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Mr David Boymal
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Dear Mr Boymal

INVITATION TO COMMENT ON THE DEFINITION OF “CONTRIBUTION BY OWNERS”

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to the Board’s invitation to comment on the definition of “Contribution by Owners” (issued by the AASB in March 2005).

HoTARAC has reviewed the AASB’s four options for “Contribution by Owners” (refer to Appendix 1). HoTARAC considers that Option 3 is preferable to Option 4. Option 3 has the advantage of minimising both the reporting differences between “for-profit” and “not-for-profit” entities and the disadvantages of Option 4.

However, it is HoTARAC’s opinion that Option 3 will not adequately deal with equity transfers that do not meet the definitions in AASB 3 (in both the public and private sectors) and therefore require the transfer to be written down to nil. To rectify this, HoTARAC proposes either:

- expanding the scope of AASB 3 paragraph Aus 56.1 to address any transfer with entities within the same reporting entity i.e. not just those that meet the definition of “business combinations” as currently required under AASB 3 paragraph Aus 56.1; or
- including an additional Australian specific paragraph to AASB 3 paragraph 4. This paragraph could clarify that transfers between entities under common control, that are not business combinations, may be measured at either cost or fair value, where they constitute contributions by equity participants.

If you have any queries regarding this submission, please contact Robert Williams, at New South Wales Treasury, on (02) 9228 3019.

Yours sincerely

D W Challen
CHAIR
HEADS OF TREASURIES ACCOUNTING AND
REPORTING ADVISORY COMMITTEE

May 2005

Encl

INVITATION TO COMMENT ON THE DEFINITION OF
“CONTRIBUTION BY OWNERS”

HoTARAC’s comments on the preliminary Conclusions

HoTARAC agrees with the preliminary conclusion that the definition of contributions by owners should be removed from AASB 3 Appendix A and that AASB 3 paragraph Aus 56.1 should be amended. However, HoTARAC recommends Option 3 and is strongly opposed to Option 4. In short, Option 4 has serious disadvantages to the public sector in prohibiting transactions that are, in substance, equity transfers from being recognised. Option 3 has distinct advantages for the public sector. HoTARAC’s reasons for strongly preferring Option 3 are discussed below under “HoTARAC comments on the four options raised in the invitation to comment”.

Even if Option 3 is adopted, HoTARAC considers that the proposed amendments are not sufficient for either the public sector or the private sector. Briefly put, some equity transfers in both the public and private sector will not meet the definitions in AASB 3. This includes tax consolidation related transactions, which is stated to be one of the reasons for the proposed amendments. It also includes many equity transfers in the public sector. To correct the deficiency, further amendments to AASB 3 are urgently required. This is discussed below under “In particular, the AASB is interested in knowing if constituents consider that there exists circumstances in which the excess dealt with in paragraph Aus 56.1 would meet the definition of income.”

HoTARAC comments on the four options raised in the invitation to comment

HoTARAC considers that Option 3 is preferable to Option 4. Option 3 results in a similar outcome to Option 4 but has the advantage of minimising the reporting differences between “for-profit” and “not-for-profit” entities. See below for HoTARAC’s comments in respect of each option.

Option 1: Do nothing.

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

HoTARAC accepts the need to amend the definition of “contribution by owners”.

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

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

In principle, HoTARAC would not object to a change in the definition of “contribution by owners” to address the difference. However, given the likely divergence of views resulting from the issue of any proposed change, this may not be a practical solution.

Option 3: Delete the definition of contribution by owners and rewrite AASB 3 paragraph Aus 56.1, AASB 1004 Contributions and UIG Interpretation 1038 Contributions by Owners Made to Wholly-Owned Public Sector Entities using generic language that does not create potential inconsistencies with IFRSs.

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

HoTARAC considers Option 3 is preferable to Option 4. Option 3 results in a similar outcome to Option 4 (below) but has the advantage of minimising the reporting differences between for-profit and not-for-profit entities. The main reason for issue of UIG Interpretation 1038 was because the definition of “contribution by owners” was, in many instances, not sufficient to distinguish between “contribution by owners” and revenue/expense in the public sector. That is, where the transferee does not issue equity instruments, or is not party to a formal agreement, formal designation is the determining factor for classification as contribution by owners. Accordingly, removing the definition of “contribution by owners” is expected to have limited impact, as for the most part, designation is required.

