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Mr David Boymal 
Chairman
Australian Accounting Standards Board
PO Box 204
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22 April 2005
Our Ref: FB:DR

Dear David

Re: Invitation to Comment – *The Definition of “Contribution by Owners”*

Thank you for the opportunity to provide our feedback on the AASB’s Invitation to Comment – *The Definition of “Contribution by Owners”*. Set out below are our comments on the AASB’s proposals in the Invitation to Comment.

Removal of the definition from A-IFRS

We fully support the AASB’s proposal that the definition of “contribution by owners” be deleted from Australian Equivalents to International Financial Reporting Standards (A-IFRS), i.e. in relation to for-profit entities.

We also continue to strongly oppose the AASB’s decision to delete from AASB 3 *Business Combinations* (AASB 3), the scope exception for business combinations involving entities under common control that is in IFRS 3 *Business Combinations*, which gave rise to the inclusion of the definition of “contribution by owners” in AASB 3.

Whilst we understand the AASB’s reasoning for originally amending the scope of AASB 3, we believe that the basis for doing so is not valid and the AASB should therefore reconsider the scope exceptions of AASB 3, particularly in light of the proposal in the Invitation to Comment to remove the “contribution by owners” definition which in reality forms an integral part of the AASB’s original scope amendments.

We have written a separate letter to the Board outlining our concerns and recommendations in relation to this issue.

Comments on the proposed wording of paragraph Aus56.1

In our view, the proposed wording of paragraph Aus56.1 is not appropriate and might be considered inconsistent with International Financial Reporting Standards (IFRS).

We believe that it may be difficult to identify a situation where a business combination involving entities under common control would give rise to a 'genuine' discount that would be recognised as income, leading to the conclusion that these transactions should always result in an equity contribution rather than income.

However, paragraph 57 of AASB 3 itself identifies a number of reasons why a gain might arise. In the context of business combinations involving entities under common control, only sub-paragraphs (a) and (b) of paragraph 57 could potentially be considered a 'gain', as a 'bargain purchase' would be expected to result in the recognition of an amount directly in equity.

Entities participating in business combinations involving entities under common control may therefore face significant additional costs allocating the excess between equity and gains if paragraph Aus56.1 remains worded as outlined in the Invitation to Comment. We would strongly prefer an approach that recognised the entire amount of the excess in equity. This approach would also be more closely aligned with the initial conclusions reached by the International Accounting Standards Board (IASB) as part of its Phase II Business Combinations Project in relation to business combinations between mutual entities or by contract alone.

Furthermore, in the public sector, a business combination may in some cases satisfy the definition of a government grant and should therefore be recognised in accordance with the requirements of AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance* where they involve 'for-profit' government entities.

Therefore, in the event that the Board chooses to retain the scope amendment to AASB 3, we believe that the wording of paragraph Aus56.1 would need to be reconsidered in light of the above comments.

Application of the "contribution by owners" definition to the public and not-for-profit sectors

We would prefer that the definition of "contribution by owners" be removed from all Australian Accounting Standards as we believe that the concept is not contemplated within the *Framework for the Preparation and Presentation of Financial Statements*. In our view, the concept of "contribution by owners" can at best be used to differentiate between issued capital and other forms of equity (or capital) but this distinction is not necessarily contemplated under the *Framework*. Furthermore, we believe that accounting for the public and not-for-profit sectors should align with IFRS wherever possible.

If the definition of 'contribution by owners' is to be kept in AASB 1004 *Contributions* and Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities*, it should be revised using generic language that does not create potential inconsistencies with

IFRS, i.e. a modified "Option 3" as identified in the Invitation to Comment. This revision would need to acknowledge that "contributions by owners" are a subset of equity contributions under the *Framework*, or alternatively, seek to provide generic guidance on 'equity contributions' as a whole.

If the definition is not deleted or amended, we believe that it will create difficulties for some entities. For instance, we are aware of some public sector entities that adopt the principles of tax consolidation under the so-called tax-equivalent regime (TER). Although in some cases these entities may have little interest in making a statement of compliance with IFRS, it may be difficult for these entities to comply with the totality of Australian accounting pronouncements due (for instance) to a conflict between (proposed) Interpretation 1052 *Tax Consolidation Accounting* and the definition of "contribution by owners".

