of each individual transaction determined at the date of each exchange transaction (i.e. the date that each individual investment is recognised in the acquirer's financial report). This means that for this example, the cost to Investor of the business combination is the aggregate of the cost of the initial 20% ownership interest (CU3,500,000) plus the cost of the subsequent 60% ownership interest (CU22,000,000), irrespective of the fact that the carrying amount of the initial 20% interest has changed.

In addition, and in accordance with paragraph 58 of AASB 3, each transaction must be treated separately to determine the goodwill on that transaction, using cost and fair value information at the date of each exchange transaction. Therefore, Investor recognises the following amounts for goodwill in its consolidated financial statements:

For the 20% ownership interest costing CU3,500,000:	
goodwill = 3,500,000 – [20% × 10,000,000] =	CU1,500,000
For the 60% ownership interest costing CU22,000,000:	
goodwill = 22,000,000 – [60% × 19,000,000] =	CU10,600,000

The following shows Investor's consolidation worksheet (all amounts in CU) immediately after the acquisition of the additional 60% ownership interest in Investee, together with consolidation adjustments and associated explanations:

	Investor	Investee	Consolidation Adjustments Dr	Consolidation Adjustments Cr	Consolidated	
Net Assets						
Cash and receivables	4,500	8,000			12,500	
Investment in Investee	28,000	–		2,500 (2) 3,500 (3) 22,000 (4)	–	
Land	–	6,000	5,000 (1)		11,000	See note (a)
Goodwill	–	–	1,500 (3) 10,600 (4)		12,100	See note (b)
	32,500	14,000			35,600	
Issued equity	30,000	5,000	1,000 (3) 3,000 (4) 1,000 (5)		30,000	See note (c)
Asset revaluation reserve	–	–	400 (3) 3,000 (4) 1,000 (5)	5,000 (1)	600	See note (d)
Retained earnings	2,500	9,000	2,500 (2) 600 (3) 5,400 (4) 1,800 (5)		1,200	See note (e)
Minority interest	–	–		3,800 (5)	3,800	See note (a)
	32,500	14,000			35,600	

Consolidation Adjustments

		Dr	Cr
(1)	Land	5,000	
	Asset revaluation reserve		5,000
	To recognise Investee's identifiable assets at fair values at the acquisition date		
(2)	Retained earnings	2,500	
	Investment in Investee		2,500
	To restate the initial 20% investment in Investee to cost		
(3)	Issued equity [20% x 5,000]	1,000	
	Asset revaluation reserve [20% × 2,000[3]]	400	
	Retained earnings [20% × 3,000]	600	
	Goodwill	1,500	
	Investment in Investee		3,500
	To recognise goodwill on the initial 20% investment in Investee and record the elimination of that investment against associated equity balances		
(4)	Issued equity [60% × 5,000]	3,000	
	Asset revaluation reserve [60% × 5,000]	3,000	
	Retained earnings [60% × 9,000]	5,400	
	Goodwill	10,600	
	Investment in Investee		22,000
	To recognise goodwill on the subsequent 60% investment in Investee and record elimination of that investment against associated equity balances		
(5)	Issued equity [20% × 5,000]	1,000	
	Asset revaluation reserve [20% × 5,000]	1,000	
	Retained earnings [20% × 9,000]	1,800	
	Minority interest (in issued equity)		1,000
	Minority interest (in asset revaluation reserve)		1,000
	Minority interest (in retained earnings)		1,800
	To recognise the minority interest in the Investee		

3 The CU2,000,000 asset revaluation reserve represents the amount by which the fair value of Investee's land at the date of the first exchange transaction exceeds its carrying amount; the carrying amount of the land at the date Investor acquired the initial 20% interest was CU6,000,000, but its fair value was CU8,000,000. In accordance with paragraph 58 of AASB 3, each transaction must be treated separately for the purpose of determining the amount of goodwill on that transaction, using cost and fair value information at the date of each exchange transaction.

Notes

The above consolidation adjustments result in:

(a) investee's identifiable net assets being stated at their full fair values at the date Investor obtains control of Investee. This means that the 20% minority interest in Investee also is stated at the minority's 20% share of the fair values of Investee's identifiable net assets;

(b) goodwill being recognised from the acquisition date at an amount based on treating each exchange transaction separately and using cost and fair value information at the date of each exchange transaction;

(c) issued equity of CU30,000,000 comprising the issued equity of Investor of CU30,000,000;

(d) an asset revaluation reserve of CU600,000. This amount reflects that part of the increase in the fair value of Investee's identifiable net assets after the acquisition of the initial 20% interest that is attributable to that initial 20% interest [20% × CU3,000,000];

(e) a retained earnings balance of CU1,200,000. This amount reflects the changes in Investee's retained earnings after Investor acquired its initial 20% interest that is attributable to that 20% interest [20% × CU6,000,000].