In summary, as long as designation is retained as the determining factor in UIG Interpretation 1038, the removal of the “contribution by owners” definition should have limited impact for the public sector. Therefore, HoTARAC disagrees with the AASB’s conclusion that that “use of generic language would make AASB 1004 and Interpretation 1038 more difficult to understand”. As long as designation is retained in UIG Interpretation 1038, this should not be an issue.

Further, HOTALARAC disagrees with the disadvantages of Option 3 asserted by the AASB. The use of generic language would not make AASB 1004 and Interpretation 1038 more difficult to interpret. Because designation is the determining factor in UIG Interpretation 1038, there is no misunderstanding as to when a contribution is a contribution by owners. Instead, it was the current definition that was more difficult to understand and which led to the need for Interpretation 1038 (see comments under Option 4).

Further, HoTARAC recommends that the proposed amendment to paragraph Aus 56.1 (ie changing “a contribution by owners” to “a contribution by equity participants” used in Option 4) should be used as the “generic language” proposed by the AASB for Option 3.

Finally, and importantly, Option 3 has other advantages to the public sector in removing circumstances where AASB 3 paragraph 4 would require contributions by owners that do not meet the definitions in AASB 3 to be written down to nil. It would remove all circumstances if paragraph Aus 56.1 is further amended as suggested by HoTARAC. This is discussed below under “In particular, the AASB is interested in knowing if constituents consider that there exists circumstances in which the excess dealt with in paragraph Aus 56.1 would meet the definition of income.”

Option 4: Delete the definition of contribution by owners from AASB 3 and rewrite AASB 3 paragraph Aus 56.1 to make it consistent with the accounting under IFRSs, but retain the definition in AASB 1004 and Interpretation 1038.

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

HoTARAC's view is that there is no benefit to not-for-profit entities in retaining the current definition of "contribution by owners" in AASB 1004. As previously noted above regarding Option 3, because designation is the determining factor in UIG Interpretation 1038, there is no misunderstanding as to when a contribution is a contribution by owners. Instead, the existing definition has caused misunderstanding when the definition of "contribution by owners" was satisfied in the public sector. That led to Interpretation 1038. The definition was the problem and is still unnecessary.

Therefore, the proposed removal of the "contribution by owners" definition will have a positive impact for the public sector; and this positive impact will be greater if done in conjunction with further amendments to paragraph Aus 56.1 as discussed below. This is discussed under "In particular, the AASB is interested in knowing if constituents consider that there exists circumstances in which the excess dealt with in paragraph Aus 56.1 would meet the definition of income."

Further, HoTARAC disagrees with the reasons advanced by the AASB for Option 4. They do not justify the AASB's position for the following reasons:

- The AASB should evaluate alternative options based on accounting principles to reflect the substance of transactions and events. It is not appropriate for the AASB to make decisions based on its assessments about the interest shown by not-for-profit entities. HoTARAC also considers that this assertion is not correct.
- The fact that not-for-profit entities are likely to be non-compliant with IFRS is an equally irrelevant assertion in developing sector neutral accounting standards in Australia. The objective of developing sector neutral Standards is to minimise the differences between for-profit and not-for-profit entities. In fact, the long-term objective should be to eliminate any differences. Based on this, the major disadvantage of Option 4 is to increase divergences between these two sectors in an area where, in principle, there are similar issues.
- There is no justification in the AASB proposing an amendment to an accounting standard that creates the risk that "not-for-profit entities might not be able, even if they wished, to recognise equity for ..." "... a reconstruction within a reporting entity". First, within that asserted conclusion, is the equally implied assertion that there are such reconstructions in the public sector that are in substance equity transfers. This is a fact, not a risk, and the fact is that the public sector is vitally concerned to see that transfers that are in substance equity transfers are correctly accounted for. This means that the proposed amendment to

the standard is clearly deficient and does not meet the needs of the not-for-profit sector, including the public sector. Instead, the critical issue is whether paragraph Aus 56.1 is wide enough to sufficiently address transfers that HoTARAC regards as equity transfers or whether paragraph 4 should be amended.

In particular, the AASB is interested in knowing if constituents consider that there exists circumstances in which the excess dealt with in paragraph Aus 56.1 would meet the definition of income.

HoTARAC does not have a view as to whether such circumstances exist or not.

