

Regulation Impact Statement
AASB 2005-6
Amendments to Australian Accounting Standards

Background

The Australian Accounting Standards Board (AASB) is implementing the Financial Reporting Council's (FRC) strategic directives to adopt International Financial Reporting Standards [the Standards and Interpretations of the International Accounting Standards Board (IASB)] for application to reporting periods beginning on or after 1 January 2005 and to harmonise the requirements applicable to general purpose financial reports of public sector entities and those applicable to Government Finance Statistics. To put the first of the FRC directives into effect the AASB is issuing Australian equivalents to IASB Standards and has undertaken a separate project in respect of harmonising financial reporting requirements and Government Finance Statistics. Implementation of the FRC's Year 2005 strategic directive does not, of itself, cause a change in the underlying economic circumstances of an entity but at times results in events and transactions being portrayed differently so as to achieve improvements in the transparency and quality of Australian financial reports.

The AASB has decided to continue to issue one series of sector-neutral Standards, that is, Standards applicable to both for-profit and not-for-profit entities, including public sector entities. The AASB has regard to the Standards of the International Public Sector Accounting Standards Board of the International Federation of Accountants (IPSASB) in respect of issues affecting not-for-profit entities. The IPSASB is using the IASB's Standards, to the extent possible, as the basis for International Public Sector Accounting Standard (IPSAS). Accordingly, adopting IASB Standards simultaneously helps convergence with existing and future IPSASs. Except for Standards that are specific to the not-for-profit or public sectors or that are purely of a domestic nature, the AASB is using the IASB Standards as the "foundation" Standards to which it adds material detailing the scope and applicability of a Standard in the Australian environment. Additions are made, where necessary, broadening the content to cover sectors not addressed by an IASB Standard and domestic, regulatory or other issues. The AASB also retains guidance from superseded AASB Standards in an Appendix to the new Standards where it considers that guidance to be important to facilitate implementation and compliance with a Standard. In addition, in respect of optional treatments included in IASB Standards, the AASB decided it would generally require only one treatment in order to facilitate comparability of financial reports in Australia.

AASB 3 *Business Combinations* is part of the set of Australian equivalents to IASB Standards, and is the Australian equivalent of the IASB's IFRS 3 *Business Combinations*.

1. Problem

IFRS 3 does not apply to business combinations involving entities or businesses under common control. AASB 3 as issued in July 2004 does not exclude those transactions from its scope. In addition, AASB 3 includes the defined term "contributions by owners". Since issuing AASB 3, the AASB has become aware of some concerns that the presence of the Australian definition of "contribution by owners" in AASB 3 may give rise to different treatments compared with the treatments under IFRSs, particularly in relation to business combinations involving entities or businesses under common control.

2. Objectives

The AASB's objectives in addressing the problem are to improve the quality and usefulness of financial reporting in Australia in respect of both for-profit and not-for-profit reporting entities in the private and public sectors and to implement the FRC's directives.

3. Options

Option 1

Do nothing.

Option 2

Amend AASB 3 to remove the definition "contribution by owners".

Option 3

Amend AASB 3 to remove the definition "contribution by owners" and make the scope the same as IFRS 3.

Options 1 would be inconsistent with the FRC's policy directive relating to adoption of IASB Standards. Option 2 seems likely to remove most of the inconsistencies identified with IFRSs; however, it may also be inconsistent with the FRC directive. Option 3 clearly enables compliance with the FRC directive.

4. Impact Analysis

When issuing Exposure Drafts of Australian equivalents of IASB Standards, the AASB specifically sought comment from constituents on whether the proposals are in the best interests of the Australian economy and on whether there are regulatory or other issues that may affect the implementation of the proposals. The AASB assesses from a public interest perspective whether the costs of providing certain financial information exceed the benefits to be derived from its provision. There is no universally accepted methodology for quantitatively measuring costs and benefits of information presented in financial reports. The costs of providing financial information are incurred, in the main, by reporting entities, but extend in various direct and indirect ways to the users of general purpose financial reports. There is no guarantee that the costs are borne ultimately by those who derive the benefits. The AASB considers the benefits and costs for individual Standards in the context of the Year 2005 strategic directive as a whole.