The views presented in this letter may not necessarily represent the views of the global firm of Deloitte Touche Tohmatsu and should be read in this context.

If you have any questions concerning our comments, please contact Darryn Rundell on (03) 9208 7916.

Yours sincerely



Darryn Rundell
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Dear David

AASB 3 *Business Combinations* – business combinations involving entities under common control

This letter is designed as an adjunct to our submission on the Australian Accounting Standards Board (AASB) Invitation to Comment – *The Definition of "Contribution by Owners"*. It seeks to further elucidate our concerns regarding the AASB's removal of the scope exceptions available under IFRS 3 *Business Combinations* when AASB 3 was originally issued.

We continue to strongly oppose the AASB's decision to delete from AASB 3 *Business Combinations* (AASB 3), the scope exception for business combinations involving entities under common control that is in IFRS 3 *Business Combinations*, which gave rise to the inclusion of the definition of "contribution by owners" in AASB 3.

The difficulties with the removal of the scope exceptions to IFRS 3 is evident in the IASB and AASB deciding to not proceed with the proposals in ED 133 "Request for Comment on IASB ED of Proposed Amendments to IFRS 3 *Business Combinations – Combinations by Contract Alone or Involving Mutual Entities*". These proposals were not well accepted by constituents and were considered by some commentators to be inappropriate in the context of the existing requirements of IFRS 3, i.e. that the requirements of IFRS 3 did not contemplate accounting for the types of transactions proposed to be brought within its scope, or could do so only with substantial modification.

There are numerous issues and application difficulties that result from the AASB's scope amendments to AASB 3. It is clear from our experience with the application of AASB 3 to business combinations involving entities under common control that the Standard does not contemplate these types of transactions. The following paragraphs outline some of our concerns.

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Applying the “business combination” definition

The definition of a “business combination” requires the “bringing together of separate entities or businesses into one reporting entity”. Transactions involving entities under common control often occur *within* a reporting entity and therefore deal with businesses that are already part of the reporting entity so that there can be no “bringing together” of separate entities or businesses.

Therefore, it is unclear whether transactions such as the following are considered “business combinations” that would be within the scope of AASB 3 as it is currently worded:

- incorporation of a new holding company, particularly where it has no existing or subsequent ‘business’ of its own
- incorporation of an interposed holding company within a group structure
- redomiciling of an entity in a different jurisdiction, either directly or through the use of a legal purchase, sale or exchange mechanism
- consolidation of an existing business of the reporting entity in one entity rather than through a number of subsidiaries
- creation of ‘stapled’ securities for a previously single security entity

In our view, these transactions are often not in substance ‘business combinations’ and should then be excluded from the scope of AASB 3.

Furthermore, many of the entities involved in these types of transactions are not reporting entities but are required to prepare (special purpose) financial reports under the *Corporations Act 2001*. Some commentators argue then that these transactions fail to meet the definition of a “business combination” on a further level, because there is in essence no reporting entity¹.

Identification of an ‘acquirer’

Accounting for business combinations relies on the concept of the obtaining of ‘control’ and the identification of an ‘acquirer’ – where business combinations involve entities that are already under common control this concept can at best be arbitrarily applied, as true control ultimately lies with parties outside the combining entities and businesses. In other words, in transactions involving entities under common control, the entities are in effect operating under ‘delegated’ control in respect of the transaction that the controlling parties wish to occur.

Therefore, the identification of an ‘acquirer’ in common control business combinations transcends even the additional guidance in paragraphs 18 – 23 of AASB 3 and is further complicated by the possible application of the ‘reverse acquisition’ concept under AASB 3.

Therefore, there is effectively no guidance on how an acquirer can be determined in business combinations involving entities under common control because the same control exists both before and after the transaction.

¹ This argument is often articulated in light of the IASB’s intentional focus on ‘reporting entity’ as documented in IFRS 3.BC9.

Determination of the cost of the combination

When a business combination occurs outside entities under common control, the transactions are at an arm's-length basis, generally permitting the determination of the cost of the combination on the basis of market based evidence. This evidence then serves in practical terms as a guide to the aggregate fair values of the assets and liabilities acquired in the business combination.