However, HoTARAC has a strong view that AASB 3 may prevent transfers that are in substance equity from being recognised at fair value, a conceptually wrong consequence for both the private sector and the public sector.

In AASB 3, under the heading “Differences between AASB 3 and AASB 1013 and AASB 1015”, the AASB states that the definition of a business combination is more restrictive in AASB 3 than in AASB 1015. It quotes the AASB 3 definitions of a business combination and a business. It notes that the AASB 1015 definition of an acquisition as “obtaining control of an asset, group of assets or net assets ...”. It then states as follows:

“AASB 1015 contrasts the acquisition of a group of assets or net assets that forms an entity or operation to the acquisition of a group of assets that does not form an entity or operation.”

But, AASB 3 paragraph 4 (and AASB 1015 paragraph 6.2.1 in similar words) then states:

“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.”

Simply put, a write-down to the consideration paid (often nil) is required. The scope of AASB 3 therefore includes non-business combinations, and leads to an unacceptable result for both public and private sector entities. UIG Abstract 40 previously addressed this.

Part of this problem also relates to the different treatment of “common control” business combinations in AASB 3 and IFRS 3. That is, in AASB 3, the AASB deleted the IFRS 3 “common control” exclusion. Therefore, the scope of AASB 3 in this respect is wider than IFRS 3. Given this wider scope, the AASB added extra Australian specific paras to address common control transactions (refer paragraphs Aus 3.1 – Aus 3.2 and paragraph Aus 56.1). However, in HoTARAC’s view, as discussed above, these paragraphs do not go far enough, as they do not address transfers within an economic entity that do not meet the definition of a business combination.

The Problem for the Private Sector (or For-Profit Entities)

One of the reasons put forward for the ITC proposal concerns the treatment of equity contributions relating to share based payments and tax consolidations (refer ITC paras 4 and 5). However, the proposed amendments are unlikely to fall within the scope of paragraph Aus 56.1 (see below). Further, the proposed amendment may result in an outcome that conflicts with the treatment as equity proposed in UIG Interpretation 1052.

This is because:

- Aus 56.1 refers to “business combinations involving entities or businesses within the same reporting entity.” But, the share based payment and tax consolidation examples are unlikely to meet the definition of either a “business combination” or a “business”. Therefore, these equity transfers would not be subject to paragraph Aus 56.1.
- If Aus 56.1 does not apply, AASB 3 paragraph 4 seems to apply. As noted above, it states:

“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.”

In the case of for-profit entities where “cost” is less than “fair value”, this implies that assets and liabilities transferred must be written down to “cost” which may be nil or a nominal amount. However, not-for-profit entities would be required to recognise assets received at nil or nominal consideration at fair value (per AASB 116, paragraph Aus 15.1, AAS 29 paragraph 7.4). This also results in inconsistent treatment between for-profit and not-for-profit entities.

The objective of the AASB’s proposals in the ITC is that the share based payment and tax consolidation examples should be treated as an equity contribution. That does not seem possible, because of AASB 3 paragraph 4. The question arises whether paragraph 4 can be read down or interpreted to have a narrower scope than it appears? In other words, are there equity transfers that should be viewed as outside the scope of AASB 3, especially paragraph 4? Put in other words, because AASB 3 paragraph 3 has extended the scope of AASB 3 beyond the scope of IFRS 3, does AASB 3 paragraph 4 need an additional Australian paragraph to deal with the extended scope?

Abstract 40 stated the above issue clearly. It said:

“... Accounting Standards in Australia do not include general requirements for accounting for acquisitions that occur through non-reciprocal transfers. Accounting Standards AASB 1015 and AAS 21 specify the accounting for acquisitions that occur through reciprocal transactions ...”.

HoTARAC agrees and also notes that accounting standards do not include general requirements for accounting for equity transfers that occur through non-reciprocal transfers (other than in AAS 29 and UIG Interpretation 1038). This comment equally applies to AEIFRS standards.

Abstract 40 was therefore written to permit non-reciprocal transactions within entities in a reporting entity to be recognised as equity transfers and measured at fair value if the definition of contributions by owners is satisfied (Abstract 40 paras 7 and 8).

Abstract 40 would therefore permit tax consolidation transfers to be treated as equity transfers and valued at fair value. But Abstract 40 has not been carried forward into AEIFRS Interpretations, and AASB 3 paragraph Aus 56.1 does not allow this treatment, because these transfers do not meet the definition of a business combination or business. But AASB 3 paragraph 4 does apply, resulting in an inappropriate outcome.