Therefore, the effect of applying the requirements in AASB 3 to business combinations involving successive share purchases for which the investment was previously accounted for at fair value with changes in value included in profit or loss is to cause:

- changes in the fair value of previously held ownership interests to be reversed (so that the carrying amounts of those ownership interests are restated to cost);

- changes in the investee's retained earnings and other equity balances after each exchange transaction to be included in the post-combination consolidated financial statements to the extent that they relate to the previously held ownership interests.

Applying AASB 3 if the investee had previously been accounted for at cost or using the equity method

As discussed above, paragraph 25 of AASB 3 requires the cost of a business combination involving more than one exchange transaction to be measured as the aggregate cost of the individual transactions, with the cost of each individual transaction determined at the date of each exchange transaction (i.e. the date that each individual investment is recognised in the acquirer's financial report). Therefore, irrespective of whether the initial 20% investment in Investee is accounted for at cost, by applying the equity method or at fair value, the cost to Investor of the combination is the aggregate of the cost of the initial 20% ownership interest (CU3,500,000) plus the cost of the subsequent 60% ownership interest (CU22,000,000).

In addition, and again irrespective of whether the initial 20% investment in Investee is accounted for at cost, by applying the equity method or at fair value, each transaction must be treated separately for the purpose of determining the amount of goodwill on that transaction, using cost and fair value information at the date of each exchange transaction.

Therefore, the effect of applying AASB 3 to any business combination involving successive share purchases is to cause:

- any changes in the carrying amount of previously held ownership interests to be reversed (so that the carrying amounts of those ownership interests are restated to cost);

- changes in the investee's retained earnings and other equity balances after each exchange transaction to be included in the post-combination consolidated financial statements to the extent that they relate to the previously held ownership interests.

Consequently, the consolidated financial statements immediately after Investor acquires the additional 60% ownership interest and obtains control of Investee would be the same irrespective of the method used to account for the initial 20% investment in Investee before obtaining control.

Changes in the values assigned to the acquiree's identifiable assets

Completing the initial accounting for a business combination

The following example illustrates the application of the guidance in paragraph 62 of AASB 3 on completing the initial accounting for a business combination when the acquirer has, at the end of the first period after the combination, accounted for the combination using provisional values. This example does not address the accounting for any income tax effects arising from the adjustments.

AASB 3 requires the acquirer to account for a business combination using provisional values if the initial accounting for a business combination can be determined only provisionally by the end of the reporting period in which the combination is effected. The acquirer is required to recognise any adjustments to those provisional values as a result of completing the initial accounting:

(a) within twelve months of the acquisition date; and

(b) from the acquisition date. Therefore:

    (i) the carrying amount of an identifiable asset, liability or contingent liability that is recognised or adjusted as a result of completing the initial accounting is calculated as if its fair value at the acquisition date had been recognised from that date;

    (ii) goodwill or any gain recognised in accordance with paragraph 56 is adjusted from the acquisition date by an amount equal to the adjustment to the fair value at the acquisition date of the identifiable asset, liability or contingent liability being recognised or adjusted;

    (iii) comparative information presented for the periods before the initial accounting for the combination is complete is presented as if the initial accounting had been completed from the acquisition date. This includes any additional depreciation, amortisation or other profit or loss effects recognised as a result of completing the initial accounting.

Example 7

An entity prepares financial reports for annual periods ending on 31 December and does not prepare interim financial reports. The entity was the acquirer in a business combination on 30 September 20X4. The entity sought an independent appraisal for an item of property, plant and equipment acquired in the combination. However, the appraisal was not finalised by the time the entity completed its 20X4 annual financial report. The entity recognised in its 20X4 annual financial report a provisional fair value for the asset of CU30,000, and a provisional value for acquired goodwill of CU100,000. The item of property, plant and equipment had a remaining useful life at the acquisition date of five years.

Four months after the acquisition date, the entity received the independent appraisal, which estimated the asset's fair value at the acquisition date at CU40,000.

As outlined in paragraph 62 of AASB 3, the acquirer is required to recognise any adjustments to provisional values as a result of completing the initial accounting from the acquisition date.

Therefore, in the 20X5 financial report, an adjustment is made to the opening carrying amount of the item of property, plant and equipment.
That adjustment is measured as the fair value adjustment at the acquisition date of CU10,000, less the additional depreciation that would have been recognised had the asset's fair value at the acquisition date been recognised from that date (CU500 for three months' depreciation to 31 December 20X4). The carrying amount of goodwill is also adjusted for the reduction in value at the acquisition date of CU10,000, and the 20X4 comparative information is restated to reflect this adjustment and to include additional depreciation of CU500 relating to the year ended 31 December 20X4.