When business combinations occur between entities under common control, the ability to determine the cost of the combination is difficult as market based evidence is seldom available, or alternatively available only as a "what if" valuation contingent on a future uncertain event, e.g. a possible float of the entity.

Furthermore, where entities within an entity undertake transactions that might be considered 'business combinations' under AASB 3, the exact determination and attribution of the fair value of intangible assets can be difficult, particularly where a business is conducted through a number of legal entities.

These difficulties illustrate that the general requirements of AASB 3 can be difficult, if not impracticable, to reliably apply to business combinations involving entities under common control.

Determination of goodwill

AASB 3 does not currently adequately address how to recognise and measure the amount of goodwill that might arise in a business combination involving entities under common control.

Because the cost of a business combination involving entities under common control can be difficult to determine (as noted above), the measurement of goodwill as a 'residual' is then compromised.

Furthermore, these business combinations may not involve 'arm's-length' consideration, meaning that the cost of the combination determined in accordance with paragraph 24 of AASB 3 may or may not include an amount for goodwill. However, to be conceptually consistent with the treatment in the current and proposed paragraph Aus56.1, an additional equity contribution of the amount of goodwill should be recognised when initially accounting for the combination.

AASB 3 does not currently address this issue, nor address how any such goodwill should be measured.

Concept of "reconstruction within the reporting entity"

AASB 3 currently makes reference to the concept of a "reconstruction within a reporting entity" and this term is defined in equivalent terms to that applied under AAS 21 "Acquisitions of Assets".

In our view, the definition of “reconstruction within a reporting entity” is inappropriate within the context of AASB 3 because it focuses on the legal form and not substance of transactions. For instance, it identifies a newly-formed entity as the acquirer even though this might not be the case when the general concepts under paragraphs 17 – 23 of AASB 3 are applied. In some cases, this type of transaction may not even be considered a ‘business combination’ at all.

Because of these potential inconsistencies, the application of the definition and the related requirements in paragraphs Aus3.1 and Aus3.2 of AASB 3 cause further difficulties in the application of the Standard and may further undermine compliance with International Financial Reporting Standards (IFRS).

Comparison with AASB 1015

Many of the issues documented above did not arise under AASB 1015 “Acquisition of Assets” because the concept of an ‘acquisition’ under that Standard focussed on the legal form and was not principles based as is AASB 3.

Therefore, ‘acquisitions’ were accounted for by reference to their legal form, i.e. the entity making the purchase from a legal perspective was considered to be the ‘acquirer’ and fair value adjustments were made even though such transactions might in substance not be a ‘business combination’ or the legal acquirer was not obtaining control.

The Parliamentary disallowance of the paragraphs of AASB 1015 that would have permitted carrying amounts to be used in reconstructions within an economic entity should not automatically be considered justification for scope amendments to AASB 3 and A-IFRS in general. Due to the differences between AASB 1015 and AASB 3, and the latter’s much stronger focus on substance over form and ‘true’ business combinations, the need for scope *inclusions* is much more limited, particularly in light of the problematic application of the requirements to these types of transactions (as discussed above).

IASB’s deliberations on this issue

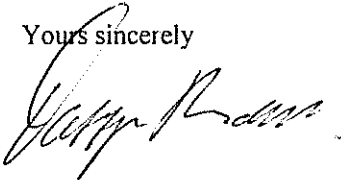
We also note that the IASB has not yet considered the accounting for business combinations involving entities under common control as part of Phase II of its Business Combinations project. In our view, it would be better for the AASB to reinstate the scope exemption in AASB 3 pending any developments at the IASB level.

Therefore, in light of the above analysis, we again request that the AASB reconsider its scope amendments to AASB 3 as part of the consideration of its response to comments received on the Invitation to Comment or otherwise, with a view to reinstating the exemption for business combinations involving entities under common control available under IFRS 3 in AASB 3.

The views presented in this letter may not necessarily represent the views of the global firm of Deloitte Touche Tohmatsu and should be read in this context.

If you have any questions concerning our comments, please contact Darryn Rundell on (03) 9208 7916.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Darryn Rundell', written in a cursive style.

Darryn Rundell
Partner