HoTARAC therefore also disagrees with the UIGs stated reason for not reissuing UIG Abstract 40, as follows:

“A revised Abstract 40 requiring fair value measurements for non-reciprocal transfers is not appropriate as many of the transfers that would have been covered might be reconstructions within a reporting entity that do not satisfy the definition of a business combination (so that AASB 3 does not apply).”

HoTARAC disagrees, because AASB 3 paragraph 4 applies, as stated above and applies to equity transfers that should be beyond the scope of AASB 3.

This may be addressed in one of two ways:

- expanding the scope of Aus 56.1 to address any transfer with entities within the same reporting entity i.e. not just those that meet the definition of “business combinations” as currently required under AASB 3 paragraph Aus 56.1; or
- including an additional Australian specific paragraph to paragraph 4. This paragraph could clarify that transfers between entities under common control, that are not business combinations, may be measured at either cost or fair value, where they constitute contributions by equity participants.

The problem for not-for-profit entities but especially including the Public Sector

As stated above under “HoTARAC comments on the four options raised in the invitation to comment”, Option 3, by amending the definitions, eliminates some, but not all, of the circumstances where this could apply in the public sector.

HoTARAC therefore recommends that further amendment to AASB 3 is required to address the unintended consequences, as the following discusses.

There is current debate as to whether AASB 3 applies to the public sector; and if so, what are the implications? HoTARAC recently submitted an Issues Proposal to the UIG concerning the application of AASB 3 and the measurement of contributions made to wholly owned public sector entities (see Appendix 2).

In summary, the Issues Proposal notes that some commentators suggest that AASB 3 does not apply to the public sector and, if that is true, UIG Interpretation 1038 does not address measurement of the equity transfer. If the AASB agrees with this view, then it is an issue for the UIG.

However, other commentators suggest that AASB 3 does apply to the public sector, but that many contributions or reconstructions will not meet the definitions in AASB 3 of “business combination”, “business” or “reconstruction within a reporting entity”. If this is correct, paragraph 4 requires a write-down to the consideration paid, often nil. Such a write-down would not reflect that the contribution is a “contribution by owners” that should be measured at fair value or the amount recognised by the transferor.

Even if the proposed amendment to AASB 3 paragraph Aus 56.1 and Appendix in this Invitation to Comment are made, and Option 3 is adopted, the Paper argues that the problem would still apply to some reconstructions. In short, some reconstructions will not meet the definition of a business ie “an integrated set of activities and assets conducted to provide a return to investors ... or other economic benefits”. Examples are provided at Appendix 2

page 11. Tax consolidation transactions should be added to this list. If this view is correct, this is a matter that the AASB should address as a necessary part of revising AASB 3.

The Issues Proposal therefore recommends that AASB 3 should include an Australian amendment to permit any contribution that meets the definition of a contribution by equity participants (previously a contribution by owners) to be valued at either fair value or the transferor's carrying amount as otherwise allowed in AASB 3 paragraph Aus 56.1 and Aus 3.1.

Australian Accounting Standards Board

URGENT ISSUES GROUP

Issues Proposal 05-X

Accounting for Contributions by Owners Made to Wholly-Owned Public Sector Entities –

Debate as to whether the *measurement* of such transfers at less than fair value is adequately dealt with by AASB 3 and/or UIG Interpretation 1038

Executive Summary

The measurement of contributions by owners to wholly-owned public sector entities as a result of a government decision, at less than fair value, under AEIFRS, is subject to considerable debate.

AASB 3 paragraph 56.1 allows that, for business combinations within the same reporting entity, if an acquirer's interest in the net fair value of the acquiree's net assets exceeds the cost of the acquisition, the excess can be recognised as a contribution by owners. And paragraph Aus 3.1 allows the option to value the acquisition at the carrying amount of the acquiree immediately prior to the reconstruction.

However, commentators argue that in some circumstances the measurement of contributions by owners made to wholly-owned public sector entities is unclear or not addressed in proposed AEIFRS standards/interpretations. Concern has been expressed that, in the absence of clarification, diverse or unacceptable accounting practices may occur.