Under section 227(1) of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the functions of the AASB are to:

- develop a conceptual framework, not having the force of an accounting standard, for the purpose of evaluating proposed accounting standards and international standards;
- make accounting standards under section 334 of the *Corporations Act 2001* for the purposes of the corporations legislation;
- formulate accounting standards for other purposes; and
- participate in and contribute to the development of a single set of accounting standards for world-wide use having regard to the interests of Australian corporations that raise or propose to raise capital in major international financial centres.

Functions of the FRC include determining the AASB's broad strategic direction, monitoring the development of international standards and the accounting standards that apply in major international financial centres, to further the development of a single set of standards for world-wide use with appropriate regard to international developments and to promote the adoption of international best practice in the Australian accounting standard-setting process.

Both the AASB and the FRC are required to advance the main objects of Part 12 of the ASIC Act, Section 224, to:

- facilitate the development of accounting standards that require the provision of financial information that allows users to make and

evaluate decisions about allocating scarce resources, assists directors to discharge their obligations in relation to financial reporting, is relevant to assessing performance, financial position, financing and investment, is relevant and reliable, facilitates comparability and is readily understandable;

- facilitate the Australian economy by reducing the cost of capital, enabling Australian entities to compete effectively overseas and having accounting standards that are clearly stated and easy to understand; and
- maintain investor confidence in the Australian economy (including its capital markets).

It is in this context that the FRC has decided to direct the AASB to:

- adopt IASB Standards with effect from 1 January 2005; and
- harmonise the requirements applicable to general purpose financial reports of public sector entities and those applicable to Government Finance Statistics.

Adopting AASB 2005-6 will have an impact on current Australian practice. The resulting amended AASB 3 does not apply to business combinations involving entities or businesses under common control.

Accordingly, whereas AASB 3 (issued in July 2004) required the purchase method to be applied to all business combinations involving entities under common control, the amended AASB 3 will result in some such business combinations being treated at carrying amounts. As a result, fewer assets and liabilities will be recognised at fair value in the financial reports of entities involved in common control business combinations, however, there will be no impact on the group level because common control transactions are unwound on consolidation.

5. Consultation

The AASB issued an Invitation to Comment (ITC) in March 2005. The main proposals were to amend AASB 3 by deleting the definition of contribution by owners from AASB 3 and rewriting AASB 3 paragraph Aus56.1.

The majority of respondents supported the proposal to amend AASB 3. In addition, some respondents commented that business combinations involving entities or businesses under common control should not be within the scope of AASB 3 in the same way that these transactions are scoped out of IFRS 3 *Business Combinations*. These respondents are concerned that the presence of the Australian definition of contribution by owners in AASB 3,

particularly in relation to business combinations involving entities under common control, may give rise to unintended consequences for IFRS compliance.

Some respondents also suggested that the definition of contribution by owners should be deleted from AASB 1004 *Contributions* (which applies to not-for-profit entities) and UIG Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities* (which applies to not-for-profit entities).

6. Conclusion and Recommendation

In complying with the FRC directive in relation to IASB Standards, the AASB decided to follow Option 3 and adopt IFRS 3 by making a stand-alone Standard that amends AASB 3 so that it is compliant with IFRS 3. In forming this conclusion, the AASB considered that, on balance, the benefits of facilitating the Australian economy by reducing the cost of capital, enabling entities to compete effectively overseas and the provision of information that is relevant, reliable and facilitates comparability outweighed the costs to individual entities of adopting Australian equivalents to IASB Standards.

7. Implementation and Review

AASB 3 as amended by AASB 2005-6 will be subject to review and revision taking account of overseas developments, particularly the processes for review and revision undertaken by the IASB, and of the experience of constituents in implementing the Standard.