In accordance with paragraph 69 of AASB 3, the entity discloses in its 20X4 financial report that the initial accounting for the business combination has been determined only provisionally, and explains why this is the case. In accordance with paragraph 73(b) of AASB 3, the entity discloses in its 20X5 financial report the amounts and explanations of the adjustments to the provisional values recognised during the current reporting period. Therefore, the entity discloses that:

- the fair value of the item of property, plant and equipment at the acquisition date has been increased by CU10,000 with a corresponding decrease in goodwill; and

- the 20X4 comparative information is restated to reflect this adjustment and to include additional depreciation of CU500 relating to the year ended 31 December 20X4.

Error corrections

The following examples illustrate the application of the guidance in paragraphs 63 and 64 of AASB 3 on the accounting for error corrections related to the initial accounting for a business combination. These examples do not address the accounting for any income tax effects arising from the adjustments.

With three exceptions,[4] AASB 3 requires adjustments to be made to the initial accounting for a business combination after that initial accounting is complete only to correct an error in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. After that accounting is completed, adjustments cannot be recognised for the effect of changes in accounting estimates. In accordance with AASB 108, the effect of a change in an accounting estimate is recognised prospectively. AASB 108 provides guidance on distinguishing corrections of errors from changes in accounting estimates.

Example 8

An entity prepares financial reports for annual periods ending on 31 December and does not prepare interim financial reports. The entity was the acquirer in a business combination on 30 September 20X1. As part of the initial accounting for that combination, the entity recognised goodwill of CU100,000. The carrying amount of goodwill at 31 December 20X1 was CU100,000.

During 20X2, the entity becomes aware of an error relating to the amount initially allocated to property, plant and equipment assets acquired in the business combination. In particular, CU20,000 of the CU100,000 initially allocated to goodwill should be allocated to property, plant and equipment assets that had a remaining useful life at the acquisition date of five years.

As outlined in paragraph 64 of AASB 3, AASB 108 requires the correction of an error to be accounted for retrospectively, and for the financial report to be presented as if the error had never occurred by correcting the error in the comparative information for the prior period(s) in which it occurred.

Therefore, in the 20X2 financial report, an adjustment is made to the opening carrying amount of property, plant and equipment assets. That adjustment is measured as the fair value adjustment at the acquisition date of CU20,000 less the amount that would have been recognised as depreciation of the fair

4 Two of the three exceptions relate to adjustments to the cost of a business combination after the initial accounting for the combination is complete. The third relates to the subsequent recognition by the acquirer of the acquiree's deferred tax assets that did not satisfy the criteria for separate recognition when initially accounting for the business combination.

value adjustment (CU1,000 for three months' depreciation to 31 December 20X1). The carrying amount of goodwill is also adjusted for the reduction in value at the acquisition date of CU20,000, and the 20X1 comparative information is restated to reflect this adjustment and to include additional depreciation of CU1,000 relating to the year ended 31 December 20X1.

In accordance with AASB 108, the entity discloses in its 20X2 financial report the nature of the error and that, as a result of correcting that error, an adjustment was made to the carrying amount of property, plant and equipment. The entity also discloses that:

- the fair value of property, plant and equipment assets at the acquisition date has been increased by CU20,000 with a corresponding decrease in goodwill; and

- the 20X1 comparative information is restated to reflect this adjustment and to include additional depreciation of CU1,000 relating to the year ended 31 December 20X1.

Example 9

This example assumes the same facts as in Example 8, except that the amount initially allocated to property, plant and equipment assets is decreased by CU20,000 to correct the error, rather than increased by CU20,000. This example also assumes that the entity determines that the recoverable amount of the additional goodwill is only CU17,000 at 31 December 20X1.

In the 20X2 financial report, the opening carrying amount of property, plant and equipment assets is reduced by CU19,000, being the fair value adjustment at the acquisition date of CU20,000 less CU1,000 in depreciation expense recognised for the three-month period to 31 December 20X1. The carrying amount of goodwill is increased by CU17,000, being the increase in value at the acquisition date of CU20,000 less a CU3,000 impairment loss to reflect that the carrying amount of the adjustment exceeds its recoverable amount. The 20X1 comparative information is restated to reflect this adjustment and to exclude the CU1,000 depreciation and include the CU3,000 impairment loss.

In accordance with AASB 108, the entity discloses in its 20X2 financial report the nature of the error and that, as a result of correcting that error, an adjustment was made to the carrying amount of property, plant and equipment. The entity also discloses that:

- the fair value of property, plant and equipment assets at the acquisition date has been decreased by CU20,000 with a corresponding increase in goodwill; and

- the 20X1 comparative information is restated to reflect this adjustment and to exclude CU1,000 depreciation recognised during the year ended 31 December 20X1 and include a CU3,000 impairment loss for goodwill relating to the year ended 31 December 20X1.