The issues are:

- If AASB 3 applies, some contributions will not meet the definition of “business” and therefore AASB 3 paragraph 4 requires a write-down to the consideration paid. If this view is correct, to address this issue, some commentators propose that AASB 3 should be amended to allow any transfer that meets the definition of a contribution by owners under UIG Interpretation 1038 to be valued at either fair value or the transferor's carrying amount as otherwise allowed in AASB 3 by paras Aus 56.1 and Aus 3.1 and Aus 3.2.
- If UIG Interpretation 1038 applies (and AASB 3 does not apply), measurement of such contribution is simply not addressed. If this view is correct, to address this issue, these commentators argue that:
 - either UIG Interpretation 1038 ‘*Contributions by Owners Made to Wholly-Owned Public Sector Entities*’ should be amended to address measurement, or
 - UIG Abstract 40 should be retained to address the measurement of such contributions, but the scope reduced to entities subject to UIG Interpretation 1038 or

- AASB 3 should be amended to allow any transfer that meets the definition of a contribution by owners under UIG Interpretation 1038 to be valued at fair value or transferor's carrying amount as otherwise allowed in AASB 3 by paras Aus 56.1 and Aus 3.1 & Aus 3.2.

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Accounting for Contributions by Owners Made to Wholly-Owned Public Sector Entities –

Debate as to whether the *measurement* of such transfers at less than fair value is adequately dealt with by AASB 3 and/or UIG Interpretation 1038

Issue

The measurement of contributions by owners to wholly-owned public sector entities as a result of a government decision, at less than fair value, under AEIFRS, is subject to considerable debate.

Under AEIFRS, different views have arisen. The issues are:

- whether UIG Interpretation 1038 applies (and AASB 3 does not apply) or AASB 3 applies (together with UIG Interpretation 1038);
- if AASB 3 applies, whether all or only some restructures within government meet the definition of business combinations in AASB 3;
- if AASB 3 does not apply to certain contributions by owners, how to measure such contributions;
- if UIG Interpretation 1038 only applies, how to measure such transfers, because it is currently intended that UIG Abstract 40, which addressed measurement, will not be retained when AEIFRS commence.

Concern has been expressed that, in the absence of clarification, diverse or unacceptable accounting practices may occur or develop.

The following alternative views have been expressed by various commentators:

- Some commentators argue that AASB 3 does not apply to restructures of wholly-owned entities within government because the more specific requirements of UIG Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities*, AASB 1004 *Contributions* and AAS 29 *Financial Reporting by Government Departments* apply.

These commentators argue that the more specific standards/abstracts that apply to the public sector place public sector restructures outside of the scope of AASB 3, or at least those reconstructions that are at less than fair value.

If this is correct, the issue is that UIG Interpretation 1038 does not address the measurement of government restructures. This was previously covered by UIG

Abstract 40 *Non-Reciprocal Transfers within an Economic Entity for Monetary or No Consideration*, which required such transfers to be measured at fair value. However, it is currently intended that UIG Abstract 40 will not be retained when AEIFRS commence. Further, AAS 29 only applies to a more narrow scope of entities, namely Government Departments. Finally, AASB 1004 *Contributions* only applies to not-for-profit entities, and only to contributions that are recognised as revenue.

To address this issue, these commentators argue that UIG Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities* should be amended to address measurement, or UIG Abstract 40 should be retained to address the measurement of such contributions, or AASB 3 should be amended to allow any transfer that meets the definition of a contribution by owners under UIG Interpretation 1038 to be valued at fair value or the transferor's carrying amount as otherwise allowed in AASB 3 by paras Aus 56.1 and Aus 3.1 & Aus 3.2 (but contrary to AASB 3 paragraph 4).

Other commentators argue that AASB 3 applies to restructures within government, or at least to such restructures that meet the definitions of "business combination", "business" or "reconstruction within a reporting entity".

First, these commentators note that AASB 3 paragraph Aus 3.1 explicitly includes *reconstructions within a reporting entity* within the scope of AASB 3, if the entity is not required to comply with the Corporations Act. IASB 3 does not apply to business combinations involving entities under common control, because IASB 3 paragraph 3(b) excludes these. However, the exclusion in IASB paragraph 3(b) was deleted by the AASB from AASB 3 and replaced with paragraph Aus 3.1 which includes *reconstructions within a reporting entity* within the scope of AASB 3, if the entity is not required to comply with the Corporations Act. This is supported by paragraph Aus 56.1 which allows the excess of the acquirer's interest in the net assets over the cost to be recognised as contributions by owners. Such commentators therefore argue that AASB 3 is intended to apply to all non-Corporations Act Australian entities, including those in the public sector.

