PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers
ABN 52 780 433 757

333 Collins Street
MELBOURNE VIC 3000
GPO Box 1331L
MELBOURNE VIC 3001
DX 77 Melbourne
Australia
www.pwc.com/au
Telephone +61 3 8603 1000
Facsimile +61 3 8603 1999

Professor David Boymal
The Chairman
Australian Accounting Standard's Board
PO Box 204
Collins St West Vic 8007

27 April 2005

Dear David

Response to Invitation to Comment: *The Definition of "Contribution by Owners"*

We are pleased to submit our comments in response to the Invitation to Comment on *The Definition of "Contribution by Owners"*.

We thank the Board for addressing our concerns in relation to the inconsistencies the Australian definition of contributions by owners could create with International Financial Reporting Standards (IFRS). We agree with the deletion of the definition of contributions by owners from AASB 3 *Business Combinations*, as proposed by the Board. However, we believe the proposed amended paragraph Aus56.1 should be restricted to not-for-profit entities.

Our initial concern with the definition of contribution by owners was that it would have broader application than business combinations covered by AASB 3, so would result in Australian entities not being able to treat some transactions with parents as equity contributions in line with IFRS or other AIFRS (eg, the share-based payment and tax consolidation transactions referred to on pages 4 and 5 of the invitation to comment). This will be remedied by removing the Australian definition of contributions by owners from AASB 3.

We were also concerned that Australian entities may have to report an excess of the interest in net assets acquired in an internal reconstruction over the cost of the business combination acquisition as a gain in the profit or loss, because it did not meet the Australian definition of a contribution by owners. We expect the majority of entities reporting under IFRS would apply the common control scope exclusion in IFRS 3 in this situation and treat this excess as a movement in equity. We would like Australian entities to be able to account for internal reconstructions in the same way, including the treatment of contributions from equity participants.

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However, if entities reporting under IFRS do elect to apply IFRS 3 to business combinations involving entities under common control (common control transactions) by analogy, they will have to comply with all the provisions of the standard, including paragraph 56. This requires an excess of net assets over the cost of a business combination to be recognised in the profit or loss. This means the excess will not be treated as a movement in equity, even if the transaction is with an equity participant, as proposed in the amended paragraph Aus56.1.

Accordingly, we do not believe the Board should amend and retain paragraph Aus56.1, as proposed. This will introduce more inconsistencies in the reporting under AASB 3 and IFRS 3. This is not appropriate for profit entities, at this stage.

We suggest that the proposed amended paragraph Aus56.1 should be restricted to not-for-profit entities, which would be in line with AASB 1004 *Contributions* and UIG 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities*.

This will result in Australian profit entities having to recognise all excesses of net assets over the cost of business combinations in the profit or loss, rather than in equity. However, it seems this is an anomaly we will have to accept because the Board has determined not to scope common control transactions out of AASB 3.

As we have said in our previous comments on international convergence, we believe Australia should be adopting the international standards as they are written by the IASB, except in the rare circumstance where modifications are necessary because applying IFRS as written would cause contraventions of specific Australian legislative requirements. This would minimise the inconsistencies that will prevent Australian reporting entities from preparing their financial reports in accordance with IFRS, as they apply to entities in other IFRS jurisdictions.

Set out below are our comments on the following question raised in the invitation to comment:

Could the excess dealt with in paragraph Aus 56.1 meet the definition of income?
It is possible for business combinations involving entities or businesses within the same reporting entity to give rise to an excess dealt with in paragraph Aus56.1 that would meet the definition of income.

We would expect such an excess to be treated as a contribution by equity participants when it arises on the transfer of an entity or business from a parent. However, a transfer from a fellow subsidiary may give rise to an excess that would be treated as income as the contribution is not from an equity participant.

We are continuing to work through issues relating to business combinations with our IFRS desk, including accounting for common control transactions in single entity financial statements. The resolution of these issues should clarify the appropriate accounting for an excess when it arises on a common control transaction.

We would be pleased to discuss our views at your convenience. Please contact me on 03 6803 3868 or Sue Whitechurch on 02 8266 7543 if there is any matter you would like us to elaborate further.

Yours sincerely

Jan McCahey

Jan McCahey
Partner
Assurance