

# **Explanatory Statement**

## **Accounting Standard AASB 3 *Business Combinations***

**March 2008**



**Australian Government**

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**Australian Accounting  
Standards Board**

## EXPLANATORY STATEMENT

### Reasons for Issuing AASB 3

The IASB concluded the first phase of its consideration of business combinations by issuing the previous version of IFRS 3 *Business Combinations* (March 2004). The IASB's primary conclusion in the first phase was that virtually all business combinations are acquisitions. Accordingly, the IASB decided to require the use of one method of accounting for business combinations – the acquisition method. The AASB incorporated IFRS 3 (issued March 2004) into AASB 3 *Business Combinations* (issued July 2004).

The second phase of the IASB project addressed the guidance for applying the acquisition method. The IASB concluded the second phase of the project by issuing IFRS 3 *Business Combinations* and the related amendments to IAS 27 *Consolidated and Separate Financial Statements* in January 2008.

The AASB issued revised AASB 3 *Business Combinations* and amended AASB 127 *Consolidated and Separate Financial Statements*, that incorporate IFRS 3 and the amendments made to IAS 27 respectively, in March 2008. The AASB also issued AASB 2008-3 *Amendments to Australian Accounting Standards arising from AASB 3 and AASB 127*, which makes consequential amendments to other Australian Accounting Standards that have arisen as a result of the IASB's Business Combinations project at the same time. These Standards enable Australian reporting entities, where appropriate, to continue to be compliant with IFRSs in relation to the presentation of financial statements.

### Main Features of AASB 3

The objective of this Standard is to enhance the relevance, reliability and comparability of the information that an entity provides in its financial statements about a business combination and its effects. It does that by establishing principles and requirements for how an acquirer:

- (a) recognises and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree;
- (b) recognises and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and
- (c) determines information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

## **Application by not-for-profit entities**

Prior to the mandatory application date of this Standard, being 1 July 2009, the AASB will consider its suitability for combinations among not-for-profit entities. In doing so, the AASB will have regard to the criteria being developed for judging when IFRSs should be modified for application by not-for-profit entities. Those criteria will assist in clarifying whether this Standard should be amended to include an additional scope exclusion or those amendments and, if so, the extent of an exclusion or those amendments in an Australian not-for-profit context. In light of this, not-for-profit entities cannot adopt this Standard prior to the mandatory application date.

## **Core principle**

An acquirer of a business recognises the assets acquired and liabilities assumed at their acquisition-date fair values and discloses information that enables users to evaluate the nature and financial effects of the acquisition.

## **Applying the acquisition method**

A business combination must be accounted for by applying the acquisition method, unless it is a combination involving entities or businesses under common control. It is presumed that one of the parties to a business combination can always be identified as the acquirer, being the entity that obtains control of the other business (the acquiree). Formations of a joint venture or the acquisition of an asset or a group of assets that does not constitute a business are not business combinations.

This Standard establishes principles for recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. Any classifications or designations made in recognising these items must be made in accordance with the contractual terms, economic conditions, acquirer's operating or accounting policies and other factors that exist at the acquisition date.

Each identifiable asset and liability is measured at its acquisition-date fair value. Any non-controlling interest in an acquiree is measured at fair value or as the non-controlling interest's proportionate share of the acquiree's net identifiable assets.

This Standard provides limited exceptions to these recognition and measurement principles.

- (a) Leases and insurance contracts are required to be classified on the basis of the contractual terms and other factors at the inception of the

contract (or when the terms have changed) rather than on the basis of the factors that exist at the acquisition date.

- (b) Only those contingent liabilities assumed in a business combination that are a present obligation and can be measured reliably are recognised.
- (c) Some assets and liabilities are required to be recognised or measured in accordance with other Australian Accounting Standards, rather than at fair value. The assets and liabilities affected are those falling within the scope of AASB 112 *Income Taxes*, AASB 119 *Employee Benefits*, AASB 2 *Share-based Payment* or AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*.
- (d) There are special requirements for measuring a reacquired right.
- (e) Indemnification assets are recognised and measured on a basis consistent with the item that is subject to the indemnification, even if that measure is not fair value.

This Standard requires the acquirer, having recognised the identifiable assets, the liabilities and any non-controlling interests, to identify any difference between:

- (a) the aggregate of the consideration transferred, any non-controlling interest in the acquiree and, in a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree; and
- (b) the net identifiable assets acquired.

The difference will, generally, be recognised as goodwill. If the acquirer has made a gain from a bargain purchase that gain is recognised in profit or loss.

The consideration transferred in a business combination (including any contingent consideration) is measured at fair value.

In general, an acquirer measures and accounts for assets acquired and liabilities assumed or incurred in a business combination after the business combination has been completed in accordance with other applicable Australian Accounting Standards. However, this Standard provides accounting requirements for reacquired rights, contingent liabilities, contingent consideration and indemnification assets.

## **Disclosure**

This Standard requires the acquirer to disclose information that enables users of its financial statements to evaluate the nature and financial effect of business combinations that occurred during the current reporting period or after the reporting date but before the financial statements are authorised for issue. After a business combination, the acquirer must disclose any adjustments recognised in the current reporting period that relate to business combinations that occurred in the current or previous reporting periods.

## **Application Date**

This Standard is applicable prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting periods beginning on or after 1 July 2009. Early adoption is permitted only in respect of for-profit entities for annual reporting periods beginning on or after 30 June 2007 but before 1 July 2009. If an entity applies this Standard early, it is required to disclose that fact and apply AASB 127 *Consolidated and Separate Financial Statements* (as amended in March 2008) for the same period.

## **Consequential Amendments**

Consequential amendments to other Australian Accounting Standards are included in AASB 2008-3 *Amendments to Australian Accounting Standards arising from AASB 3 and AASB 127*.

## **Transition**

Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of this Standard shall not be adjusted upon application of this Standard.

An entity, such as a mutual entity, that has not yet applied AASB 3 and had one or more business combinations that were accounted for using the purchase method shall apply the transition provisions in paragraphs AusB68 and B69.

## **Income taxes**

For business combinations with an acquisition date before this Standard is applied, the acquirer applies the requirements of paragraph 68 of AASB 112, as amended by AASB 2008-3, prospectively. That is, the acquirer does not adjust the accounting for prior business combinations for previously recognised changes in recognised deferred tax assets. However, from the date when this Standard is applied, the acquirer recognises, as an adjustment

to profit or loss (or, if AASB 112 requires, outside profit or loss), changes in recognised deferred tax assets.

### **Consultation Prior to Issuing this Standard**

The AASB issued Exposure Draft ED 139 *Proposed Amendments to AASB 3 Business Combinations*, in July 2005. The AASB's ED 139 reproduced the IASB proposals without amendment and sought constituents' views on the IASB's proposed amendments.

Seven submissions were received in respect of the proposals in ED 139 and although there was support for adopting an Australian equivalent to the proposed revised AASB 3, there was concern about the proposed changes to the treatment of goodwill and acquisition costs.

A Regulation Impact Statement has not been prepared in connection with the issue of this Standard as the amendments made do not have a substantial direct or indirect impact on business or competition, are of a minor or machinery nature or clarify existing requirements.