Second, these commentators argue that UIG Interpretation 1038 merely addresses how to determine whether a transfer of assets to a wholly-owned entity meets the definition of a contribution by owners as defined in AASB 3. Therefore, if UIG Interpretation 1038 applies to a transfer, AASB3 also applies.

If this view is correct, the issue is that commentators have expressed alternative views as to how, or to what extent, AASB 3 applies to reconstructions within the public sector and whether it correctly describes how such transfers should be valued.

- If AASB 3 applies to reconstructions within a wholly-owned public sector group, some commentators have expressed the view that AASB 3 does not apply to many reconstructions within the public sector, because they do not meet the definitions in AASB 3 of "business combination", "business" and/or "reconstruction within a reporting entity".
- Such commentators argue that the AASB 3 definition of "reconstruction within a reporting entity" only applies where the *"the acquirer only issues its own equity instruments as purchase consideration"*. If this view is correct, few reconstructions within the public sector would meet the definition of reconstructions, because most restructures occur without issuing equity instruments and many entities do not have equity instruments to evidence control.

- Other commentators disagree and argue that *most* reconstructions within the public sector meet the definitions in AASB 3 of “business combination” or “business”. These commentators argue as follows:
 - that AASB 3 applies to public sector reconstructions, so long as the definitions of “business combination” (ie “*the bringing together of entities or businesses*”) and “business” (ie it must entail “*an integrated set of activities and assets conducted for the purpose of providing a return to investors, or lower costs or other economic benefits directly and proportionately to policyholders or participants*”) are both met.
 - the view that AASB 3 definition of “reconstruction within a reporting entity” only applies where the “*the acquirer only issues its own equity instruments as purchase consideration*” simply prevents combinations involving other than the acquirer’s equity instruments being considered as business combinations. Based on this view, the definition does deny, and therefore allows, public sector reconstructions involving no equity instruments or existing equity instruments to be considered as reconstructions.
- However, other commentators argue that *some reconstructions* between wholly-owned entities within the public sector will not meet the definitions in AASB 3. These commentators note that UIG Interpretation 1038 permits a transfer to be a contribution by owners if it is evidenced by equity instruments, a formal agreement or *formal designation*. Some jurisdictions have written policies to address formal designation. For example, NSW Treasury has a policy that determines which transfers within the public sector meet the definition of contributions by owners. This policy designates certain transfers of assets or groups of assets or liabilities as contributions by owners, including:
 - Administrative restructures,
 - Corporatisations,
 - Establishment of new statutory authorities,
 - Transfers of programs/functions between agencies,
 - Transfers of parts of programs/functions between agencies,
 - Other transfers to adjust an agency’s capital structure, and
 - Other transfers with a Government controlled parent entity.

These commentators argue that some of these transfers may not meet the AASB 3 definition of “*an integrated set of activities and assets conducted to provide ...a return to investors ...*”. For example, the transfer of parts of programs/functions between agencies and the transfer of individual assets would often not meet this definition.

If this view is correct, the issue is how to *measure* such transfers to wholly-owned public sector entities. Again, alternative views exist.

- Alternative views exist as to how to recognise and measure transfers to wholly-owned public sector entities that do not meet the definition of “business”.

Some commentators have expressed the view that AASB 3 addresses this. Although AASB 3 says that it only applies to business combinations, paragraph 4 states that “*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 the relative fair values at the date of acquisition*”.

If the transfer is for no consideration or less than fair value, paragraph 4 would require such assets to be written down below their fair value.

If this view is correct, some commentators argue that this is inconsistent with the required treatment of other contributions to wholly-owned entities within the public sector (to be at fair value or optionally per paragraph Aus 3.1 & 3.2 at the transferor’s carrying value immediately prior to the reconstruction).

To address this issue, these commentators argue that a specific Australian amendment should be made to AASB 3, to allow any transfer that meets the definitions of a contribution by owners under UIG Interpretation 1038 to be valued at fair value or the transferor’s carrying amount consistent with paragraph Aus 56.1, and Aus 3.1 & 3.2, but contrary to AASB paragraph 4.

Other commentators argue that, in the public sector, when AASB 3 does not apply because the definitions are not met, the requirements of more specific requirements of standards/abstracts apply.

If this view is correct, there is a gap, because such measurement was covered by UIG Abstract 40, which is intended not to be retained under AEIFRS.

To address this issue, these commentators argue that either UIG Interpretation 1038 ‘*Contributions by Owners Made to Wholly-Owned Public Sector Entities*’ should be amended to address measurement, or UIG Abstract 40 should be retained, to address the measurement of such contributions consistent with the requirements of AASB 3 paras Aus 56.1 and Aus 3.1 & 3.2.

Current practice

In the case of transfers within an economic entity UIG Abstract 40 (paragraph 8) requires that:

“A non-reciprocal transfer, or a transfer with reciprocal and non-reciprocal components, must be recognised at the fair value of the transfer at the acquisition date.”

However, it is currently intended that UIG Abstract 40 will not be retained under AEIFRS.

Further, under AEIFRS, although AASB 3 *Business Combinations* has largely replicated AAS21 *Acquisition of Assets* and AAS18 *Goodwill*, it has a more limited scope than AAS21, because AASB 3 only applies to business combinations as defined in the standard.

AASB 3 paragraph 56.1 states:

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

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

AASB 3 paragraph 3.1 then allows an option for non-Corporate Act entities as follows:

Aus3.1 An entity that is not required to prepare financial reports in accordance with the Corporations Act and:

- (a) is a reporting entity; or
- (b) is not a reporting entity but prepares financial reports that are held out to be general purpose financial reports;

may elect to account for a *reconstruction within a reporting entity* by measuring at the acquisition date the assets acquired (and, where applicable, liabilities and contingent liabilities assumed) at their carrying amounts determined in accordance with Australian Accounting Standards immediately prior to the reconstruction within a reporting entity.

Aus3.2 Where there is a reconstruction within a reporting entity and the acquirer elects to account for the reconstruction in accordance with paragraph Aus3.1, the vendor entity must account for its acquisition of the acquirer's equity instruments by measuring those equity instruments at the aggregate of the carrying amounts immediately prior to the reconstruction within a reporting entity of the assets transferred to the acquirer (less, where applicable, liabilities and contingent liabilities assumed by the acquirer).

However, if a contribution by owners to a wholly-owned public sector entity does not meet the definitions of "*business combination*", "*business*" or "*reconstruction with an economic entity*", then the measurement of such contributions is not addressed by these paragraphs in AASB 3. Instead paragraph 4 applies as follows:

- "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".

Reasons for UIG to consider

Most commentators support that contributions by owners to wholly owned public sector entities at less than fair value should be measured at fair value; with the option to measure the transfer at the transferor's carrying amount immediately prior to the transfer.

However, under AEIFRS, commentators argue that some circumstances where the measurement of contributions by owners made to wholly-owned public sector entities is unclear or not addressed in existing standards/interpretations.

Therefore, to achieve consistency of measurement of transfers that are contributions by owners made to wholly-owned public sector entities at less than fair value, clarification is required.

The issues and potential clarifications are:

- If AASB 3 applies to contributions by owners made to wholly-owned public sector entities at less than fair value, some contributions will not meet the definition of "business" and therefore AASB 3 paragraph 4, requires a write-down to the consideration paid.

If this view is correct, to address this issue, some commentators propose that AASB 3 should be amended to allow any transfer that meets the definition of a contribution by owners under UIG Interpretation 1038 to be valued at either fair value or the transferor's carrying amount as otherwise allowed in AASB 3 by paras Aus 56.1 and Aus 3.1 and Aus 3.2.

- If UIG Interpretation 1038 applies (and AASB 3 does not apply), measurement of such contribution is simply not addressed.

If this view is correct, to address this issue, these commentators argue that:

- either UIG Interpretation 1038 '*Contributions by Owners Made to Wholly-Owned Public Sector Entities*' should be amended to address measurement, or
- UIG Abstract 40 should be retained to address the measurement, of such contributions, but the scope reduced to entities subject to UIG Interpretation 1038, or
- AASB 3 should be amended to allow any transfer that meets the definition of a contribution by owners under UIG Interpretation 1038 to be valued at fair value or the transferor's carrying amount as otherwise allowed in AASB 3 by paras Aus 56.1 and Aus 3.1 & Aus 3.2.